



# THE SCHOOL OF PUBLIC POLICY

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## MASTER OF PUBLIC POLICY CAPSTONE PROJECT

The Canada-Korea Free Trade Agreement: Impact on Canada

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## Executive Summary

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In March 2014, after years of negotiations, Canada and the Republic of Korea finally concluded negotiations for a preferential trade agreement. On January 1, 2015, the Canada-Korea Free Trade Agreement (CKFTA) became effective.

The CKFTA signifies a landmark agreement. The agreement represents Canada's most recently effective free trade agreement (FTA) and its first FTA with a country from the Asia-Pacific. As such, the CKFTA has the potential to open access for future Canadian trade agreements with other countries from the Asia-Pacific region. The CKFTA also represents a movement of Canada towards reaching trade agreements with large emerging economies. Prior to the CKFTA, Canada had accomplished little since the North American Free Trade Agreement (NAFTA) to increase trade with large emerging economies. With the signing of the CKFTA, Canada now has an agreement that is bigger and broader in scope than that of even NAFTA.

For Canada, the importance of the CKFTA lies in how it impacts Canadian consumers and producers. This capstone report looks to address this concern. To do so, the following report provides a comparison of Canada and the Republic of Korea, dissects the provisions of the CKFTA, and determines the likely effects of the CKFTA agreement. The report looks closely at the impact on what are considered some of Canada's most sensitive sectors – namely the agriculture and agri-foods, the fish and seafood, and the automobile sectors. The report also illustrates the effect on welfare of eliminating tariffs in both a small and large country case. Finally, the report provides a quick comparison of the CKFTA to the US-Korea FTA and the Australia-Korea FTA.

Overall, this report finds that the CKFTA has a small but positive impact on Canada. Though a small positive impact is not outwardly significant, the cost to Canada of not entering into the CKFTA would have been too high to not push the agreement forward. These costs would have risen in the form of lost trade opportunity, lost market growth and access, and a loss in trade competitiveness. Canada would likely have fallen well behind competitor nations like the European Union, the United States and Australia, all of whom had concluded FTAs with the Republic of Korea before Canada.

## Introduction

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In 2009, the Government of Canada identified the Republic of Korea as a priority market in its Global Commerce Strategy. A key component of the strategy involved increasing trade with emerging markets. Similarly, in the Government of Canada's 2014 Global Markets Action Plan, the Asia-Pacific region was identified as an emerging market of high interest to Canada.

Canada and the Republic of Korea have long shared a positive relationship. In recent years, South Korea has become increasingly important to Canada as an economic partner. This is no doubt due to the tremendous growth experienced in region.

Canada and the Republic of Korea (South Korea) first broached the idea of a potential FTA in November 2004. In March 2014, after a decade of negotiations, Canada and the Republic of Korea finally concluded negotiations for a preferential trade agreement. On January 1, 2015, the Canada-Korea Free Trade Agreement (CKFTA) became effective.

The CKFTA represents is a comprehensive trade agreement between Canada and South Korea. The CKFTA liberalizes barriers to trade in: goods, financial and other services, government procurement, intellectual property and investment. The CKFTA is Canada's most recent free trade agreement (FTA) and its first FTA with a country from the Asia-Pacific region. For Canada and the Rep. of Korea, the importance of the CKFTA is evident in how the FTA impacts each country's consumers and producers. As the agreement is fairly new, the impact that CKFTA has had, and will have, on consumers and producers is based largely on projections.

This capstone report compares Canada and the Republic of Korea, dissects the provisions of the CKFTA, and determines the likely impacts of the CKFTA agreement on consumers and producers. The report looks closely at the effects of CKFTA on what are considered some of Canada's most sensitive sectors – namely the agriculture and agri-foods, the fish and seafood, and the automobile sectors. The report also provides a quick comparison of the CKFTA to the US-Korea FTA and the Australia-Korea FTA.

The capstone report offers both a qualitative and quantitative analysis. The report illustrates the effect on welfare of eliminating tariffs in both a small and large country case. The report also utilizes the computable general equilibrium analysis from *The Canada-Korea Free Trade Agreement: What it means for Canada* to determine the impact of the CKFTA on the key Canadian industries.

## Literature Review

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The Canada-Korea Free Trade Agreement (CKFTA) entered into force on January 1, 2015,<sup>1</sup> making it Canada's most recent free trade agreement. Still in its infancy, the impact that the CKFTA has had, and will have, on Canadian consumers and producers is based largely on projections. At this point, there is little literature available on the actual impact of the CKFTA. The objective of this literature review is to explore the work that has been written on the CKFTA to better grasp the FTA's potential implications of the CKFTA. The review also considers literature on the US-Korea Free Trade Agreement, the Australia-Korea Free Trade Agreement, and the general impact that trade agreements have on Canada.

In 2014, Canada's Department of Foreign Affairs, Trade and Development (DFATD) published the *Canada-Korea Free Trade Agreement: Creating Jobs and Opportunities for Canadians: Final Agreement Summary*. The report summarizes the key negotiated outcomes of the CKFTA as announced in Seoul on March 11, 2014.<sup>2</sup> The report breaks down the Canadian and South Korean trade and investment relationship and, what benefits Canada can expect from the agreement. Overall, the report provides a refined summary of the CKFTA and the significance of its provisions.

On January 15, 2015, the C.D. Howe Institute released *The Canada-Korea Free Trade Agreement: What it means for Canada*. The report was written and prepared by Dan Ciuriak, the former Deputy Chief Economist at DFATD, Jingliang Xiao and Ali Dadkhah. This report provided the first in-depth analysis of the CKFTA. To analyze the agreement, the report uses a computable general equilibrium (CGE) model. As described in the methodology, "the authors use a modified version of the widely used Global Trade Analysis Project (GTAP) model to directly represent foreign-owned firms in each service sector of the economy to capture services

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<sup>1</sup> Foreign Affairs, Trade and Development Canada. "Canada's Free Trade Agreements." Government of Canada. Accessed June 13, 2015. <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fta-ale.aspx?lang=eng>.

<sup>2</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary." Government of Canada. Accessed June 13, 2015. <http://international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/korea-coree/overview-apercu.aspx?lang=eng#appendix>.

trade conducted through foreign affiliates.”<sup>3</sup> Ciuriak, Xiao and Dadkhah draw on available long-term projections to simulate the CKFTA up to the year 2035. Their report concludes that the CKFTA would likely have a small, but positive, impact on Canada.

From a regional perspective, the CKFTA will affect Canadian provinces differently. The impacts of trade depend on geographic location (east versus west coast) and areas of trade specialization.

In December 2014, Ciuriak, Lysenko and Xiao released *Province-level Impacts of Canada's Trade Agreements: Ontario and the Canada-Korea FTA*. This report estimates the CKFTA's impact on Ontario compared to the rest of Canada. This report again uses the GTAP model to generate Canada-level impacts, which are then decomposed on the basis of a computable partial equilibrium (CPE).<sup>4</sup> The report's results suggest that the CKFTA is likely to benefit Ontario, but less so than the rest of Canada.

In February 2015, the Canada West Foundation released *Canada-Korea Free Trade Agreement: What the trade agreement with South Korea could mean for western Canada*. In this short report, the authors, Dade, Li and Christensen, explain the importance of the CKFTA to Canada's western provinces – namely British Columbia, Alberta, Saskatchewan and Manitoba. These four provinces account for more than 37 percent of Canada's merchandise trade with South Korea.<sup>5</sup> Key industries in the west include energy, forestry, seafood and agriculture. The report concludes that western Canada is well-positioned to benefit from the CKFTA, as the west maintains many of the products that South Korea must import.

To further analyze the CKFTA, it is useful to compare the agreement to similar FTAs. Two FTAs worth consideration are the US-Korea Free Trade Agreement (KORUS) and the Australia-Korea Free Trade Agreement (KAFTA). It is no secret that Canada and the United States have closely-linked economies. And, that Canada and Australia share similar trade volumes and trade type with South Korea. Therefore, while the actual provisions of the KORUS, KAFTA and

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<sup>3</sup> Ciuriak, Dan, Jingliang Xiao, and Ali Dadkhah. *The Canada-Korea Free Trade Agreement: What it means for Canada*. Toronto, ON, CAN: C.D. Howe Institute, 2015.

<sup>4</sup> Ciuriak, Dan, Dmitry Lysenko, and Jingliang Xiao. *Province-Level Impacts of the Canada's Trade Agreements: Ontario and the Canada-Korea FTA*. Ottawa: Ciuriak Consulting Inc., 2014.

<sup>5</sup> Dade, Carlo, Chendong Li, and Naomi Christensen. *Canada-Korea Free Trade Agreement: What the Trade Agreement with South Korea Means for Western Canada*. Calgary: Canada West Foundation, 2015.



CKFTA are different, Canada may be impacted by the CKFTA in similar ways as the US has been by KORUS and Australia has been by KAFTA.

The US-Korea Free Trade Agreement entered into force on March 15, 2012.<sup>6</sup> The United States and South Korea have since reviewed the status of implementation of the FTA. On June 13, 2014, the Korea Institute for International Economic Policy published the journal article entitled *Korea-US FTA in its Second Year: Current Status of Implementation*. This article provides an overview of the growth in bilateral trade volumes since the KORUS entered into force, changes in import and export diversity and utilization rate, and the overall implications to the US and South Korea.

The Australia-Korea Free Trade Agreement entered into force on December 12, 2014.<sup>7</sup> Like the CKFTA, KAFTA is very much a young agreement. The Government of Australia's Department of Foreign Affairs and Trade released *Australia and Korea FTA (KAFTA) – Key Outcomes*. This report summarizes the key benefits of KAFTA by industry sector. Like Canada, key industries set to benefit from the KAFTA include agriculture, energy and minerals, and manufactured products. Also, like Canada, Australia has its own sensitive industries – namely the motor vehicles, automotive parts, steel products and textiles, and clothing and textiles sectors.<sup>8</sup> This report suggests that KAFTA will in time boost the economy and create more jobs.<sup>9</sup>

Canada is no stranger to FTAs. In fact, Canada has been engaging in free trade deals since 1986, when negotiations toward a FTA with the United States began.<sup>10</sup> Today, Canada has FTAs with more than 10 countries,<sup>11</sup> and is in on-going FTA negotiations to lock down more. How has Canada been impacted by the signing and implementation of its FTAs? In the study entitled *Free trade and Canadian performance: Which territories does the evidence support?* by Head and Ries, the authors draw from Canada's experience with North American FTAs to determine the impact of trade agreements on Canada. According to the authors, "Canada's experience provides

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<sup>6</sup> Kim, Young-Gui, Hyo-young Lee, Jungu Kang, and Hyuk-Hwang Kim. "Korea-U.S. FTA in its Second Year: Current Status of Implementation." *KIEP Research Paper no. World Economy Update* 4, no. 23 (June 13, 2014): 1-10.

<sup>7</sup> Department of Foreign Affairs and Trade. "KAFTA - a Snapshot." Australian Government. Accessed June 13, 2015.

<sup>8</sup> Department of Foreign Affairs and Trade. *Australia and Korea FTA (KAFTA) – Key Outcomes*. Australia: Australian Government, 2015.

