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Thursday, December 6, 2007

—
Chair

Mr. Lee Richardson

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•(1535)

[English]

The Vice-Chair (Mr. John Maloney (Welland, Lib.)): I'd like to bring to order meeting seven of the Standing Committee on International Trade. Our first item of business is Bill S-2, an act to amend the Canada-United States Tax Convention Act, 1984.

We have as witnesses today, from the Department of Finance, Mr. Brian Ernewein and Lawrence Purdy. Thank you for coming.

You may recall that there was some concern expressed by Mr. Julian about the clause-by-clause consideration. We have some material that has been presented in both official languages.

Mr. Julian, are you content with what has been provided?

Mr. Peter Julian (Burnaby—New Westminster, NDP): Thank you, Mr. Chair.

I am concerned. The clause-by-clause analysis is one page. It's limited to the enacting legislation that accompanies the actual treaty itself, which is basically annex A and annex B to schedule 1. I'm concerned about how this has been brought forward to the committee.

There's some concern about whether this was the appropriate committee to deal with financial legislation, or whether the finance committee should have dealt with this. That's certainly one question. But the information should have been much more fulsome and more quickly forthcoming. This isn't an adequate clause-by-clause analysis of the treaty implications, and it doesn't in any way describe the fiscal implications for at least two of the components within this protocol.

So I have some concerns and I have some questions, but I'm sure other members do too.

The Vice-Chair (Mr. John Maloney): Is there anyone else who has any concerns or questions? If not, then we will deal with Mr. Julian's specifically. The Department of Finance officials, hopefully, will be able to respond to your concerns.

Mr. Cardin.

[Translation]

Mr. Serge Cardin (Sherbrooke, BQ): We've been given other information since Tuesday, and I've expressed my view on this subject. The people will be able to answer us, and if their answer is consistent with the information I've been given, we'll be able to continue, Mr. Chair.

[English]

The Vice-Chair (Mr. John Maloney): Then I would ask you to pose your questions to our officials, and hopefully you'll receive satisfactory answers. Then we'll move on to Mr. Julian.

Mr. Cardin.

[Translation]

Mr. Serge Cardin: Good afternoon, gentlemen.

A number of aspects of the bill greatly favour the population that lives near the border and works in the United States. My main concern is this. Could the 10% withholding tax on interest have negative effects on the banking industry and the financial world as regards Canada-U.S. transactions? Was an analysis conducted of the potential effects, and, if so, what were they?

[English]

Mr. Brian Ernewein (General Director, Tax Legislation Division, Tax Policy Branch, Department of Finance): Well, thank you very much for the question.

I think that in this context, you might be touching upon one of two or three different aspects or features of the withholding tax changes. And if I may, I'll address all three, for the sake of comprehensiveness.

First of all, the withholding tax change, for the benefit of all committee members, eliminates withholding tax on arm's-length interest. That is interest paid by a Canadian—it works in both directions, of course, but I'll give you the example of interest paid by a Canadian—to a U.S. lender.

Currently, when interest is paid in those circumstances, the income tax treaty between Canada and the U.S. allows a maximum withholding tax of 10% to apply. There are many exceptions to this already in our domestic law in the case of arm's-length payments, but the treaty itself allows a maximum of 10%.

The same result currently is allowed under the income tax treaty for payments made by Canadian payors or borrowers to related party lenders. This might be the example of a Canadian subsidiary of a U.S. corporation borrowing money from the U.S. corporation. In that case, the interest payments the Canadian company makes to its parent would be subject, under the treaty, to a maximum of a 10% withholding tax.

The protocol proposes to eliminate withholding tax in both those cases. In the case of arm's-length interest to unrelated parties, the withholding tax is to be eliminated in the year in which the protocol takes effect. Some committee members may be aware of the fact that the 2007 budget legislation, recently introduced and recently considered by the finance committee, actually includes a parallel change to provide the same withholding tax exemption worldwide for payments made by Canadians to arm's-length lenders around the world, and furthermore, to make that change applicable as of January 1.

I raise that because one of the issues that has been raised is the uncertainty of when the withholding tax change would come into place. The budget legislation attempts to answer that question, not just for the U.S. but worldwide, by stipulating that it will apply as of January 1.

Finally, you ask about the implications of this, whether there'll be any reverberations or problems from or effects from eliminating this withholding tax. We think that the answer is yes, but we think they're positive effects. As I've mentioned, there are a number of exceptions already in our domestic legislation for withholding tax for arm's-length payments made to non-residents. What the treaty does, and what our complementary change to our domestic law does, is make that exemption universal. What that does, frankly speaking, is take a lot of tax advisers out of the equation who would often be working to get around the existing rules anyway. It also makes clearer or simpler the lending market so that Canadians have more competition and are able to benefit from more competition, both from lenders in Canada and in the U.S., and indeed, from third countries. So we do think that there are effects, but they are positive ones.

• (1540)

[Translation]

Mr. Serge Cardin: You mentioned a maximum of 10%. Without providing an exhaustive description, could you tell me what the variation in the rate depends on? On the amounts in question? Surely it's not simply the decision of the borrower or lender.

[English]

Mr. Brian Ernewein: There are at least a dozen current exemptions. The various things that generate an exemption are if it is long-term corporate debt—debt of more than a five-year term—or if it is paid by governments, sometimes two governments. There are those types of situations. Bank deposit interest sometimes qualifies for an exemption. As I say, there are about a dozen different headings under which exemptions already apply.

Mr. Lawrence Purdy (Senior Chief, Tax Legislation Division, Tax Policy Branch, Department of Finance): I wonder if I might just add a word.

I think you asked about the maximum language in the treaty, that is, the maximum rate being 10%, and whether there might be other rates applying. Statutorily, the rate that's applied under our Income Tax Act is 25% in 12 payments of interest to non-residents. So the treaty applies a maximum rate of 10%. That takes the 25% rate down to 10%. For all those cases in which tax applies under our domestic law, the maximum rate under the treaty is at the 10% level.

The Vice-Chair (Mr. John Maloney): Do you have any more questions, Mr. Cardin?

[Translation]

Mr. Serge Cardin: Yes.

That applies to both individuals and corporations?

[English]

Mr. Lawrence Purdy: It doesn't matter whether the recipient is an individual, an actual person, or a corporation, the fixed rate under our act is 25%, and then it's 10% under the treaty.

[Translation]

Mr. Serge Cardin: I'd like to know how things would work in practical terms. Let's suppose I've taken out a loan in the United States and I'm making interest payments. Would I be responsible for filing a return in which I would withhold an amount? For example, if the interest amounted to \$1,000 a month, I would withhold part of that amount and remit it to the Department of Revenue?