<sup>9</sup> Ibid, 2.

<sup>10</sup> Foreign Affairs, Trade and Development Canada. "Canada's Free Trade Agreements."

<sup>11</sup> Ibid.

a valuable “natural laboratory” for understanding how trade liberalization affects the economic performance of a small, high-income economy trading with a much larger country.”<sup>12</sup> The study considers the impact of FTAs on three aspects of the Canadian economy: the trade creation effects of Canada’s North American FTAs; the inter-sectoral resource allocations across manufacturing sectors; and, whether free trade has enhanced productivity.

I believe the above literature will provide the greatest contribution to the understanding and development of the CKFTA’s impact on Canada. Other sources will also be used to supplement the report, but the above remain to be the key pieces of literature under consideration.

## Methodology

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Trade policy analysis is important to determine the costs and benefits of trade. Determining an appropriate methodology to analyze trade policy depends on what approach is best suited to answer the intended question, given existing constraints. Typical methodologies include using a macroeconomics model, a partial general equilibrium or a computed general equilibrium. These methodologies differ significantly with regards to the time and resources required. As such, there are benefits and limitations to each methodology.

### Macroeconomic Model

A macroeconomic model methodology, although functional and convenient, is not without its limitations: For one, macro models often lack depth in technical analysis; two, macro models tend to think excessively in terms of aggregates, and presume circumstances to be normal and homogenous, making results far too generalized; three, there is an inconsistency between the overall and the individual changes. An aggregate model change influences different sectors of the economy differently, and thus the “general” results are misleading. For instance, a general rise in prices due to inflation will have different effects on consumers than producers, likewise

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<sup>12</sup> Head, Keith and John Ries. *Free Trade and Canadian Economic Performance: Which Theories does the Evidence Support?*. Calgary: University of Calgary Press, 2001.

for the industrial industry versus the agricultural industry;<sup>13</sup> four, macro models have unemployment due to the stickiness of wages. That is, if aggregate demand rises, employment will increase; and five, macro models have little impact on supply since markets do not clear. Overall, a macroeconomic analysis is not always representative of the economy. Thus, due to its aggregation of markets, macro models are generally not good models to analyze the economic impacts of FTAs.

### Partial Equilibrium (PE)

A partial equilibrium (PE) analysis allows for disaggregation, and therefore requires less time and data to compute. In fact, there are a number of ready-made models available online that are easy to use. PE provides a more manageable analysis, generally using a limited number of equations to calculate changes in supply and demand. The risk of error is also low compared to computable general equilibriums as the data required is considerably smaller.<sup>14</sup>

The advantages of choosing a PE analysis are often thought to be the same as the model's weaknesses. PE models do not provide an aggregate analysis. PE models do not include constraints on production factors. And, the results of PE models can be overly sensitive to the value used for the elasticities.<sup>15</sup>

### Computed General Equilibrium (CGE)

Computed General Equilibrium (CGE) models are used to determine the effect of a change in trade policy on an endogenous variable, like prices, production, consumption, exports, imports, or welfare. A CGE simulation represents what the economy would look like if a policy change or shock did occur – like the implementation of a FTA. This economy-wide representation is important, particularly when tariff changes result in changes to national currency or other factor markets. By using a CGE, a policy-maker can determine if a country is benefiting or not from a change in policy, based on the change in welfare.<sup>16</sup>

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<sup>13</sup> Agarwal, Monisha. "What are the Limitations of Macroeconomics - Explained." World's Largest Collection of Essays!. Accessed June 20, 2015. <http://www.shareyouressays.com/117061/what-are-the-limitations-of-macroeconomics-explained>.

<sup>14</sup> World Trade Organization. *A Practical Guide to Trade Policy Analysis*. Geneva, Switzerland: WTO and the United Nations Conference on Trade and Development., 2012, p.139.

<sup>15</sup> Ibid, p.139.

<sup>16</sup> Ibid, p.182.

While choosing a CGE method looks to be the obvious choice, it has its own constraints. Typically, building a CGE model takes a significant amount of time and requires a considerable amount of data. Further, running the regressions requires sufficient time series or cross sections of data. Not only does this involve high sunk costs and high economies of scale, but the risk of error is also high. Overall, while the CGE model can be used to answer many questions, it is often an impractical methodology.<sup>17</sup>

In the *Canada-Korea Free Trade Agreement: What it means for Canada*, the authors used a CGE model to evaluate the CKFTA. Using the CGE model, the authors projected the global economy to 2035, drawing on available long-term macroeconomic projections. The authors were able to quantify the CKFTA's text in terms of trade services to provide a sharper evaluation of the trade agreement impacts.<sup>18</sup> Overall, the authors were able to provide a general analysis how the CKFTA impacted Canada.

## Capstone

This capstone report includes both a qualitative and quantitative analysis. Due to the scope and nature of this report, the computable general equilibrium analysis from *The Canada-Korea Free Trade Agreement: What it means for Canada* will be used to determine the impact of the CKFTA on key Canadian industries. While this is sufficient for the scope of this report, it is important to remember the limitations of such methodology.

To determine the impact on consumers and producers, the effect of an elimination of a tariff is also illustrated and analyzed. This analysis indicates whether producers or consumers gain more from the change in tariff and the overall welfare effects. This type of analysis will be both effective and appropriate for the purpose of this capstone report.

## Canada and the Republic of Korea

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### Relations

Canada and the Republic of Korea have shared a positive relationship dating back to 1888. At that time, James Scarth Gale, a Canadian missionary, had been sent to Korea. Gale

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<sup>17</sup> Ibid, p.183.

<sup>18</sup> Ciuriak, Dan, et al. *The Canada-Korea Free Trade Agreement: What it means for Canada*.

became famous for creating the first Korean-English dictionary, and for translating the Christian bible into Korean.<sup>19</sup> In 1947, Canada officially became involved with Korea. That year, Canada participated in the United Nations Commission supervising free elections.

Since 1947, Canada-Korea relations have developed exponentially. During the Korean War, in the early 1950s, Canada was the third-largest contingent to contribute troops (behind the United States and the United Kingdom). Since the end of the Korean War, Canada has continued to contribute to peacekeeping efforts and the security on the Korean peninsula.<sup>20</sup>

In 1963, Canada and the Rep. of Korea established formal diplomatic relations, and in 1973, Canada opened its Embassy in South Korea.<sup>21</sup> Once formal diplomatic relations were established, Canada and South Korea steadily developed a friendly bilateral relationship. This further opened the door for Korean immigration into Canada and led to the gradual expansion of trade linkages between the two countries.<sup>22</sup>

## Compared

In recent years, South Korea has become increasingly important to Canada as an economic partner. This is no doubt due to the tremendous growth experienced by the region. Over the last decade, South Korea's annual GDP growth has been consistently higher than Canada and the world's (Chart 1 below).

Today, Canada and the Rep. of Korea are far more comparable in terms of economy size and GDP. Despite these similarities, Canada's Gross National Income<sup>23</sup> per capita remains to be twice as large as South Korea's.

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<sup>19</sup> Government of Canada. "Canada-Korea Relations." Government of Canada. Accessed June 13, 2015.

[http://www.canadainternational.gc.ca/korea-coree/bilateral\\_relations\\_bilaterales/index.aspx?lang=eng](http://www.canadainternational.gc.ca/korea-coree/bilateral_relations_bilaterales/index.aspx?lang=eng).

<sup>20</sup> Lee, Steven H. "the Establishment of Diplomatic Relations between Canada Korea, 1961-1963." *Acta Koreana* 8, no. 2 (January 2005, 2005): 5.

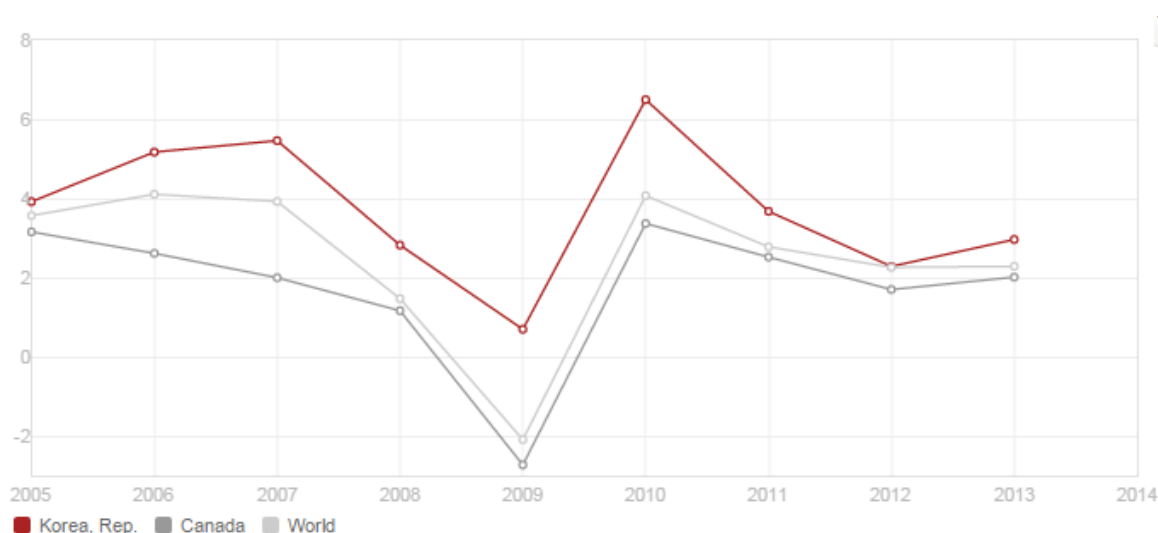
<sup>21</sup> Government of Canada. "Canada-Korea Relations."

<sup>22</sup> Lee, Steven H. "the Establishment of Diplomatic Relations between Canada Korea, 1961-1963."

<sup>23</sup> GNI differs from GDP. Gross Domestic Product is the value produced within a country's borders, whereas the Gross national Income is the value produced by all the citizens. GDP is said to be the measure of a country's overall economic output. The GNI is the total value that is produced within a country, which comprises of the Gross Domestic Product along with the income obtained from other countries (dividends, interests).

As nations, Canada and South Korea are well integrated into world trade. A country's integration is often told by its degree of openness. To compare openness, we look at Canada and South Korea's trade to GDP ratios. Trade over GDP is the sum of real exports and real imports over real GDP. Table 2 below shows Canada's and South Korea's trade to GDP percentage over the past decade. South Korea currently has a ratio of well over 100 percent. That is, South Korea imports and exports far more than it produces, acting as a trade hub. Canada is also viewed as "open" with trade to GDP ratios above 60 percent. International trade is no doubt important to both Canada and South Korea.

**Chart 1: GDP Growth (annual %)**



(The World Bank Group)<sup>24</sup>Note: Annual percentage growth rate of GDP at market prices based on constant local currency. Aggregates are based on constant 2005 U.S. dollars.

**Table 1: Size and GDP**

	Canada	Republic of Korea
Economy Ranking, 2013	14 <sup>th</sup>	11 <sup>th</sup>
GDP, 2013, US\$	\$1.83 trillion	\$1.30 trillion
Population, millions	35.15	50.22
GNI per capita, Atlas method (current US\$)	\$52,200 (up from \$22,530 in 2000)	\$25,920 (up from \$10,750 in 2000)

(Source: The World Bank Group: Country Profiles<sup>25,26</sup>)

<sup>24</sup> World Development Indicators, The World Bank. *Gross Domestic Product Ranking, 2013*. Washington, DC: World Development Indicators database, World Bank, 14 April 2015, 2014.

**Table 2: Trade as a % of GDP**

Trade as a % of GDP	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>Canada</b>	70	68.2	66.5	67.2	58.4	60	62.7	62.1	61.9
<b>Republic of Korea</b>	71.2	73.6	77.2	99.9	90.4	95.7	102.8	109.9	110

(Source: The World Bank Group: Country Profiles<sup>27/28</sup>)

## Bilateral Trade

For Canada, South Korea is its 7<sup>th</sup> largest export partner and 7<sup>th</sup> largest import partner.<sup>29</sup> In 2014, bilateral trade between Canada and South Korea reached CAD\$13.2 billion; with South Korea's imports from Canada reaching over CAD\$6.0 billion, and Canada's imports from South Korea reaching over CAD\$7.2 billion.<sup>30</sup>

What does Canada trade with South Korea? Over 70 percent of Canada's imports from South Korea consists of vehicles (other than railway and tramway), machinery (nuclear reactors, boilers etc.), and electrical/electronic equipment. South Korea's imports from Canada are much more diversified. Over 26 percent are from mineral fuels (oils, distillation products, etc.), with manufactured goods, ores, slag and ash, and machinery also making significant contributions.<sup>31</sup> Table 3 shows the trends in Canada and Korea's merchandise trade over the last 8 years. Overall, imports traded between the countries have risen over time.

For 2014, the value of South Korea's imports from Canada showed a relative increase over the rise evidenced in previous years. This is largely due to the decrease in value of the Canadian dollar that Canada has experienced over the past year. A lower Canadian dollar makes Canadian goods cheaper to importers. The exchange rate between the Canadian dollar and the South Korean won is now closer to reflecting the underlying competitive fundamentals between

<sup>25</sup> World Development Indicators, The World Bank. "Country Profile, Canada." The World Bank Group. Accessed June 21, 2015. <http://data.worldbank.org/country/canada>.

<sup>26</sup> World Development Indicators, The World bank.. "Country Profile, Republic of Korea." The World Bank Group. Accessed June 21, 2015. <http://data.worldbank.org/country/korea-republic>.

<sup>27</sup> World Development Indicators, The World Bank. "Country Profile, Canada."

<sup>28</sup> World Development Indicators, The World bank.. "Country Profile, Republic of Korea."

<sup>29</sup> World Integrated Trade Solution. "Canada." The World Bank Group. Accessed June 21, 2015. [http://wits.worldbank.org/CountryProfile/Country/CAN/Year/2013/TradeFlow/Import/Partner/by-country/Show/Partner%20Name;import%20Share%20in%20Total%20Products%20\(%60\);import%20Trade%20Value%20\(US\\$%20Thousand\);import%20Partner%20Share%20\(%60\);AHS%20Weighted%20Average%20\(%60\);MFN%20Weighted%20Average%20\(%60\);No%20Of%20Tariff%20Agreement;/Sort/Import%20Trade%20Value%20\(US\\$%20Thousand\)](http://wits.worldbank.org/CountryProfile/Country/CAN/Year/2013/TradeFlow/Import/Partner/by-country/Show/Partner%20Name;import%20Share%20in%20Total%20Products%20(%60);import%20Trade%20Value%20(US$%20Thousand);import%20Partner%20Share%20(%60);AHS%20Weighted%20Average%20(%60);MFN%20Weighted%20Average%20(%60);No%20Of%20Tariff%20Agreement;/Sort/Import%20Trade%20Value%20(US$%20Thousand)).

<sup>30</sup> International Trade Centre. "Trade Map - Trade Competitiveness Map." International Trade Centre. Accessed June 14, 2015. <http://www.trademap.org/countrymap/Bilateral.aspx>.

<sup>31</sup> Ibid.

the two nations than it has been in a decade. A more competitive exchange rate allows Canadian businesses to better compete in the South Korean market.

**Table 3: Merchandise Trade**

<b>Canada-Korea Merchandise Trade Trends, 2006-2014, Million CAD dollars</b>									
	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>Korea Imports from Canada</b>									
Total, all products	3,505	3,478	4,664	4,015	4,481	6,533	5,244	4,855	6,007
Mineral fuels	596	652	1,346	1,125	1,403	2,520	1,919	1,639	1,554
Machinery, Electronic, Optical, & Vehicles	477	479	493	688	647	434	594	744	455
Ores, Metal & Metal Products	728	762	828	650	761	757	738	726	332
Agriculture and Agri-foods	367	355	437	363	467	1,007	538	417	518
Wood, Pulp & Paper Products	436	464	511	317	382	367	336	305	295
Fertilizers	92	103	310	199	199	239	216	210	184
Fish and Seafood	54	53	45	45	49	62	54	73	56
<b>Canada Imports from Korea</b>									
All products	5,765	5,360	5,999	5,924	6,149	6,596	6,374	7,335	7,240
Vehicles	1,650	1,670	1,725	1,921	2,002	1,954	2,562	2,786	2,859
Electronic equipment	1,418	1,507	1,862	1,739	1,567	1,465	927	1,821	1,062
Machinery & equipment	1,152	809	838	819	843	1,192	1,082	1,008	1,088

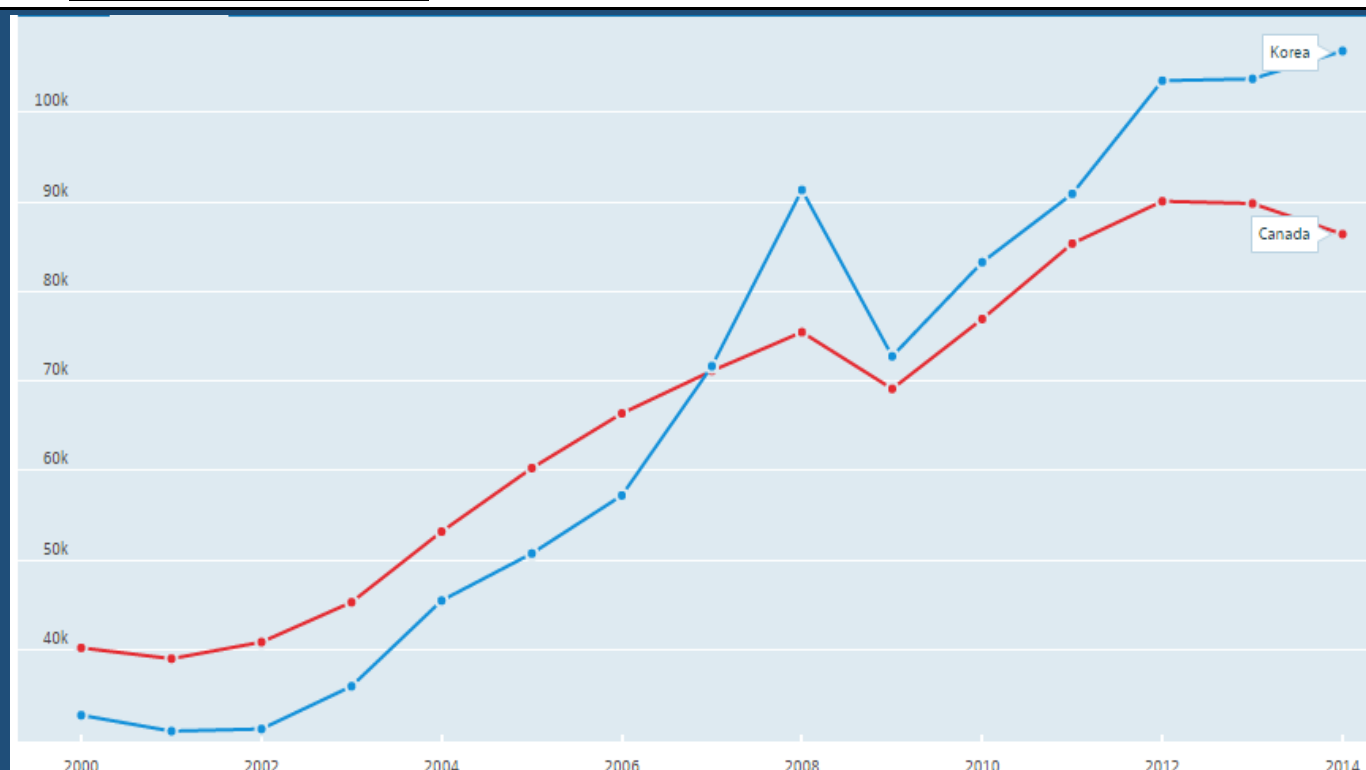
(Source: International Trade Centre (2014) Trade Map)<sup>32</sup>

Canadian and South Korean bilateral trade in services has also increased over time (Table 4). Types of services traded include transportation, financial and travel services, and commercial services such as finance, management, engineering and other professional services.<sup>33</sup> Table 4 illustrates how the bilateral exchange of service exports between Canada and the Rep. of Korea have drastically increased over the past fifteen years.

<sup>32</sup> International Trade Centre. "Trade Map - Trade Competitiveness Map."

<sup>33</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary," p.35.



**Table 4: Trade in Services****Trade in services, Exports, Million US dollars**

Location	2006	2007	2008	2009	2010	2011	2012	2013	2014
Canada Exports to Korea	66376.87	71124.2	75452.17	69117.45	76918.63	85345.36	90070.19	89813.56	86391.66
Korea Exports to Canada	57212.5	71650.5	91333.3	72752.1	83260.3	90900.1	103533.2	103739.2	106855.3

(Source: OECD (2015), Trade in services)<sup>34</sup>

As trading nations, Canada and South Korea support trade liberalization. In fact, both nations share membership in many multilateral economic organizations including the G20, the Asia-Pacific Cooperation (APEC) forum, the Organization for Economic Cooperation and Development (OECD) and the World Trade Organization (WTO).<sup>35</sup> The CKFTA is set to further advance Canada-Korea relations. The agreement will generate new trade and investment opportunities, as well as foster further innovative partnerships.

<sup>34</sup> OECD. "International Trade - Trade in Services." OECD. Accessed June 21, 2015.  
<https://data.oecd.org/trade/trade-in-services.htm#indicator-chart>.

<sup>35</sup> Government of Canada. "Canada-Korea Relations."