[English]

Mr. Lawrence Purdy: Yes, assuming that none of the exemptions Mr. Ernewein described apply and the tax therefore does apply, you as the payer of the interest are required to withhold from the amount you pay the amount of tax owing.

[Translation]

Mr. Serge Cardin: The corporation receiving my interest payment, less the given percentage, would nevertheless be entitled to claim a foreign tax credit, I imagine.

[English]

Mr. Lawrence Purdy: In a legal sense the tax is being paid by the non-resident, so in the non-resident's home country the non-resident will typically get a tax credit for the Canadian withholding tax that has applied.

But your question points to an important aspect of this. In economic terms, although these taxes are imposed legally on the non-resident, with the collection being the responsibility of the Canadian payer, in the real world of many business transactions the non-resident will say, "I'm not interested in bearing that cost, so you the Canadian will have to pay me an amount that is increased to reflect the fact that the tax liability will exist." So in practical terms you're right. Very often it is the Canadian payer who ends up on the hook for that tax.

[Translation]

Mr. Serge Cardin: As regards the proposed changes, I'd like to know whether things would balance out a little before the amounts are withheld in Canada and the individual or corporation in the United States claims a foreign tax credit. Did all corporations or individuals who received interest and were subject to a withholding tax—because this works both ways—receive the foreign tax credit?

• (1545)

[English]

Mr. Brian Ernewein: Presuming adoption of the treaty, it deals mostly with the past. In the future, if there is no tax obligation because the withholding tax is eliminated, the payments will be taxable only in the country in which the lender carries on business and is resident. But today the situation you've described is correct. The tax charged on the interest paid and withheld by the Canadian payer in the examples we've been talking about—again, it works both ways, but we're talking about payments going from Canada to the United States—the tax withheld by the Canadian and remitted to the Canadian government legally represents a tax on the non-resident, on the American lender who's receiving the interest payments.

The American lender, in calculating U.S. tax liability, will figure out how much its net income is, multiply that by a specific tax rate that applies in the United States, and subject to a number of conditions, of course, will be able to deduct the tax paid to Canada from the U.S. tax liability. The situation will work in reverse for a lender from Canada lending to the United States and receiving interest from the United States.

[Translation]

Mr. Serge Cardin: That could have become a major irritant for lending companies in the case of loans made to Canadians. Now that this aspect has been eliminated, I'm going to go back to the question I asked earlier.

Could this have an impact on banking business? For example, if there are fewer irritants, could U.S. banks try increasingly to develop their markets in Canada and Quebec?

[English]

Mr. Brian Ernewein: Thank you again for the question.

I think the reality is that foreign financial institutions already have a presence in Canada. They form part of the market. But the elimination of withholding tax does take away one of the impediments to foreign financial institutions lending to Canada—supplying money for Canadian borrowers. We think that's a good thing, because it opens up the borrowing opportunities and reduces costs for Canadian borrowers. It will increase competition for Canadian financial institutions, but we don't think that's a bad thing. Indeed, the Canadian financial institutions support this change.

[Translation]

Mr. Serge Cardin: We don't really have any control over the rates here, and even less over those of the United States. The large differentials between these rates could encourage Canadians to do more and more business with U.S. financial institutions.

[English]

Mr. Brian Ernewein: I would suggest that opening up the markets and eliminating the withholding tax would actually lead, all other things being equal, to greater rate competition. The possibility of a withholding tax can create a differential in rates where one would not otherwise exist.

There are many other factors, of course, that can lead to differences in interest rates. In this case, the tax wedge that a

withholding tax can create is not, in our view, a helpful one to have. While we all recognize the need to have taxes in certain circumstances, this does not seem to be one that is productive for the Canadian economy.

The Vice-Chair (Mr. John Maloney): Thank you.

Mr. Julian.

Mr. Peter Julian: Thank you, Mr. Chair.

Thank you very much for coming forward.

Given that we don't really have a very fulsome analysis of what the impacts of Bill S-2 are, my first question is this: There would have been impact studies done prior to the negotiation of the agreement; do you have copies of those studies with you?

Mr. Brian Ernewein: Thank you. I'm pleased to answer this question as well.

What we understood we were asked for the other day was a description—I think the term was a “clause-by-clause description”—of the bill itself, and I know reference was made to that being only one page. In fact, the clauses to the bill comprise, themselves, only a page or two, a page and three lines. It's really the annexes and appendices to the bill that represent its content. So I think we have done justice to the clauses themselves. We could certainly elaborate or take members through what we've provided, if that would be helpful.

On the content of the annexes and appendix, the protocol to the treaty and the exchange of notes between the two countries that are part of it are not part of the clauses themselves. They are, however, described in materials that the committee received earlier. In particular, I believe we included a copy of the September 21 news release announcing the signature of the treaty, and to that was attached a backgrounder, several pages in length, that describes in some detail, but tries to keep it in plain language terms as well, the principal provisions of the amendments to the treaty.

• (1550)

Mr. Peter Julian: That's actually not what I asked you, but I appreciate you describing what was in the package.

Essentially, with the tax treaty, there is duplication, because it's an exchange of notes. It's 44 pages. We have a few pages of description, but what is missing is the fiscal impact of each of these measures.

So I'll ask my question again. Was the Department of Finance involved in the preparation of an impact study on these decisions? What does the impact study reveal? Is it the actual fiscal ramifications of what's contained within the bill and in the protocol?

Mr. Brian Ernewein: Forgive me, I thought you'd asked two questions and I'd answered the first.

With respect to the costing, the fiscal impact, we don't generally cost the effects of our tax treaties, but in announcing a change to our income tax treaty policy in this year's budget, we included cost figures for that.

The revenue numbers for the elimination of a withholding tax on interest, which is the biggest cost item in the package, was estimated to be small for this fiscal year—\$10 million—and \$180 million for 2008-09.

Mr. Peter Julian: Could you say that again, please?

Mr. Brian Ernewein: I apologize. I'm not in full voice today.

The estimates included in the 2007 budget for the elimination of a withholding tax were \$10 million for 2007-08, and \$180 million for 2008-09.

Mr. Peter Julian: What were the amounts actually received under the withholding tax for 2005-06? The 2006-07 figures may not be available yet, but if they are, it would be useful to have them.

Mr. Brian Ernewein: I'm sorry; do you mean the collection of withholding tax in respect of interest, or withholding taxes generally?

Mr. Peter Julian: I mean withholding taxes in respect to interest, in respect to this particular provision.

Mr. Brian Ernewein: I don't have those figures with me. I believe we could obtain them.

I could tell you in very rough terms that the withholding tax in respect of Canada-U.S. interest payments is approximately half of the world total, so very generally you'd take these numbers and double them and you would end up with the withholding tax associated with interest generally worldwide—or were you asking specifically about the figures for the U.S. in the last couple of years?

Mr. Peter Julian: I'm thinking specifically of Canada. If the estimate was \$180 million and for 2007-08 it's \$10 million, those figures are a bit problematic, right? If we're looking at \$10 million for 2007-08 and at \$180 million for 2008-09, one has to wonder how those figures are calculated. We're being pressed to bring this in by the end of December, which would mean we're looking at one quarter of withholding taxes essentially being waived. If it's \$180 million for 2008-09, I find it difficult to understand how it could only be \$10 million for the last quarter of 2007-08. That doesn't make sense; it would presumably be \$45 million.

• (1555)

Mr. Brian Ernewein: That would be a fair assumption, except for one important fact, which is that the numbers are a combination of withholding tax for both arm's-length and non-arm's-length payments.

The treaty proposed—and the budget contemplated that the treaty would propose—that the withholding tax on arm's-length interest would be eliminated immediately, as of January 1, 2008. It assumed, however, that non-arm's-length interest would only be eliminated over three years, going down from 10% to 7% to 4% to its elimination at 0% after three years. Those factors mean that the \$180 million figure can't simply be divided by four to come up with a three-month figure, which you've done for the January to March amount. You need to take one-quarter of the arm's-length component

plus 30% times one-quarter of the non-arm's-length interest to come up with the number. I think that's how the \$10 million was arrived at.

Mr. Peter Julian: Okay.

That ignores the question over the following three years, then, because we're looking at a phase-out. What I hear you saying is the vast majority of the withholding tax is actually for non-arm's-length payments. Am I correct in that, or have I misunderstood?

Mr. Brian Ernewein: That's right. Because of the exemptions already in place, less money is collected in respect of withholding tax on arm's-length payments than on non-arm's-length payments.

Mr. Peter Julian: Okay.

Since the phase-out takes place over three years, as you've mentioned, what is the impact on 2009-10 and the fiscal year 2010-11?

Mr. Brian Ernewein: Those numbers have not been published, but I can undertake to see if we can provide them.

Mr. Peter Julian: They would be greater than \$180 million, I would think—

Mr. Brian Ernewein: I would say so, yes.

Mr. Peter Julian: —so we're looking at a graduated scale. In 2008-09 it's \$180 million. That's a significant amount of money. It surprises me that there were no discussions at the Senate level of the actual fiscal impact. We're presumably talking about three years; would it would be fair to say \$500 million?

Mr. Brian Ernewein: I'm sorry; do you mean for an individual year, or in the total?

Mr. Peter Julian: I mean over the three-year period, forgetting about the last quarter of 2007-08; it would be for 2008-09 through to 2010-11.

Mr. Brian Ernewein: Again, I don't have those numbers with me today. I believe estimates have been made; I don't believe they've been public. I can undertake to see if we can provide them.

Mr. Peter Julian: Half a billion dollars is a considerable amount of money.

I did want to ask you about the implications around the LLCs, limited liability companies, with the same question in mind. What are the fiscal impacts of those provisions?

Mr. Brian Ernewein: It has not been the subject of a revenue estimate, but I think I can confidently speak to it nonetheless. I would suggest that the revenue cost is not that significant, because in the main people were not using LLCs because of the problems that arose under the Canada-U.S. treaty with their use. They were doing other things. They were investing directly or through ordinary corporations or through ordinary partnerships, for which treaty benefits were assured.

What the treaty has done now is extend to LLCs the benefits that U.S. residents could get by investing directly, by investing through a corporation, or by investing through an entity that was recognized as a partnership by both Canada and the United States. It wasn't a question of greater treaty benefits being provided, but of greater flexibility in obtaining the same treaty benefits; I therefore don't believe the cost associated with it will be significant.

Mr. Peter Julian: We can assume that if the negative aspects of using LLCs are diminished through this tax treaty, there would be more call to use that entity.

Mr. Brian Ernewein: Yes, I agree with that, but they would be used instead of something else. That is, if an American investor wanted to invest in Canada, knowing that the LLC was the ideal way to make that investment because of its flexibility for U.S. tax and commercial purposes, the problem they ran into under the current Canadian tax law meant that the LLC simply wasn't used. I don't think it meant that the investment wasn't made.

Now that LLCs are there and are recognized as being eligible for treaty benefits, it seems to me they will be used more often. But I don't think you can judge that increased take-up that I'm predicting to reflect a revenue loss.

• (1600)

Mr. Peter Julian: I'll come back to my initial question, because these are surprising impacts. I think we can all agree on that. And it hasn't been anything that's been examined in any detail through Bill S-2's movement through Parliament thus far.

There was an impact study done that would presumably show not only the tax impact for the end of this fiscal year and next fiscal year, but also for subsequent years. It would be actually based on what the actual withholding tax amounts were in previous years. Right?

Is that study, then, something this committee can receive? Because I think that's something on which we would all want to consult our various caucuses. If we're talking about a half a billion dollars over three years, presumably that's over \$1 billion in the next five or six years. That's a lot of money. I don't think anyone would want to take a snap decision when we're talking about that large a fiscal impact.

Are those studies something that can now be released to the committee, since we're the ones who are charged to study this—though I'm sure Mr. Pallister regrets that we were given that responsibility.

Mr. Brian Ernewein: I can only repeat my previous answer. I will undertake to see if that is something we can provide to the committee.

Mr. Peter Julian: Well, Mr. Chair—

The Vice-Chair (Mr. John Maloney): Have you finished your questioning, Mr. Julian?

Mr. Peter Julian: Well, yes, though I would suggest we move on to Canada-Korea. We're talking about substantial fiscal impacts. I certainly don't feel comfortable ramming this through right now.

The Vice-Chair (Mr. John Maloney): I would appreciate any comments of other persons.

My feeling on the consensus is that we move ahead with this clause-by-clause consideration. If that consensus is inaccurate, let's hear from it.

You may take your position, Mr. Julian, and we appreciate that. Of course, it has to go back to the House for report stage and third reading, and your concerns and the concerns of anyone else can be voiced at that time.

Mr. Cardin, any questions?

[*Translation*]

Mr. Serge Cardin: We were told earlier that there would be negative effects. Could you tell us the three main ones and what consequences they would have? You mentioned a negative difference of \$180 million in 2007-2008.

U.S. companies whose interest was subject to withholding tax could normally claim foreign tax credits in their country in their income tax return. However, they could claim 100% of the credits. Does that mean that Americans did not claim a refund of the entire foreign tax withheld by Canada, and what caused the gap?