## CKFTA Negotiation and Implementation Process

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Canada and South Korea first broached the idea of a potential FTA in November 2004. At the time, both countries were in attendance at an Asia Pacific Economic Cooperation Leaders' Meeting. By the end of the meeting, Canada and South Korea had agreed to explore the possibility of a FTA further. By July 2005, official negotiations were launched.<sup>36</sup>

Negotiating a FTA between Canada and South Korea was no task. At times, it was doubtful that Canada and South Korea would ever come to agreement. Both nations wanted to ensure the FTA accounted for the interests of its people. Whenever interests conflicted, the negotiation process hit a speed-bump. Both Canada and South Korea held concerns for key sensitive sectors – namely, the agriculture and resource based sectors and the automotive industry. And, though a Canada-Korea FTA projected major trade gains for these sensitive sectors, it was not without disruption.<sup>37</sup>

Meanwhile, while negotiations between Canada and South Korea remained slow and ongoing, Canada's competitor nations were able to conclude FTAs with South Korea: In July 2011, the European Union enforced the European Union-South Korea Free Trade Agreement (*EUSKFTA*);<sup>38</sup> in March 2012, the US enforced the United States-Korea Free Trade Agreement (*KORUS FTA*);<sup>39</sup> and, in December 2014, Australia enforced the Korea-Australia Free Trade Agreement (*KAFTA*).<sup>40</sup> As a consequence, Canada began losing trade opportunities and competitive edge. This gave Canada a major incentive to finalize negotiations with South Korea in order to level the playing field.

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<sup>36</sup> Report of the Standing Committee on International Trade. *A Study of the Canada-Korea Free Trade Negotiations*. Ottawa: House of Commons Canada, 2008.

<sup>37</sup> Ciuriak, Dan and Jingliang Xiao. "The Impact of the Canada-Korea Free Trade Agreement as Negotiated." *Journal of East Asian Economic Integration (JEAI)* 18, no. 4 (December 30, 2014): 425-461.

<sup>38</sup> European Commission. "Trade Policy: South Korea." European Commission. Accessed June 13, 2015. <http://ec.europa.eu/trade/policy/countries-and-regions/countries/south-korea/>.

<sup>39</sup> Kim, Young-Gui, et al. "Korea-U.S. FTA in its Second Year: Current Status of Implementation."

<sup>40</sup> Department of Foreign Affairs and Trade. *Australia and Korea FTA (KAFTA) – Key Outcomes*.

In the end, Canada and South Korea went through 14 rounds of negotiations before an agreement could be reached.<sup>41</sup> (See Appendix A: CKFTA Negotiation Process, for dates). Negotiations for the CKFTA concluded in March 2014, almost a decade after conception. In September 2014, South Korean President, Park Guen-hye, visited Canada. During her visit, both she and Prime Minister Steven Harper witnessed the signing of the Canada-Korea Free Trade Agreement. Canada and the South Korea subsequently ratified the CKFTA, and the CKFTA officially came into effect on January 1, 2015.<sup>42</sup>

The CKFTA is viewed as having established a 21<sup>st</sup>-century framework for future economic and trade partnerships. According to the Len Edwards, a former Canadian Ambassador to South Korea and Deputy Minister of Foreign Affairs, the CKFTA trade framework replaces an outdated General Agreement on Tariffs and Trade (GATT)/WTO-focused structure on which Canadian FTAs have traditionally been based.<sup>43</sup> The CKFTA is also viewed as having a broad political significance. As Canada's first FTA with the Asia-Pacific region, the CKFTA signals to other Asian nations that Canada is ready to tie its economic future to their region.<sup>44</sup>

## Acts and Regulations

*Bill C-41: An Act to Implement the Free Trade Agreement between Canada and the Republic of Korea* represents the CKFTA's implementing legislation. The legislation was sponsored by the Minister of International Trade, Ed Fast, and received Royal Assent on November 26, 2014.<sup>45</sup> (See Appendix A: CKFTA Legislation Process, for dates).

The act is cited as the *Canada–Korea Economic Growth and Prosperity Act* ("The Act"). The *Act* is divided into three parts. As per the *Act*:

Part 1 approves the Free Trade Agreement and provides for the payment by Canada of its share of the expenditures associated with the operation of the

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<sup>41</sup> Ministry of Foreign Affairs. "FTA Status of ROK: Korea-Canada FTA." Republic of Korea. Accessed June 13, 2015. [http://www.mofat.go.kr/ENG/policy/fta/status/negotiation/canada/index.jsp?menu=m\\_20\\_80\\_10&tabmenu=t\\_4](http://www.mofat.go.kr/ENG/policy/fta/status/negotiation/canada/index.jsp?menu=m_20_80_10&tabmenu=t_4).

<sup>42</sup> Government of Canada. "Canada-Korea Relations."

<sup>43</sup> Edwards, Len. "Canada-South Korea Trade Deal Gives both Countries a Global Boost." *The Globe and Mail*, September 18, 2014, 2014, sec. Opinion.

<sup>44</sup> Ibid.

<sup>45</sup> Parliament of Canada. "House Government Bill: C-41 an Act to Implement the Free Trade Agreement between Canada and the Republic of Korea." Parliament of Canada. Accessed June 13, 2015. <http://www.parl.gc.ca/legisinfo/BillDetails.aspx?billId=6697001&Language=E&Mode=1>.

institutional aspects of the Agreement and the power of the Governor in Council to make orders for carrying out the provisions of the enactment. Part 1 also provides protection for certain geographical indications. Part 2 amends existing laws in order to bring them into conformity with Canada's obligations under the Free Trade Agreement between Canada and the Republic of Korea. Part 3 contains coordinating amendments and the coming into force provision.<sup>46</sup>

In Part 2, the existing laws and sections that required amendment are as follows: s. 23–24. *Crown Liability and Proceedings Act*; s.25. *Financial Administration Act*; s. 26–31. *Customs Act*; s.32. *Commercial Arbitration Act*; s. 33–42. *Canadian International Trade Tribunal Act*; s. 43–56. *Customs Tariff*; and s. 57–58 *Department of Employment and Social Development Act*.<sup>47</sup>

## Quantifying Trade Policy

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Governments adopt a variety of trade policies toward international trade. Among those policies are tariff and non-tariff measures (NTM). According to the World Trade Organization (WTO), a tariff is a “tax levied on imports, or more rarely on exports, of a good at the border.”<sup>48</sup> The effect of a tariff is to raise the price of the imported (or exported) product above its price on the world (domestic) market. Non-tariff measures (NTMs), according to the WTO, are “policy measures other than ordinary customs tariffs that affect international trade in goods at the border by changing quantities traded, prices, or both.”<sup>49</sup> NTMs include instruments such as quotas, licenses, technical barriers to trade (TBTs), sanitary and phytosanitary (SPS) measures,<sup>50</sup> export restrictions, custom surcharges, financial measures and anti-dumping measures.

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<sup>46</sup> *Canada-Korea Economic Growth and Prosperity Act*, (2014): .

<sup>47</sup> Ibid.

<sup>48</sup> World Trade Organization. *A Practical Guide to Trade Policy Analysis*, p.64.

<sup>49</sup> Ibid, p.72.

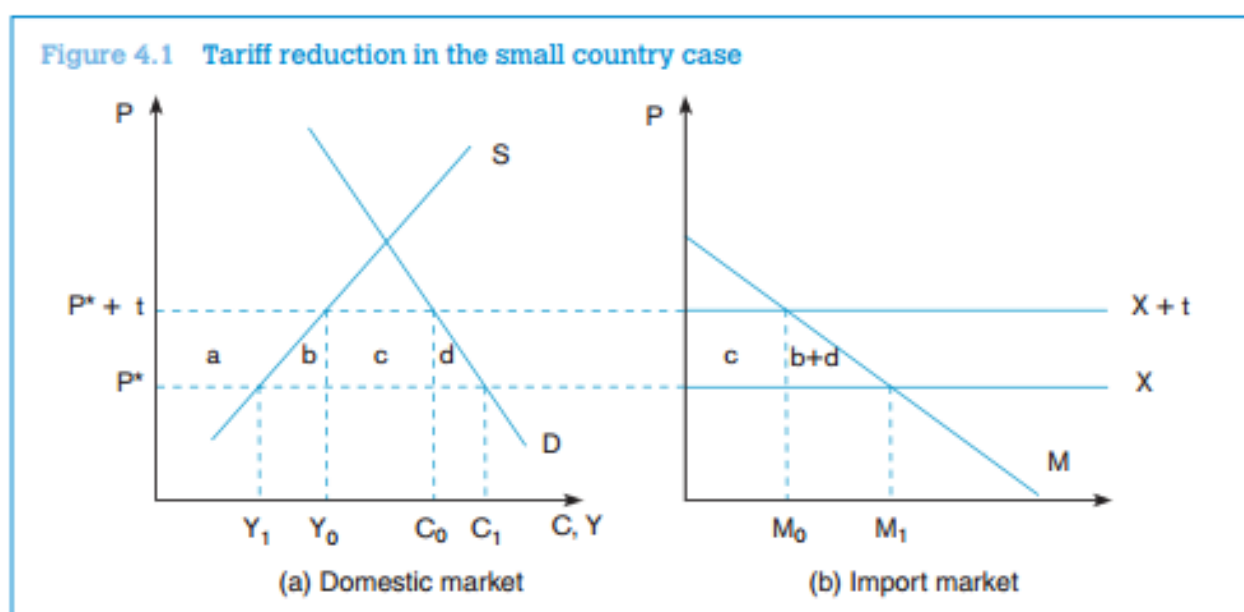
<sup>50</sup> sanitary and phytosanitary measures are defined as any measures applied: to protect human or animal life from risks arising from additives, contaminants, toxins or disease-causing organisms in their food; to protect human life from plant- or animal-carried diseases; to protect animal or plant life from pests, diseases, or disease-causing organisms; to prevent or limit other damage to a country from the entry, establishment or spread of pests.

Governments typically apply a combination of tariffs and NTMs to protect domestic markets. To analyze the effect of a tariff or NTM, using a statistical method, the policy or policy reform has to have been in place for a sufficient amount of time. That being said, policymakers can determine the likely effect of different trade policies.