I'd like you to give me some clarification on that point and to tell us about the negative effects for Canada. I know there are many positive effects, particularly for individuals working in the United States. They will now be able to deduct amounts that are normally deducted.

[*English*]

Mr. Brian Ernewein: First of all, I don't think we necessarily regard a tax cut as being a negative repercussion. Reducing the taxes by \$180 million means there's \$180 million more in incentives to invest in Canada, because there's less tax applying to the investment.

You've raised a very perceptive question with respect to the foreign tax credits, and it points up that the answer I gave you before requires some elaboration.

The point, when answering your question before about getting a credit for foreign taxes, was that this is the theory. When a withholding tax on an interest payment is imposed in Canada, the theory is that the U.S. lender, in our example from before, is able to calculate U.S. taxes payable and deduct the full amount of the Canadian tax withheld against U.S. taxes payable.

The reality is, particularly in the banking industry, that there isn't enough room or spread on a loan to absorb a 10% gross withholding tax. If you have an 8% loan, just to pick an interest rate, and a 10% withholding tax represents an 80-basis-point cost on that transaction, there often won't be 80 basis points of profit in those transactions for the tax to be absorbed. Indeed, for it to be fully absorbed, there would have to be something in the order of 200 or 250 basis points of spread to calculate the tax, to use up the full 80 basis points. So the tax, while theoretically creditable in the U.S., often is not.

That's what leads to the point my colleague raised earlier. In point of fact, what often happens with a withholding tax is that rather than being absorbed by the non-resident, it's in fact added to the cost of the Canadian borrower. By eliminating the withholding tax, once again we can help reduce the cost for Canadian borrowers.

• (1605)

[*Translation*]

Mr. Serge Cardin: Is that calculated in the \$180 million impact?

[*English*]

The Vice-Chair (Mr. John Maloney): Excuse me, Monsieur Cardin. There's a point of order.

Mr. Pallister.

Mr. Brian Pallister (Portage—Lisgar, CPC): Mr. Chairman, just in the interests of efficiency, each of these questions could be asked in the context of the clause-by-clause as we go through it. I think that might give more structure and efficiency to the way we're conducting our inquiry today.

I would like to move that we go to clause-by-clause now. If members have questions, then certainly they can continue to raise them.

The Vice-Chair (Mr. John Maloney): I suppose that motion is debatable. The whole idea was to provide a forum for questions to be put to our officials, and we departed from our ordinary rotation. I thought we had in fact exhausted the questions on the actual bill.

I was asking for consensus that we proceed to clause-by-clause. Your continuation of questioning, Mr. Cardin, would indicate a lack of consensus.

We can sit here and debate this, and I think Mr. Pallister's point is well taken. If someone were to make that motion, then we could vote on it.

Mr. Julian.

Mr. Peter Julian: Thank you, Mr. Chair.

The Vice-Chair (Mr. John Maloney): Mr. Pallister, we can't move a motion on a point of order, but we—

Mr. Peter Julian: Mr. Cardin was exercising his right to ask questions of the witnesses who are before this committee, so I don't believe the motion is in order.

The Vice-Chair (Mr. John Maloney): There's been, I think, a very positive suggestion on how to deal with further questions, as we go through the clause-by-clause.

Mr. Dhaliwal.

Mr. Sukh Dhaliwal (Newton—North Delta, Lib.): Thanks, Mr. Chair.

I would like to clarify this. You say the motion is not in order. In fact, Mr. Pallister brought in the motion to go clause by clause, and the witnesses will stay, and if we have questions on a particular clause, that is the clause we will pose questions on.

Is that the intent?

Mr. Brian Pallister: Let me respond, Mr. Chair.

I believe, if you check with your clerk, you'll find that I was on the speaking order earlier. I deferred to Mr. Cardin when he raised his questions, despite the fact that I was there.

I was going to make the motion earlier. I've certainly tried to encourage latitude here, as you are doing, Mr. Chair, but I think it is time to move to clause-by-clause. I think we just need to move on here.

I concur with Mr. Julian's observation, for perhaps the very first time, that we want to set aside time to deal with Korea. We have as a committee said that's a priority, so let's move on here.

The Vice-Chair (Mr. John Maloney): The clerk has confirmed that you in fact were on the speaking list before, Mr. Cardin, which I wasn't aware of. But you have the floor now, and it's now in order to make the motion, if you wish.

Mr. Brian Pallister: Thank you, sir. I so move.

• (1610)

[*Translation*]

Mr. Serge Cardin: Is the time allotted to me up?

[*English*]

The Vice-Chair (Mr. John Maloney): Your time was up before the intervention, in fact. You had more than you—

[*Translation*]

Mr. Serge Cardin: I'll put my next questions to Mr. Pallister.

[*English*]

The Vice-Chair (Mr. John Maloney): We have the motion on the table.

Are you debating the motion, sir?

Mr. Peter Julian: Yes, thank you, Mr. Chair.

This is ridiculous. We had a push from the government to ram this through on Tuesday without any of the impacts being known to committee. We've been charged by Parliament to do our due diligence, and now we have Mr. Pallister bringing forward a motion to ram through clause-by-clause consideration.

At no point in the legislative process had the figures that are just being revealed today been brought forward. Would Canadians consider us as doing our due diligence if we simply said that half a billion dollars is being given away, effectively through a tax treaty, without due consideration, without having at least some witnesses come before the committee, and without having the impact studies that have been drafted by the Department of Finance?

I'm sorry that the government has brought this forward in what I think is a very clumsy manner—bringing it forward just a week before we take our Christmas recess. But the government's mistake and the government's clumsiness are not an excuse for our not performing our due diligence. I think it's fair to say that having a session with witnesses to actually go into the implications of what is before us now is the least we can do on behalf of the taxpayers of Canada. We have a responsibility as a committee, and we're clearly not exercising that responsibility if we adopt Mr. Pallister's motion.

The Vice-Chair (Mr. John Maloney): Are there any other speakers on the motion?

(Motion agreed to) [See *Minutes of Proceedings*]

The Vice-Chair (Mr. John Maloney): We'll move to clause-by-clause consideration.

Mr. Ernewein, you had your hand up. I couldn't recognize you when we were debating that motion, but if you have further comments, I'm sure the committee would appreciate hearing them.

(On clause 1)

Mr. Brian Ernewein: Thank you, Chair.

I doubted that I had standing during the debate on a motion, but I wanted to make the point that we did provide the numbers. They're part of the 2007 budget plan. I've given them here today.

The honourable member apparently isn't satisfied and would like them to have been for years further out. Those have not been put out as part of the budget plan. But the budget plan from 2007 has the numbers I have provided.

I just wanted to remind the committee of that.

Thank you.

The Vice-Chair (Mr. John Maloney): Thank you, Mr. Ernewein.

Yes, Mr. Julian.

Mr. Peter Julian: Clause 1 is the overall amending of the Canada-United States Tax Convention Act. What we saw in the budget was actually a very small part of what the impacts of the overall amendments to the Canada-United States Tax Convention Act are. We found out today that the largest proportion—the withholding tax that is simply abolished or given up—is the non-arm's length, which is implemented in stages over the next three fiscal years. What we saw in budget 2007 was only a very small part of the actual fiscal implications. It's simply not correct to say that we've had full disclosure of figures.

We have not seen, either, from the department on what basis the figures were arrived at for the budget document, and that's extremely important too. We have to do our due diligence to compare past figures and then surmise to what extent the figure of \$180 million that was in the budget is accurate and what the full ramifications of this tax treaty are in subsequent years. We're talking about half a billion dollars over three years, and presumably well over a billion dollars over six years.

That is a considerable amount of money, when we have 300,000 people who are homeless in our country, when we have families who are finding it very hard to make ends meet. To say that over six

years, if it's a billion.... None of us around this table is very sure, because none of us has seen the actual impact studies. But let's surmise, based on the testimony we've heard, that we're talking about a billion dollars. That is not something you give up in five minutes without any understanding of what the implications are for fiscal policy and what the implications are for the government's ability to take action, hopefully, on some of the crises that exist in the country.

I think it is foolhardy for this committee to push forward on adoption of a tax treaty that has significant ramifications for the taxpayer and for public policy.

• (1615)

The Vice-Chair (Mr. John Maloney): Mr. Pallister.

Mr. Brian Pallister: Well, in reference to Mr. Julian's comments, which are.... I shouldn't be surprised by a representative of the NDP arguing against tax reductions for Canadians; that's an all too frequent position they take. But the arguments he's making, it should be understood, are arguments that would result in reduced competition among financial institutions and therefore a higher burden on Canadians and Americans, frankly. So he's actually arguing for higher assured profits for financial institutions.

That being said, I grow very weary of his comments, because they are dull, repetitive, and erroneous. So I would like to move that we limit comments to one minute on the clause-by-clause debate.

The Vice-Chair (Mr. John Maloney): Mr. Pallister, thank you for your input, but we can't deal with that motion at this point. We have a motion to deal with clause 1. We must continue with that, and then if you care to make your motion at a future time in this committee's deliberations, we can entertain it.

Is there any more discussion on clause 1?

(Clause 1 agreed to)

The Vice-Chair (Mr. John Maloney): Mr. Pallister.

Mr. Brian Pallister: I think we'll just continue with the discussion and see how it goes.

(On clause 2)

The Vice-Chair (Mr. John Maloney): Shall clause 2 carry?

Mr. Julian.

Mr. Peter Julian: Mr. Chair, I have a point of clarification, then. If I understand your interpretation of procedure—and I'd like you to clarify this for me—by the adoption of the enacting legislation, we are then moving to adopt the treaty as a whole.

Is that true? Is it true that the procedure you will be following is to deal with the five clauses, and then overall adoption?

The Vice-Chair (Mr. John Maloney): That would be my interpretation.

Mr. Peter Julian: So, Mr. Chair, for the interest of the committee, does that mean any subsequent discussions of treaties the government may choose to bring forward would be interpreted the same way, so that enacting legislation would be the only element brought before this committee?

The Vice-Chair (Mr. John Maloney): I'm not prepared to comment on that, Mr. Julian.

We're dealing with clause 2. Is this debate on clause 2?

Mr. Peter Julian: No, it was a point of order.

The Vice-Chair (Mr. John Maloney): Well, you didn't say point of order.

(Clause 2 agreed to)

(On clause 3)

The Vice-Chair (Mr. John Maloney): Mr. Julian, you have a question, and then Mr. Cardin.

Mr. Peter Julian: No, it's a comment, Mr. Chair.

The arbitration provisions of the tax treaty are provisions we definitely can support. They're very clear and well written. They're the one aspect of the treaty that's been brought forward, I think, in a fulsome way by the government. So the arbitration provisions are effective. It's the rest of the treaty and the fact that this government just seems hell-bent on throwing away \$1 billion without any real analysis of what the implications are, or where the money is going, that I find completely irresponsible. I think for those who have may have voted Conservative in the past, they'll find it quite irresponsible as well.

The Vice-Chair (Mr. John Maloney): Mr. Cardin, you have a question or comment?

[Translation]

Mr. Serge Cardin: Yes, Mr. Chair.

Clause 3 states:

3. Schedule 1 to the Act is amended by adding [...]

[English]

Mr. Brian Pallister: On a point of order, what would be foolhardy, Mr. Chair, would be what the NDP and the Liberals did in a hotel room, which was to guarantee that \$4.6 billion would be thrown away in empty promises.

The Vice-Chair (Mr. John Maloney): That was a point of debate.

I'll go back to Mr. Cardin.

● (1620)

[Translation]

Mr. Serge Cardin: Thank you, Mr. Chair.

Here's what clause 3 states:

3. Schedule 1 to the Act is amended by adding at the end of that Schedule the Annexes A and B to the Convention set out in the Schedule 1 to this Act.

[English]

The Vice-Chair (Mr. John Maloney): Let's calm down the conversations on the side. Mr. Cardin has the floor.

[Translation]

Mr. Serge Cardin: We can write down their names, Mr. Chair.

Earlier, we mainly discussed the total cost of the changes. With respect to clause 3, are we evaluating the total cost of Annexes A and B to the Convention? When you mentioned the \$180 million, that was strictly withholding tax, but there are also costs for all the other applications of this treaty. When you analyzed Annexes A and B, was there a cost directly related to these amendments?

[English]

Mr. Brian Ernewein: As I said earlier, as a general matter, the tax changes or the effects of changes or of signing of new tax treaties is not generally costed as an independent matter. When there's a change in our treaty policy that has a material fiscal implication, it is costed. That was the case with the elimination of arm's-length interest and the elimination in the Canada-U.S. treaty of non-arm's-length interest, and that was costed.

There hasn't been costing done specifically on the other measures themselves, but many of them, arbitration being an example, and many of the understandings expressed in the other annex accompanying the protocol would not be considered to have a material fiscal cost.

[Translation]

Mr. Serge Cardin: For example, if you consider investments for taxpayers, Canadian and Quebec workers working in the United States will now be able to deduct their employer's pension fund from their taxable income here, thus enjoying a cut in their taxes. These things aren't necessarily evaluated as such. For workers, this represents an additional deduction, an additional amount of money at the end of the fiscal year. However, that was not evaluated.