Below, the welfare effects of eliminating a tariff in both a small country and large country case are examined. The effects of NTMs, on the other hand, are generally more difficult to determine. That is because NTMs, though intrinsically protectionist, may be in place to address market failures – such as externalities or asymmetric information between consumers and producers. NTMs that address market failures may actually improve welfare while restricting trade. Other NTMs may actually expand trade, such as standards or export subsidies. Therefore, determining the likely effect of an NTM requires far more comprehensive data than that for tariffs.<sup>51</sup>

## Eliminating a Tariff

### Small Country



(Source: The World Trade Organization<sup>52</sup>)

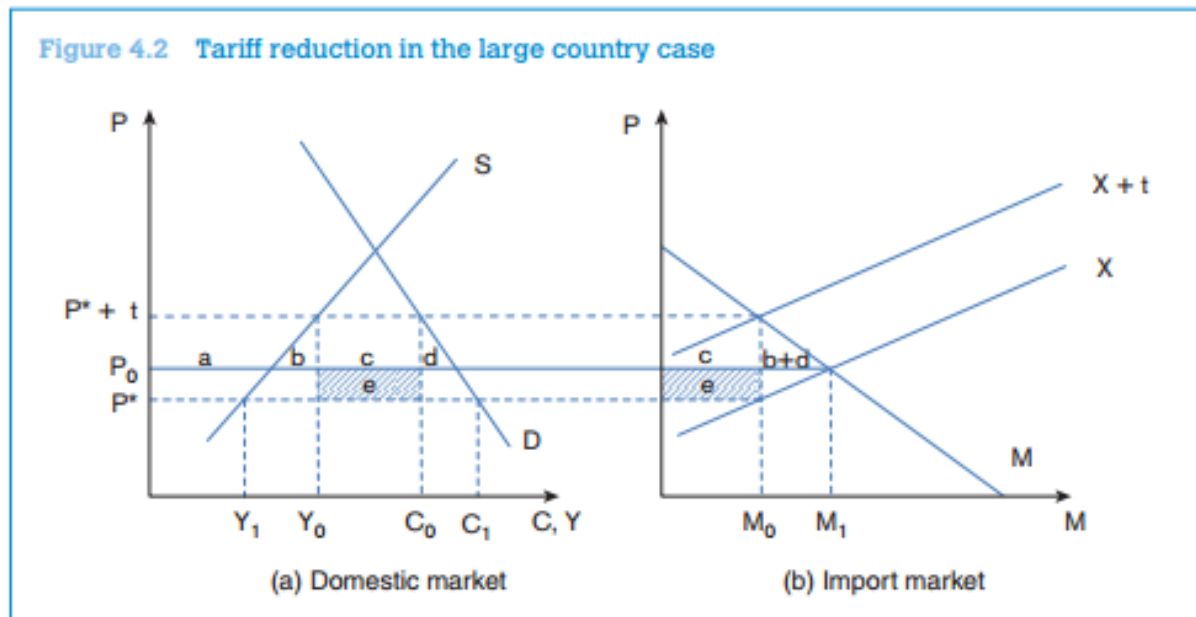
<sup>51</sup> Ibid, p. 72.

<sup>52</sup> Ibid, p.141.

The above figure shows the effects of the elimination of a tariff ( $t$ ) by a small country. The small country faces fixed world prices ( $P^*$ ). At the world price (price plus tariff)  $P^* + t$ , domestic demand is  $C_0$ , domestic supply is  $Y_0$ , and imports are  $M_0$ . The elimination of the tariff decreases the domestic price by the full amount of  $t$ . As a consequence, domestic demand increases to  $C_1$ , domestic supply decreases to  $Y_1$ , and imports increase from  $M_0$  to  $M_1$ .<sup>53</sup>

The tariff elimination results in welfare changes. Consumers are now able to purchase a larger amount of goods ( $C_1 - C_0$ ) as domestic prices have decreased. The consumer surplus gained is equal to the areas of ( $a + b + c + d$ ). Producers, on the other hand, now receive less in profits due to the decreased price. The producer surplus loss is equal to area ( $a$ ). Taxpayers also lose out on tariff revenue, area ( $c$ ). The total welfare gain by the tariff elimination is thus equal to ( $a + b + c + d - a - c$ ) or simply ( $b + d$ ). This area is denoted by the triangle under the import demand curve. Overall, in the case of a small country, eliminating an import tariff lowers the domestic price by the full amount of tariff and results in a net welfare gain.<sup>54</sup>

### Large Country



(Source: The World Trade Organization<sup>55</sup>)

<sup>53</sup> Ibid, p.141.

<sup>54</sup> Ibid, p. 141.

<sup>55</sup> Ibid, p.141.

The above figure shows the effects of the elimination of a tariff ( $t$ ) by a large country. In this case, we assume that the foreign supply curve  $X$  is upward sloping, as depicted in the import market. The large country faces the price equilibrium of  $(P_0 + t)$ , with domestic demand  $C_0$ , domestic supply  $Y_0$ , and imports  $M_0$ . The elimination of the tariff shifts the export supply to  $X$  in the import market, which results in a new domestic price of  $P_0$ . As the supply curve is upward sloping, the decrease in the domestic price is less than the full amount of the tariff ( $t$ ). As seen in the diagram, the foreign price in the presence of the tariff ( $P^*$ ) is lower than the free trade price  $P_0$ . This results in a trade gain of area  $(e)$  for the importing country.<sup>56</sup> Recall, the terms of trade are usually defined by the price of a country's exports divided by the price of its imports.

The fundamental argument here is that if a large country is a net importer, a tariff can force down the imported price, which improves the terms of trade (potential welfare gain) for the large country. The potential welfare gain, however, does not necessarily offset the welfare loss by imposing the tariff that hurts consumers and leads to a loss in producer rents.

The large country scenario is similar to that of the small country case, where the elimination of the tariff leads to lower domestic prices, more imports and less domestic supply. The welfare change, however, is different in the large country case, as there exists terms of trade gains, represented by area  $(e)$ . The area  $(e)$  measures these terms of trade losses by multiplying the drop in prices by the new import demand  $M_1$ . The net gain is still represented by the triangle  $(b + d)$ . The size of the gain depends on the square of the tariff,  $t$ . The net welfare effects of  $(e - (b + d))$  thus depends on the size of the tariff; net welfare effects are positive for sufficiently small tariffs and are negative for larger tariffs.<sup>57</sup>

### Distributional Effects of Trade Policy

The relationship between trade policy and social welfare is complex. Trade policies generally have strong redistribution effects, benefiting some individuals while costing others. The impact of a trade policy depends on the influence the policy has on domestic prices and an individual's reliance to specific economic sectors. For example, imposing tariffs on certain food items disproportionately affects poor households that spend a larger share of their income on food.

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<sup>56</sup> Ibid, p. 142.

<sup>57</sup> Ibid, p. 142.

Similarly, reducing trade barriers may reduce the wages of workers in import-competing sectors, while benefiting the wages of workers in export-oriented sectors.<sup>58</sup>

According to the WTO, the effect trade policies have on individuals and households can be captured by considering the following effects:

- 1) **The Consumption Effect:** the effect of trade policies on the prices of goods consumed by the household;
- 2) **The Income Effect:** the effect of trade policies on the income of the household (wages, sales of products, and employment opportunities); and
- 3) **The Revenue Effect:** the effect of trade policies on government revenues and indirectly on households via government transfers.<sup>59</sup>

To analyze the distributional effect of trade policy, the consumption effect, income effect and revenue effect have to be estimated. As told by our elimination of tariff examples above, the consumption effect is generally positive in the case of trade liberalization, as lowering or eliminating tariffs reduces the price of foreign goods. This, in turn, increases the purchasing power of households. The income effect is more telling from a poverty and distributional perspective. However, the income effect is far more difficult to determine, as you would need to link policy-driven changes in prices to wages and employment.<sup>60</sup> Regardless of the difficulty of analysis, general findings are that trade liberalization leads to a rise in the skill premium, changes in industry wage premiums and increases in employment opportunities for individuals.<sup>61</sup> In terms of the revenue effect, data on government transfers at the household level is not readily available. However, it is intuitive that when a large share of government revenues depends on trade policy that changes in trade policy will have a substantial impact on government revenues and the programs (ie. anti-poverty programs) the revenue supports.

The general framework describing the effects of trade policies on household welfare is illustrated by Winters (2002) (reproduced in the figure below).

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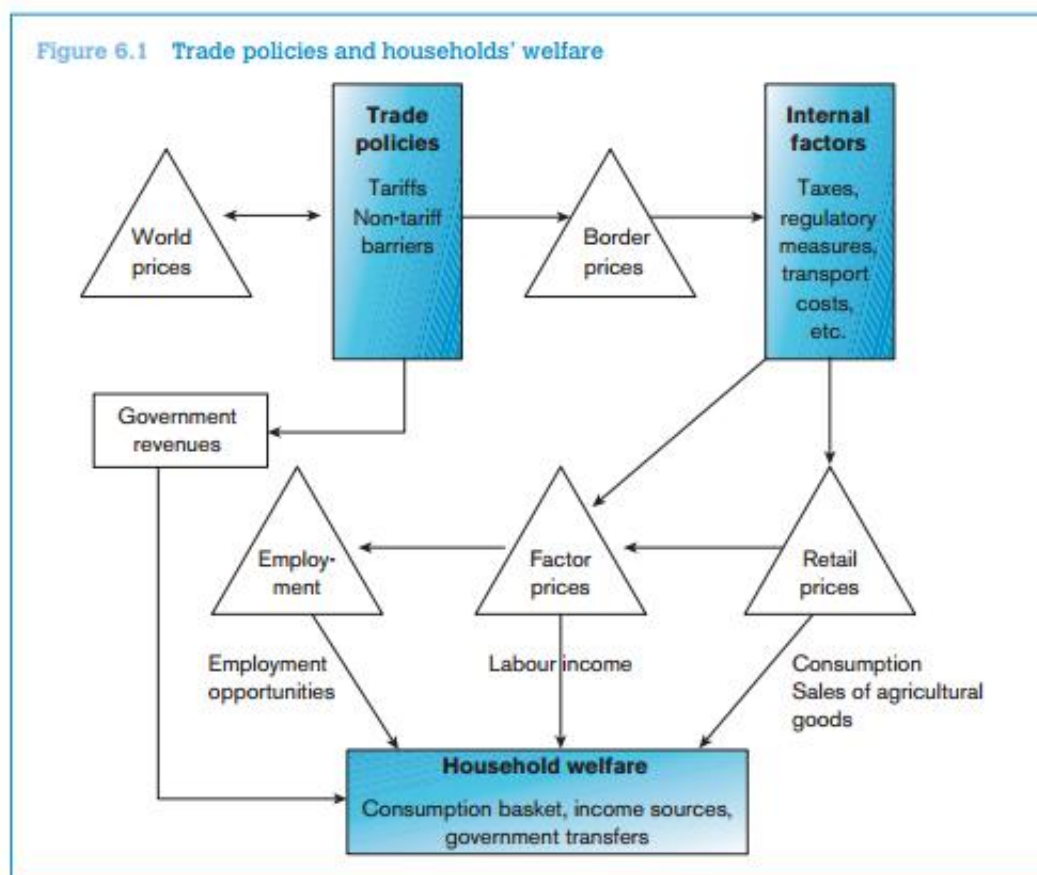
<sup>58</sup> Ibid, p. 212.

<sup>59</sup> Ibid, p.213.

<sup>60</sup> Ibid, p.213.

<sup>61</sup> Ibid, p.213.





(Source: The World Trade Organization<sup>6263</sup>)

What does this quantification of trade policy mean for Canada and the Rep. of Korea? Both Canada and South Korea are considered to be small open economies. That is, both countries participate in international trade, but are small enough compared to their trading partners that their policies do not alter world prices, interest rates or incomes.<sup>64</sup> The CKFTA opens market access for both Canadian and South Korean exporters and investors by removing tariffs and NTMs that hinder trade. The welfare effects of eliminating a tariff in a small country indicates an overall welfare gain, with consumer surplus being greater than producer loss from decreased profits and the government loss from decreased tariff revenue. Canadian and South Korean consumers are thus projected to gain extra surplus from the tariff reductions on goods

<sup>62</sup> Winters, L. A. (2002), "Trade liberalization and poverty: what are the links?" *The World Economy* 25(9): 1339–67.

<sup>63</sup> World Trade Organization. *A Practical Guide to Trade Policy Analysis*, p.212.