[English]

Mr. Brian Ernewein: You're correct, there hasn't been. As I said, the only item that has been specifically costed is the elimination of interest, of the withholding of tax on arm's-length and non-arm's-length interest. You're also right, though, that there are other measures that will help taxpayers. A good example, I think, is the change to an institute, the deductibility of certain pension contributions for cross-border workers, and for temporary transfers from one country to another. That will represent some tax savings in some cases, and tax savings to taxpayers implies a revenue cost to governments. It's not considered to be a large amount. It works both ways as well, because it will facilitate American cross-border workers in Canada or temporarily working in Canada too, so that has to be taken into account.

The Vice-Chair (Mr. John Maloney): Thank you, Mr. Cardin.

Mr. André, do you have a question? No?

I'll call the question.

(Clause 3 agreed to)

(On clause 4)

Mr. Peter Julian: Mr. Chair, could you just clarify clause 4?

The Vice-Chair (Mr. John Maloney): Perhaps you could address your questions to the officials.

Mr. Peter Julian: Clause 4 of the bill adds new schedule VI to the actual schedule VI containing the fifth protocol. I would like some clarification as to exactly which section that refers to.

The Vice-Chair (Mr. John Maloney): Mr. Purdy?

Mr. Lawrence Purdy: Thank you, Chair.

Within the bill itself, there are indeed two references to the schedule. The first one, in clause 1, is merely for purposes of reference within the bill. The actual material change is made by this clause 4, which actually adds schedule VI to the existing schedules of the act.

• (1625)

The Vice-Chair (Mr. John Maloney): Mr. Julian, are you satisfied with the explanation?

Mr. Peter Julian: He simply reiterated what was in the background. It doesn't explain the exact sections that are covered, which is more what I was looking for.

Which articles within the protocol are covered by schedule VI?

Mr. Brian Ernewein: Perhaps I can help.

If the pagination in the version before members of this committee is the same as mine—that is, the bill as passed by the Senate—page 21 in annex 2 has schedule II, schedule VI. What this doing in clause 4 is seeking approval to add schedule VI to the Canada-U.S. treaty implementation act.

And for completeness, schedule VI comprises the amendments, the protocol amending the Canadian-U.S. Tax Convention.

The Vice-Chair (Mr. John Maloney): Thank you for your explanation.

Go ahead, Mr. Julian.

Mr. Peter Julian: These are exactly the provisions, if I'm not mistaken, that we're concerned about.

I reiterate, Mr. Chair, given the amount of funds that are involved, I don't understand why the government would push through this convention without hearing witnesses, without having a full release of the impact study, so we can see what, over the next decade, government is losing and who, essentially, will be benefiting from it, as well. There are some benefits, there's no doubt, within this tax convention. There are some very positive aspects within this tax convention. There are obviously some that should be of concern to all who are interested in public policy and in furthering the work of our government. It just staggers me that the government is trying to ram this through.

Now, since Mr. Pallister's comments were in order, I'll respond to him that the NDP budget is the one the Conservatives seem to raise the most often in the House, both the housing grant—that foundation, that money came through the NDP budget—and public transit today, which they raised, as well.

The most often quoted aspects of any budget over the last few years have been in the NDP budget, and it's quoted by Conservative

members because it's actually gotten the job done where the Conservatives have failed.

The Vice-Chair (Mr. John Maloney): I think we're getting off track here. I call the question.

(Clauses 4 and 5 agreed to)

The Vice-Chair (Mr. John Maloney): Shall schedule 1 carry?

Mr. Julian.

Mr. Peter Julian: Okay, Mr. Chair, you're now responding to the question I asked earlier.

What you are doing, then, is going through schedule 1, annex A, annex B. We don't have any clause-by-clause diagram to follow, which has been the practice certainly for any bills that I've seen since I arrived here three and a half years ago.

Could you please tell us where you're going next, in terms of approval of this?

The Vice-Chair (Mr. John Maloney): We're going to approve all the schedules, schedule 1 and schedule 2, and then the bill, the title.

Mr. Peter Julian: I'll just object to process, Mr. Chair. I just find

—
• (1630)

The Vice-Chair (Mr. John Maloney): Your objection is noted.

Mr. Dhaliwal.

Mr. Sukh Dhaliwal: Mr. Chair, I have learned some really good tactics from Conservatives to filibuster the meeting—

The Vice-Chair (Mr. John Maloney): Mr. Dhaliwal, your comments are not really appropriate. Are you dealing with schedule 1?

Mr. Sukh Dhaliwal: Yes, I'm coming back to that.

The Vice-Chair (Mr. John Maloney): Okay, thank you; let's go there now.

Mr. Sukh Dhaliwal: So if we really want to filibuster this, then we can go either word by word or we can go paragraph by paragraph too.

The Vice-Chair (Mr. John Maloney): I don't detect any filibustering at this time. There's certainly legitimate questioning back and forth.

Shall schedule 1 carry?

(Schedule 1 agreed to)

The Vice-Chair (Mr. John Maloney): Shall schedule 2 carry?

Oh, excuse me, Mr. Cardin.

[Translation]

Mr. Serge Cardin: One moment, Mr. Chair. What did you talk about? Are you on Schedule 2?

[English]

The Vice-Chair (Mr. John Maloney): Schedule 2.

You have a question? Okay, go ahead.

[*Translation*]

Mr. Serge Cardin: I have a question on Schedule 2, I believe.

This shows us, as Mr. Julian said, that the procedures for analyzing bills are being somewhat abused along the way. For me, and I've been here for nine years, it is a precedent to study a bill without considering it clause by clause and without assessing and comparing what exists and what is being proposed.

I don't even know if this is Schedule 2, but earlier we were talking about interest. This bill also talks about dividends. There are also withholding taxes on dividends. In your assessment, I imagine that, in the \$180 million, not only interest, but dividends paid by investors and financial corporations were subject to a withholding tax. Now foreign investors will no longer have to pay withholding tax on dividend payments. Were those withholding taxes on dividends part of the \$180 million? Since the Conservative government favours foreign investment, those withholding taxes will probably disappear. That will have the effect of increasing foreign investment.

[*English*]

Mr. Lawrence Purdy: On cross-border dividend payments, the protocol includes some technical adjustments that update the language in some cases and accommodate particular situations. But there is no change of substance to the possibility of imposing withholding tax on dividends, and Canada domestically imposes that tax.

It's imposed under the treaty at two different rates: a rate of 5% in the case of so-called direct dividends between a subsidiary and the parent corporation, and a rate of 15% in other cases. That's not changed by the protocol.

[*Translation*]

Mr. Serge Cardin: I have a general question to put to my Conservative Party colleagues. Have they read the bill? Are they aware of all the financial effects it entails?

[*English*]

The Vice-Chair (Mr. John Maloney): Thank you for your question. I don't think there was an answer forthcoming or required.

(Schedule 2 agreed to)

The Vice-Chair (Mr. John Maloney): Shall the title carry?

Mr. Julian.

Mr. Peter Julian: Mr. Chair, you are now going to the title?

The Vice-Chair (Mr. John Maloney): We are now moving to the title.

Mr. Peter Julian: Next is the subsequent motion?

I apologize for this. You're not chairing in a poor way at all, but we have no supporting documentation to track the discussion and debate around this. So you can understand it's of concern to any member of the opposition that we're not following any pre-set plan for debate on this.

Normally we have clause-by-clause analysis accompanied by a diagram of clause-by-clause debate and votes. We have none of that. The government has prepared absolutely nothing on this half-a-billion-dollar bill. It's just appalling.

● (1635)

The Vice-Chair (Mr. John Maloney): So you're objecting to the process again, Mr. Julian. We've heard you.

Mr. Peter Julian: No, I'm asking where we're going. So we're going to the title, and after that...?

The Vice-Chair (Mr. John Maloney): I will ask, "Shall the bill carry?", and then, "Shall we report the bill to the House?" There are three motions.

Mr. Peter Julian: Thank you, Mr. Chair.

The Vice-Chair (Mr. John Maloney): Shall the title carry?

Some hon. members: Agreed.

The Vice-Chair (Mr. John Maloney): Shall the bill carry?

Mr. Julian.

Mr. Peter Julian: I believe it's in order for debate on that.

The Vice-Chair (Mr. John Maloney): Yes, go ahead.

Mr. Peter Julian: This has been an appalling process, Mr. Chair. What we have is a government that's brought forward a bill, brought it to the Senate. There was no examination, there were no witnesses at the Senate in terms of the overall fiscal implications of the bill, then it was brought forward this week to this committee. At the time, Conservatives on the committee, you'll recall, Mr. Chair, didn't even want to open up the bill to see what the implications were. They didn't want it read. They didn't want any discussion. They just wanted to adopt it—let's just throw the Christmas present out.

Subsequent to that, Mr. Chair, it's fair to say that in answer to questions we have—and I'm thankful at least that we did have our Department of Finance experts come forward—we know now that the implications are considerable. We're talking about half a billion dollars. There was no preparation—a diagram—on clause-by-clause, no analysis of the articles of the treaty itself, and now we're talking about something that at least has implications of half a billion dollars in taxpayers' funds. We don't know where those funds are going and who will benefit from that. We've had no witnesses come forward to actually examine the bill in detail.

If this is how the new government functions, Mr. Chair, I think it would be appalling to taxpayers across the country and to Canadians across the country. This has been a complete abdication of due process. There's been no due diligence, aside from the questioning from Bloc members and from NDP members. I think it's a very sad, sad chapter in parliamentary life. It appears that Conservative and Liberal members are going to adopt a tax treaty that has such huge ramifications for the fiscal capacity of the government and the ability to get things done when we have so many problems in this country—environmental, housing, economics. Two-thirds of Canadian families have actually seen their incomes decline since 1989, and yet we're giving half a billion dollars away, and we're not sure to whom.

In some cases, beyond that half a billion dollars for the cross-border interest payments, we have some additional measures that I think members of this committee can support. On the half a billion dollars that is being given away on withholding tax on cross-border interest payments, we don't know who that is going to, and Conservative members can't pretend it's going to ordinary folks. I doubt that very much. Their track record belies that it might go to ordinary Canadians. They seem to be willing to give to the wealthiest of Canada's corporations with alacrity, but they're very miserly when it comes to ordinary Canadians.

So, Mr. Chair, I just protest in the strongest terms this action by the government. I think this is a shameful day for Canada's Parliament.

• (1640)

The Vice-Chair (Mr. John Maloney): Mr. Dhaliwal.

Mr. Dhaliwal withdraws his question.

Shall the bill carry?

Some hon. members: Agreed.

The Vice-Chair (Mr. John Maloney): Shall I report the bill to the House?

Some hon. members: Agreed.

The Vice-Chair (Mr. John Maloney): Thank you very much, officials from the department. We appreciate it.

Thank you, members of the committee.

I think we'll just suspend for a few minutes and we'll have our next witnesses come forward.

• _____ (Pause) _____
•

The Vice-Chair (Mr. John Maloney): We'll come back now.

We very much appreciate having the witnesses from the Department of Foreign Affairs and International Trade, as well as Mr. Landreville, from the Department of Agriculture and Agri-Food.

We apologize for the delay. We have approximately half an hour to deal with this panel at this time.

Are there presentations someone would like to open with? Would it be possible to perhaps abbreviate those to five minutes and then we'll open up to questions and answers? If there are more fulsome presentations, perhaps they could be e-mailed to the clerk and the clerk can distribute them to the committee members.

Mr. Burney, you look like you're anxious to start.

Mr. Ian Burney (Chief Trade Negotiator, Bilateral and Regional, Department of Foreign Affairs and International Trade): Thank you very much, Mr. Chairman.

Indeed we did come prepared with a statement. It was going to run about ten minutes. I'll try to abbreviate it to keep it to within five minutes.

I'll dispense with the introductions. The team can be introduced as called upon to answer questions.

I do appreciate this opportunity to come again before the committee to provide an update on the Canada-Korea FTA negotiations, following my appearance in June of last year.

On Tuesday Minister Emerson spoke before this committee to the importance of our bilateral FTA agenda and the steps we were taking on this front. He stressed, in particular, the aggressive bilateral activity of our competitors and the need for Canada to maintain a level playing field. Nowhere is this more clear than in the case of South Korea, a point that was implicitly acknowledged by the Standing Committee on International Trade when it recommended in April of this year that the government should, among other things, complete the FTA negotiations with South Korea.

Indeed, South Korea has already implemented FTAs with Chile, Singapore, EFTA, and the countries of ASEAN. In June this year the United States and Korea signed their bilateral FTA known as KORUS. The agreement is politically controversial in both countries, but most observers believe that it will be ratified, given its importance in each country.

Meanwhile, Korea is in the advanced stages of negotiating an FTA with the European Union, Korea's second-largest trading partner after China. There are indications that this could wrap up early in 2008.