<sup>64</sup> Macroeconomic Analysis: Theory, Policy, News. "Small Open Economy." Genesis Framework. Accessed June 8, 2015. <http://macroeconomicanalysis.com/macroeconomics-wikipedia/small-open-economy/>.

specified in the CKFTA. Canadian and South Korea producers are projected to lose surplus from the reduction of tariffs on goods specified in the CKFTA. But, overall, the impact of the trade policies effectively depends on the distributional effects of the trade policy. For instance, while producers may lose surplus from the reduction in revenues, they may also gain from any reduction in wages they need to pay their workers.

Note, while Canada and South Korea are generally thought to be small open economies, each country is often considered to be large players in the trade of certain good and services. Canada, for instance, would be considered a large economy in the trade of potash or some specific minerals. Likewise, South Korea would be considered a large economy in the trade of electronic equipment or machinery.<sup>65</sup>

## **CKFTA's Important Provisions**

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The CKFTA covers virtually all aspects of trade between Canada and the Rep. of Korea. This includes provisions for the rules of origin, trade in goods and services, investment, government procurement, intellectual property, non-tariff barriers, dispute settlement and institutional provisions, environment and labour cooperation, and detailed tariff schedules.

### **Rules of Origin**

The CKFTA includes specific rules of origin for all products. These rules specify how much production must occur in Canada and/or South Korea for a product to be considered originating from that country. This is important because only goods that originate in Canada and/or South Korea may benefit from preferential tariffs. The rule of origin section allows Canadian companies to benefit from preferential access as it encourages the use of Canadian inputs. One noteworthy clause is the rule of origin for vehicles. South Korea has agreed to provisions that allow Canadian manufacturers to source inputs from the US and still qualify for preferential treatment.<sup>66</sup>

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<sup>65</sup> International Trade Centre. "Trade Map - Trade Competitiveness Map." International Trade Centre.

<sup>66</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary," p. 30.

## Trade in Goods

The CKFTA's trade in goods section is the most extensive section of the agreement. The main benefit of this section is the ambitious elimination of tariffs by Canada and South Korea. As of January 1, 2015, South Korea effectively removed duties on 81.9 percent of tariff lines and Canada removed duties on 76.4 percent of tariff lines.<sup>67</sup> The removal of duties will gradually increase over time. Once the agreement is fully implemented, South Korea will have removed duties on 98.2 percent of tariff lines and Canada will have removed duties on 97.8 percent of tariff lines.<sup>68</sup>

For Canadian producers and consumers, the tariff elimination will be particularly advantageous. That is because, on average, South Korea's tariffs are three times higher than Canada's (13.3 percent vs. 4.3 percent).<sup>69</sup> Further, the CKFTA protects against NTMs that could reduce or nullify the market access gained through the elimination of tariffs.

## Trade in Services, Investment and Related Matters

The CKFTA's trade in services and investment section establishes greater transparency and more predictable access to the Canadian and South Korean markets. The agreement goes beyond South Korea's obligations under the WTO's General Agreement on Trade in Services by establishing new sectoral market access of interest to Canadian exporters. The CKFTA enhances market access in the areas of environmental services, business services and professional services, such as consultancy services, commercial education and training, and research and development. The liberalization of trade in services is based on a "negative list" approach, where services in all sectors will be granted market access and non-discriminatory treatment subject to specific exceptions listed in the agreement. The agreement also uses the "ratchet mechanism" which ensures that any future changes designed to make it easier for Canada's service providers to access the South Korean market will be locked in as a new obligation under the CKFTA.<sup>70</sup>

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<sup>67</sup> Ibid, p.12.

<sup>68</sup> Ibid, p.12

<sup>69</sup> Ibid, p.12.

<sup>70</sup> Ibid, p.35.

## Government Procurement

The CKFTA's government procurement section sets out the rules on how the public sector should make purchasing decisions for goods and services for its own use. The agreement provides Canadian suppliers of products and services preferential access to the South Korean government's procurement activities. Specifically, the agreement allows Canadian suppliers to benefit from additional access to procurement by South Korean central government agencies for contracts valued above 100 million South Korean Won (CAD\$100,000). Likewise, South Korean suppliers will have access to procurement by Canadian government agencies for contracts valued above CAD\$100,000.<sup>71</sup>

## Intellectual Property

The CKFTA's intellectual property (IP) section commits to strong IP rights and rules that contribute to a framework of regulatory certainty. The main purpose of this section is to ensure that Canadian IP rights-holders can do business with confidence in the South Korean market. The agreement covers Canadian copyright, patents, and trademarks. On the whole, the agreement's IP provision reflects existing aspects of Canada's regime.<sup>72</sup>

## Dispute Settlement and Intuitional Provisions

The CKFTA's dispute settlement section sets to resolve disputes quickly and effectively. The institutional provisions section sets out the ground rules for how the agreement will be interpreted, implemented, and managed. This is important as trade disputes can cost all parties involved millions of dollars in lost opportunity. The agreement provides for three-person dispute settlement panels, with panelists appointed through an ad-hoc appointment process. More importantly, the agreement provides for the accelerated timeline for disputes involving perishable goods and motor vehicles.<sup>73</sup>

## Environment and Labour

The CKFTA's environment and labour section provides for the protection of environment and labour rights. The agreement maintains the effective enforcement of environmental laws, and the not wavering from such laws to promote trade and investment. Similarly with labour, the

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<sup>71</sup> Ibid, p.44.

<sup>72</sup> Ibid, p. 47.

<sup>73</sup> Ibid, p.50.

agreement respects international labour standards and maintains a non-derogation clause preventing either party from deviating from its labour laws in order to encourage trade and investment.<sup>74</sup>

## Tariff Schedules

The CKFTA's tariff schedules section specifies the duties levied on the goods traded between Canada and the Rep. of Korea as they enter each country. The schedule divides all goods into major groups and sub-groups so that tariffs can be charged according to which group the traded good falls within. For some goods, tariffs became fully eliminated on the CKFTA's implementation. For other goods, tariffs are gradually reduced using a specified timeframe. The timeframe duration for tariff elimination depends on the good. The duties on South Korean vehicles, for example, will be eliminated after two years. The duties on Canadian beef, on the other hand, will be incrementally eliminated over a 15-year timeframe.<sup>75</sup>

## Impact by Sector

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The CKFTA provisions affect different sectors in different ways. As witnessed during the CKFTA negotiation process, some sectors – namely the agriculture and auto sectors – are more sensitive and require more care than others. The following indicates the CKFTA provisions for what are arguably the three most sensitive sectors included in the agreement – the agriculture and agri-foods, the fish and seafood, and the automotive sectors. The following provides a summary of CKFTA provisions for these three sectors. Further, the overall impact is provided – as determined by the computed general equilibrium analysis done by the C.D. Howe Institute's *The Canadian-Korea Free Trade Agreement: What it means for Canada*. (See Appendix A: Methodology – Non-technical Summary for the methodology).

## Agriculture and Agri-Foods Products

The CKFTA provides an opportunity for significant benefits to Canadian exporters of agriculture (crops and animals) and agri-foods (food and beverages) products. In 2014, Canada's

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<sup>74</sup> Ibid, p. 54.

<sup>75</sup> Government of Canada, Department of Foreign Affairs, Trade and Development. 2014. "Canada-Korea Free Trade Agreement (CKFTA)." <http://www.international.gc.ca/trade-agreements-accordscommerciaux/agr-acc/korea-coree/index.aspx>.

annual agriculture and agri-foods exports to South Korea were worth over CAD\$518 million.<sup>76</sup> Prior to CKFTA, Canadian agricultural exports to South Korea faced high tariff rates. For instance, oats faced a duty of up to 554.8 percent, while fresh/chilled/frozen beef cuts faced duties of up to 72 percent.<sup>77</sup> The elimination of these high tariffs on Canadian export products opens access to the South Korean market providing opportunity for growth for agriculture and agri-food product producers.

### **South Korean tariff elimination**

The CKFTA allows for the progressive elimination of tariffs on 86.8 percent of agricultural tariff lines. Products of interest to Canada that will receive immediate duty-free access include: grains and special crops, oilseeds and oilseed products, meat and animal products, animal foods, processed products and alcoholic beverages. Products of interest to Canada that will eliminate tariffs within three to five years of the agreement include: refined canola oil, chickpeas, lentils and broad beans, wheat flour, processed products (i.e. sugar confectionery products), most baked goods, active and inactive yeasts and cranberry and blueberry juice. Products of interest to Canada that will eliminate tariffs within five to fifteen years of the agreement include: beef and pork, pulses, oils and oilseeds, and processed grains and animal feeds. Note, South Korea excluded select agricultural products from tariff elimination. These products, which represent 3.1 percent of Canada's agricultural exports, include most dairy products, poultry and poultry products, ginseng and its products, rice and rice products, refined sugar and most tobacco products.<sup>78</sup>

### **Canadian tariff elimination**

The CKFTA provides South Korea with immediate duty-free access on 50.7 percent of agricultural tariff lines. South Korea will receive a further 36.3 percent reduction of duties on agricultural tariff lines over five years. Canada's supply-managed products, namely dairy, poultry and eggs, are excluded from duty elimination.<sup>79</sup>

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<sup>76</sup> International Trade Centre. "Trade Map - Trade Competitiveness Map."

<sup>77</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary," p. 63.

<sup>78</sup> Ibid, p.63.

<sup>79</sup> Ibid, p.64.

## Fish and Seafood Products

Canada, with access to the Arctic, Atlantic and Pacific oceans, has one of the world's most valuable commercial fishing industries. The industry itself represents the economic mainstay of approximately 1,500 communities in rural and coastal Canada.<sup>80</sup> Canada already exports a significant share of its fish and seafood products to China, Japan and Hong Kong – demonstrating Canada's capacity to export to Asian markets. The same can be said about South Korea. In 2014, South Korea imported over CAD\$56 million in fish and seafood products from Canada.<sup>81</sup>

The CKFTA looks to create significant market access opportunities for Canada's fish and seafood sector by eliminating high South Korean tariffs.

### South Korean tariff elimination

Within five years of CKFTA's implementation, nearly 70 percent of fish and seafood tariff lines will benefit from duty-free access. Tariffs were eliminated immediately on lobster (frozen) (pre-CKFTA duties of 20 percent) and Pacific and Atlantic salmon (fresh/chilled/smoked) (pre-CKFTA duties of 20 percent). Tariffs to be eliminated within three years are on lobster (not frozen) (current duties of 20 percent). And, tariffs to be eliminated within five years are on prepared/preserved salmon in airtight containers (current duties of 20 percent), Bai top shell (sea snails) (current duties of 20 percent), frozen sardines (current duties of 10 percent), fish oil (current duties of 3 percent), and frozen *Pandulus borealis* shrimp (current duties of 20 percent).<sup>82</sup>

### Canadian tariff elimination

Upon implementation, 77.2 percent of tariff lines became duty free upon implementation. All remaining tariffs are to be phased out within three years.<sup>83</sup>

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<sup>80</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary, " p. 20.

<sup>81</sup> International Trade Centre. "Trade Map - Trade Competitiveness Map."

<sup>82</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary, " p. 61.

<sup>83</sup> Ibid, p.62.

## Automotive Industry

The CKFTA provides an opportunity for stakeholders in the automotive industry to benefit from increased access to the Canadian and South Korean markets. Bilateral trade in automobiles is important for both Canada and South Korea. In 2014, South Korea imported over CAD\$78 million worth of vehicles (other than railway and tramway) from Canada, and Canada imported more than CAD\$2 billion worth of vehicles (other than railway or tramway) from South Korea.<sup>84</sup> The elimination and reduction of tariffs on vehicles has already proven to provide benefit to Canadian consumers. Hyundai Auto Canada Corp., for instance, celebrated the implementation of the CKFTA by reducing many Hyundai models by up to CAD\$1,300, passing on the benefits to consumers.<sup>85</sup>

Along with reducing tariffs, the CKFTA offer an equivalency provision to Canadian automakers. The equivalency provision gives Canadian automakers preferential access to the South Korean market for cars built to US or European Union (EU) safety standards, with no limits on quantity. This awards Canadian car manufacturers added flexibility as cars intended for the EU market can also be shipped to South Korea. The CKFTA also includes most-favoured nation (MFN) obligations that include vehicle emissions and fuel economy regulation as automotive parts. MFN obligations ensure that any additional benefits granted by South Korea to other trading partner will automatically be extended to Canada.<sup>86</sup>

### South Korean tariff elimination

Upon the Agreement's entry into force, all existing tariffs will be eliminated. This includes: all light vehicles (pre-CKFTA duties of 8 percent) and all automotive parts (pre-CKFTA duties ranging from 3 to 8 percent).<sup>87</sup>

### Canadian tariff elimination

The Canadian tariffs will be eliminated progressively. For all light vehicles, tariffs will be eliminated within three or five years (pre-CKFTA duties of 6.1 percent). And, for all

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<sup>84</sup> International Trade Centre. "Trade Map - Trade Competitiveness Map."

<sup>85</sup> Ling, Andrew. *Hyundai Vehicles Now Cheaper Thanks to Canada-Korea Free Trade Agreement* Open Road Auto Group, 2015.

<sup>86</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary," p. 22.

<sup>87</sup> *Ibid*, p.59.



automotive parts, 69.8 percent of tariff lines became duty free on January 1, 2015, and all remaining tariffs are to be phased out within three to five years (pre-CKFTA duties ranging from 0 to 8.5 percent).<sup>88</sup>

## CGE Analysis

According to *The Canadian-Korea Free Trade Agreement: What it means for Canada's* CGE analysis, the impact of CKFTA on each Canadian sector varies sharply. The analysis showed that the CKFTA expands agricultural output – especially for beef and pork production. Likewise for the fish and seafood industry, the increased market access in South Korea expands output. The Canadian automotive industry, on the other hand, is projected to show a small decline in production. The impact calculated is small, however, compared to the expansion of Korean auto imports. This “softened blow” to Canadian automotive production may also be due, in part, to the overall Canadian income gains from the deal which stimulates overall demand. And, interestingly enough, the impact of CKFTA’s auto provisions will likely hit third party imports into Canada the hardest – not Canada directly. In the end, the production declines are small compared to the encroachments made by Canada into the Korean market. Overall, the analysis projects the impacts of the CKFTA to be small but positive in terms of economic welfare for both Canada and South Korea.<sup>89</sup>

## KORUS/KAFTA

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Canada was a little late to the FTA party with the Rep. of Korea. In fact, by the time Canada had finalized its agreement, South Korea had concluded agreements with the US, the European Union and Australia – Canada’s largest competitors. This undoubtedly resulted in lost trade opportunities for Canada. In fact, in 2012, growth in Canada’s merchandise trade with South Korea diminished significantly – the same time that the Korea-US FTA entered into force.<sup>90</sup>

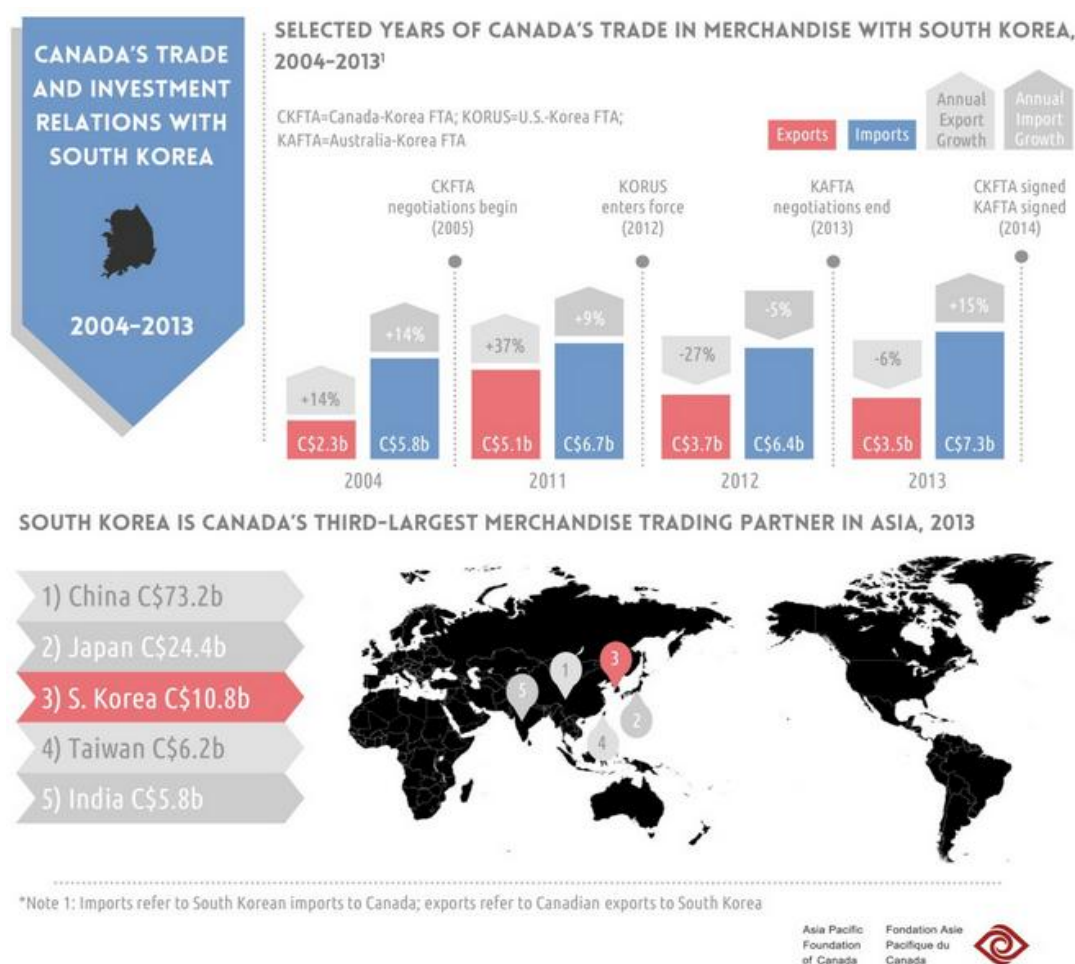
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<sup>88</sup> Ibid, p.60.

<sup>89</sup> Ciuriak, Dan, et al.. *The Canada-Korea Free Trade Agreement: What it means for Canada*, p.7.

<sup>90</sup> Kim, Young-Gui, Hyo-young Lee, Jungu Kang, and Hyuk-Hwang Kim. "Korea-U.S. FTA in its Second Year: Current Status of Implementation." *KIEP Research Paper no. World Economy Update 4*, no. 23 (June 13, 2014): 1-10.

The image below breaks down Canada's trade and investment relations with South Korea from 2004-2014. From 2004 to 2012, Canada experienced growth in imports and exports. This trend came to a halt when FTAs with the US and Australia entered into force. After the implementation of KORUS in 2012, the value of Canadian merchandise exports to South Korea declined by 27.1 percent, and South Korean imports to Canada declined by 4.5 percent.<sup>91</sup> Likewise, when the Korea-Australia FTA negotiations ended in 2013, Canadian merchandise exports to South Korea declined by 6 percent.<sup>92</sup> By the end of 2013, Canada and South Korea held a trade deficit of C\$3.8 billion, the largest held between the two nations.<sup>93</sup>



(Source: Asia Pacific Centre for Canada<sup>94</sup>)

<sup>91</sup> Asia Pacific Foundation of Canada. *Crossing the Finish Line: Canada and South Korea's Nine-Year Free Trade Marathon is almost Complete* Asia Pacific Foundation of Canada, 2014.

<sup>92</sup> Ibid.

<sup>93</sup> Ibid.

<sup>94</sup> Ibid.

It is evident that Canada's trade competitiveness declines when countries with goods and services similar to its own reach trade agreements. It is thus in Canada's best interest to ensure its FTA negotiations are not drawn out. And, if negotiations are lengthy, that Canada comes out with a better deal than its competitors.

The following table provides a quick comparison of the CKFTA, KORUS and KAFTA with respect to tariff eliminations.

**Table 5: KORUS, KAFTA and CKFTA**

	<b>KORUS</b> Mar 2012	<b>KAFTA</b> Dec 2014	<b>CKFTA</b> Jan 2015
<b>Tariff Elimination</b>	At full implementation almost 80 percent of U.S. exports to Korea of consumer and industrial products will become duty free, and nearly 95 percent of bilateral trade in consumer and industrial products will become duty free within five years of that date. Most remaining tariffs would be eliminated within 10 years. <sup>95</sup>	At full implementation, KAFTA will reduce South Korea's tariffs by 99.8% and Australia's tariffs by 100%. <sup>96</sup>	At full implementation, CKFTA will reduce South Korea's tariffs by 98.2% and Canada's tariffs by 97.8%. <sup>97</sup>

With respect to tariff eliminations, the three FTAs are relatively on par, reducing virtually all tariffs once FTAs are fully implemented. What is notable, according to Ciuriak et al, is that "due to the CKFTA, not all of the bilateral export gains anticipated by the United States and Australia from their agreements with Korea will in fact be realized."<sup>98</sup> That is because when competitor countries also sign FTAs with your trading partner, it reduces your overall competitive advantage – leveling the playing field. In this case, the CKFTA helps re-establish Canada as a competitive player in the South Korean market.

<sup>95</sup> Office of the United States Trade Representative. "U.S. - Korea Free Trade Agreement." Executive Office of the President. Accessed June 12, 2015. <https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta>.

<sup>96</sup> Department of Foreign Affairs and Trade. "KAFTA - a Snapshot."

<sup>97</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary, " p. 12.

<sup>98</sup> Ciuriak, Dan, et al.. *The Canada-Korea Free Trade Agreement: What it means for Canada*, p.7.

## Automotive Industry

We can also compare the KORUS, KAFTA and CKFTA with respect to the automobile industry. For Canada, South Korea's 8 percent auto tariff will be eliminated immediately, while for South Korea, Canada's 6.1 percent auto tariff will be phased out in three annual cuts. Likewise for Australia, Korea's tariffs on automotive part imports from Australia were eliminated immediately when KAFTA entered into force. KORUS, on the other hand, had a longer phase-out of five years. Therefore, Canadian automotive exporters can benefit from tariff-free South Korean market faster than provided to the US.<sup>99</sup>

With respect to dispute settlements for vehicles, the CKFTA has a specialized dispute settlement provision to ensure vehicle-related disputes are settled within 177 days. The dispute settlement provision in the KORUS allows disputes to carry on for up to 10 years.<sup>100</sup> Remember, long disputes have high economic costs.

Another area where Canada holds an advantage is with respect to its rules of origin provisions. The CKFTA allows Canadian vehicle manufacturers the ability to source inputs from the US and still benefit from the Agreement when exporting to South Korea. Neither KORUS nor KAFTA allow for such "culmination."<sup>101</sup>

Where the US does hold the advantage is in its "snap-back provision." The US's "snap-back" provision allows the US to suspend tariff concessions on South Korean vehicles if South Korea does not conform to its obligations. Neither CKFTA nor KAFTA have a "snap-back" mechanism, and as such, cannot re-impose duties on South Korean vehicles if South Korea violates its obligations in respect of Canadian or Australian manufactured vehicles.<sup>102</sup>

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<sup>99</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary, " p. 22.

<sup>100</sup> Goldman, Jesse I. and Laura A. Murray. *Canada-Korea Free Trade Agreement: Breakthrough in Asian Trade*. International. Bennet Jones Thought Network, 2014.

<sup>101</sup> Foreign Affairs, Trade and Development Canada. "Canada-Korea Free Trade Agreement (CKFTA) - Overview: Final Agreement Summary, " p. 22.

<sup>102</sup> Goldman, Jesse I. and Laura A. Murray. *Canada-Korea Free Trade Agreement: Breakthrough in Asian Trade*. International. Bennet Jones Thought Network, 2014.

## Future Policy Implications

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Canada and South Korea have both actively pursued establishing preferential trade agreements. In addition to the CKFTA, Canada has signed numerous FTAs with smaller economies – like Panama, Jordan, Colombia and Peru – as well as FTAs with the larger US and EU economies. The Rep. of Korea has also aggressively cut trade deals with major economies like the US, EU, and Australia. As established, once major economies enter FTAs, it puts pressure on other trading partners to cut deals of their own in order to mitigate competitive losses. This is no truer than with Canada and the Rep. of Korea finalizing the CKFTA. Canada concluding negotiations with South Korea allowed some of the pressure on Canada to release and allowed Canada to play catch-up its competitor nations. Now, the CKFTA has the potential to act as a stepping stone to establishing FTAs with other nations in the Asia-Pacific.<sup>103</sup>

In Canada, while establishing FTAs falls under the jurisdiction of the federal government, it is Canadian provinces and industries that are strongly impacted by trade deals. After all, it is businesses and people, not governments, who engage in trade once FTAs are finalized. Therefore, it is important that the Canadian federal government support trade policies that will benefit Canada as a whole. To do so requires transparent, evidence-based analysis on how FTAs will impact not just different sectors, but also different provinces. This is especially true for sensitive sectors which are also often province-specific.<sup>104</sup> Moving forward, Canada should take proactive policy steps when engaging in future preferential trade agreements, whether it is with the Asia-Pacific region or elsewhere.

Canada should also be cognizant of different nations' business cultures when engaging in trade deals. There is often a big difference between formal inter-governmental agreements versus business relationship. Canada and the Rep. of Korea, for instance, have very different business cultures. For South Korea, social capital remains extremely important. This is evidenced by South Korea's chaebol system – where large wealthy families own major corporations (think

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<sup>103</sup> Ciuriak, Dan et al. "The Impact of the Canada-Korea Free Trade Agreement as Negotiated."

<sup>104</sup> Ciuriak, Dan, et al. *Province-Level Impacts of the Canada's Trade Agreements*.

Samsung and Hyundai). Canada must consider whether trade partnerships can penetrate the maze of corporate and personal relationships in countries with cultures like South Korea.<sup>105</sup>

## What about the TPP?

Canada is currently taking part in negotiations for a Trans-Pacific Partnership (TPP) agreement. The TPP includes 12 countries, many of which are in the Asia-Pacific region. The TPP is aimed at liberalizing trade in nearly all goods and services, going beyond WTO establishments. A common question is whether the TPP will make the CKFTA redundant?

Simply put: No. For one, the Rep. of Korea, although showing interest in the TPP, has not yet engaged in negotiations. And two, it is unclear whether the TPP negotiations will ever reach conclusion, as there are key concerns regarding agricultural products and intellectual property rights. Canada can thus enjoy liberalized trade with South Korea without having to wait for the TPP to be ratified to establish a presence in the Asian market.<sup>106</sup>

Even if the Republic of Korea was engaged in TPP negotiations, the CKFTA maintains provisions that are not covered, or covered differently, than in the TPP. The trade provisions maintained in the CKFTA would have greater bearing for trade between Canada and South Korea than those covered in the TPP.

## Conclusion

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The Canada-Korea Free Trade Agreement has officially reached eight months since enforcement. While it may be too soon to determine to quantify the exact impact of the agreement, it is possible to evaluate the potential impacts of the CKFTA's major provisions. Overall, the CKFTA will positively impact Canada. This is due largely to Canada and South Korea's aggressive elimination of tariffs.

The CKFTA affects Canadian consumers and producers differently. As illustrated by the Canadian auto industry, Canadian consumers are likely to benefit, while Canadian producers are

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<sup>105</sup> Ciuriak, Dan et al. "The Impact of the Canada-Korea Free Trade Agreement as Negotiated."

<sup>106</sup> Dade, Carlo, et al. *Canada-Korea Free Trade Agreement: What the Trade Agreement with South Korea Means for Western Canada*.

expected to experience a small decline in output. The CKFTA tends to reinforce existing patterns of comparative advantage between Canada and South Korea. For Canada, the agriculture sector gains, while for Korea the automotive sector gains.

Overall, the CKFTA is projected to result in positive, but small, gains to Canada in economic welfare and activity. The CKFTA's gains, though relatively small, are nonetheless significant. The alternative of not engaging in a FTA with South Korea would mean huge potential losses for Canada. Canada's major competitors (EU, US, and Australia) had long concluded FTAs with South Korea. The costs to Canada would have risen in the form of lost trade opportunity, lost market growth and access, and a loss in trade competitiveness. The CKFTA now acts to level the international playing field for Canada.

Overall, the implementation of the CKFTA represents a strengthening of Canada's relationship with the Republic of Korea. It also signals to the rest of the Asia-Pacific that Canada is willing to tie its economic future to their region. Establishing trade agreements clearly holds benefits for Canadian consumers and producers. Moving forward, Canada should take proactive policy steps when engaging in future preferential trade agreements, whether it is with the Asia-Pacific region or elsewhere.

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## Appendix A – Additional Material

### 1. CKFTA Negotiation Process

#### 📌 Korea-Canada FTA

Jan. 8~9, 2009	The Korea-Canada FTA Intercessional Meeting on Origin Matters (Vancouver, Canada)
May 7~8, 2008	The Korea-Canada FTA Intercessional Meeting on Agriculture (Vancouver, Canada)
Mar. 25~28, 2008	13th round of the Korea-Canada FTA negotiations (Ottawa, Canada)
Nov. 26~29, 2007	12th round of the Korea-Canada FTA negotiations (Seoul, Korea)
Oct. 9~12, 2007	11th round of the Korea-Canada FTA negotiations (Ottawa, Canada)
Sep. 11~14, 2007	Working Level Consultations on Goods (Seoul, Korea)
Jun. 25~28, 2007	Working Level Consultations on Goods (Ottawa, Canada)
Apr. 23~26, 2007	10th round of the Korea-Canada negotiations (Seoul, Korea)
Jan. 29~Feb. 1, 2007	9th round of the Korea-Canada FTA negotiations (Vancouver, Canada)
Nov. 20~23, 2006	8th round of the Korea-Canada FTA negotiations (Seoul, Korea)
Sep. 25~28, 2006	7th round of the Korea-Canada FTA negotiations (Ottawa, Canada)
Jun. 26~29, 2006	6th round of the Korea-Canada FTA negotiations (Seoul, Korea)
Apr. 24~27, 2006	5th round of the Korea-Canada FTA negotiations (Ottawa, Canada)
Feb. 13~17, 2006	4th round of the Korea-Canada FTA negotiations (Seoul, Korea)
Nov. 28~Dec. 2, 2005	3rd round of the Korea-Canada FTA negotiations (Ottawa, Canada)
Sep. 27~30, 2005	2nd round of the Korea-Canada FTA negotiations (Seoul, Korea)
Jul. 28, 2005	1st round of the Korea-Canada FTA negotiations (Ottawa, Canada)
Jul. 15, 2005	Korea-Canada agree to launch the Korea-Canada FTA negotiations at the Korea-Canada Trade Ministers' Meeting held in Dalian, China on Jul. 11, 2005
May. 23, 2005	Ministerial Meeting for External Economic Affairs
May. 21, 2005	FTA Promotion Committee
May. 10, 2005	FTA Private Advisory Committee
May 6, 2005	Public hearing on the Korea-Canada FTA
Mar. 31~Apr.1, 2005	2nd round of preparatory talks
Jan. 25~26, 2005	1st round of preparatory talks
Nov. 19, 2004	Korea and Canada agree to launch preparatory talks for the Korea-Canada FTA

(Source: Ministry of Foreign Affairs, Republic of Korea)<sup>107</sup>

<sup>107</sup> Ministry of Foreign Affairs. "FTA Status of ROK: Korea-Canada FTA." Republic of Korea.

## 2. CKFTA Legislative Process

### House of Commons

#### First Reading

[Show Sittings](#)

**Introduction and First Reading** 2014-09-23

#### Second Reading

[Show Sittings](#)

**Second Reading and Referral to Committee** 2014-10-01

#### Committee

##### STANDING COMMITTEE ON INTERNATIONAL TRADE

[Show Meetings](#)

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**Committee Reporting the Bill without Amendment** 2014-10-10

#### Report Stage

[Show Sittings](#)

**Concurrence at Report Stage** 2014-10-24

#### Third Reading

[Show Sittings](#)

**Third Reading** 2014-10-29

### Senate

#### First Reading

[Show Sittings](#)

**First Reading** 2014-10-30

#### Second Reading

[Show Sittings](#)

**Second Reading** 2014-11-05

**Referral to Committee** 2014-11-05

#### Committee

##### STANDING SENATE COMMITTEE ON FOREIGN AFFAIRS AND INTERNATIONAL TRADE

[Show Meetings](#)

[Show Sittings](#)

**Committee Report Presented without Amendment** 2014-11-20

#### Third Reading

[Show Sittings](#)

**Third Reading** 2014-11-25

*Bill passed by the Senate without amendment*

#### Royal Assent

**Royal Assent** 2014-11-26  
Statutes of Canada: 2014, c. 28

(Parliament of Canada)<sup>108</sup>

<sup>108</sup> Parliament of Canada. "House Government Bill: C-41..."