Korea is also negotiating FTAs with Mexico and India. It may soon revive its talks with Japan and China, the Gulf Cooperation Council, and others waiting in the wings.

Clearly, if Canada were not also pursuing an FTA with Korea, we would be running the risk of Canadian companies finding themselves, over time, at a greater and greater competitive disadvantage in this market.

• (1645)

[Translation]

Consequently, Mr. Chair, we are trying to reach an exhaustive, high-quality free trade agreement with Korea that is ideally of a scope similar to that reached between Korea and the United States, that is to say Korus.

The purpose of this initiative is essentially to maintain and reinforce opportunities for Canadian businesses to face the competition on an equal footing in one of the most dynamic markets in the world. Korea has a socially upwardly mobile population of nearly 50 million inhabitants and an economy in the order of \$1 billion. Not only does Korea rank second among the most prosperous economies, it is also strategically located among the regions experiencing the strongest economic growth in the world.

Korea is already Canada's seventh largest trading partner. Canada exports \$3.3 billion worth of goods to Korea every year, more than all Canadian exports to Brazil and India together.

Korea is also becoming a big market for Canada's service sector, which exported more than \$650 million worth of services in 2005. In addition, bilateral investment between the two countries now exceeds \$1.1 billion.

[English]

An FTA with Korea could generate much more two-way business by dismantling the tariff, regulatory, and other barriers to commerce that limit opportunities. Preliminary macroeconomic modelling results, which are available on our website, indicate that on the basis of tariff elimination alone, our exports to Korea could have been nearly 60% higher in 2005—the reference year of the study—and that our GDP could have been \$1.6 billion larger the same year, had we had an FTA in place. The reason is that Korea maintains relatively high tariffs—13% on average versus about 4% for us. The elimination of tariffs in an FTA would therefore generate substantial opportunities for Canada.

The Korean market is particularly important for the agricultural and resource-based segments of our economy, with FTA gains expected in areas like agrifood, fisheries, metals and metal products, a wide range of forestry and wood products, coal, and other minerals.

We also expect gains in a variety of industrial and manufacturing sectors that provide high-value jobs in Canada, including chemicals, aerospace, and urban transportation equipment, fertilizers, auto parts, pharmaceuticals, cosmetics, prefab buildings, environmental goods, and machinery and equipment, to name a few.

We see ample opportunities in the service sector of the economy, as well, where 80% of new jobs are created today in Canada. Some examples include financial services, high-tech and environmental services. An FTA would also provide a more secure and stable climate for Canadian investors in Korea and assist in attracting Korean investment to Canada.

Let me now turn to the auto sector, the area of the negotiation that has attracted the most attention in Canada. To improve the Canadian auto industry's access to the Korean market, Canada is seeking to eliminate Korea's 8% tariff on autos and auto parts and to establish the most extensive, robust, state-of-the-art provisions Canada has ever sought in an FTA with respect to Korea's non-tariff barriers in the auto sector. Canada has also proposed an innovative dispute settlement mechanism for autos.

At the same time, Canada's auto industry has expressed concerns regarding the potential impact of eliminating Canada's automotive tariff. Members of this committee may be aware that in September 2006 the government released two studies that concluded that any negative impact on the automotive sector from an FTA with Korea would be very limited.

The first study, by Industry Canada, estimates a decrease in Canadian production of fewer than 1,000 units per year on average, which represents 0.04% of the 2.6 million vehicles we produce each year. That assessment was supported by a second study commissioned by this department and carried out by Dr. Van Biesebroeck of the University of Toronto, a respected academic who specializes in economic analysis of the automotive industry.

Professor Van Biesebroeck also concluded that a Canada-Korea FTA would only have a modest impact in terms of additional imports from Korea—less than 10%—and that this would come largely at the expense of other imports. The expected result was only a fractional decrease in Canadian vehicle production of about 2,000 vehicles, or 0.08% of production. Among the reasons is the high level of imports

already in the Canadian market, about 75%, and the very high percentage of Canadian production, about 85%, that is exported to the United States, which would not be affected by an FTA between Canada and Korea.

At the same time, the study projects that Canadian automotive parts exports to Korea stand to benefit from tariff elimination, and forecasts increased Canadian exports of between 8% and 12%. Both studies are available online.

● (1650)

[Translation]

Where do we stand now?

Since negotiations began in July 2005, we have held 12 negotiation sessions with Korea. Our most recent meeting was last week in Seoul. In principle, the next meeting should be held in Canada in March.

Presidential elections will be held in Korea later on this month, and the new president will enter office in late February. We have made major progress to date, but as the end of negotiations approaches, we are definitely facing the toughest issues. Among other things, Canada is seeking greater access to Korea's agricultural, fishing and forest industries, which are highly protected sectors.

Korea, for its part, is seeking faster reductions in Canadian tariffs in the sensitive manufacturing sectors, such as the automotive sector.

These issues are very difficult, and Minister Emerson has clearly made it known that we prefer a satisfactory agreement with Korea over a quick end to negotiations.

[English]

To conclude, the government's view is that there are compelling commercial reasons to pursue an FTA with Korea, both to protect our current business in the face of Korea's other negotiations, and to strengthen our position in this vital economic region of the world.

At the same time, while we know that all FTAs inevitably result in some economic adjustment, the best available economic analysis indicates that the overall impact of this FTA in Canada would be positive and that the negative effects in our areas of sensitivity would be very modest.

Of course, in the event negotiators are able to reach an agreement, it will be up to ministers in the first instance to pass judgment on its merits before any agreement could be signed, and then parliamentarians would ultimately need to decide whether or not to pass the implementing legislation required to allow for ratification and entry into force of the agreement.

The Vice-Chair (Mr. John Maloney): I believe we're going to have to go to five-minute rounds because of the time constraints.

Mr. Bains.

Hon. Navdeep Bains (Mississauga—Brampton South, Lib.): Five minutes?

The Vice-Chair (Mr. John Maloney): Yes, five minutes. Clear questions and short clear answers, please.

Hon. Navdeep Bains: Thank you very much, Chair. I will do my best. I have a tendency to ramble on.

Thank you very much for coming, I appreciate that. Thanks for your patience today. It's unfortunate we don't have more time to discuss this. I hope we might ask you to come back again, if some of the questions go unanswered today.

In your opening remarks you talk about on balance this trade will be good for Canada and you've cited some reasons. Currently we have a negative trade balance with South Korea. In your analysis, in your forecast, do you ever project a positive trade balance with South Korea?

Mr. Ian Burney: No. The forecast has to do with the impact on the changes in the level of exports and the changes in GDP.

Hon. Navdeep Bains: But not a net analysis of the imports and exports and in seeing if we're going to be in a positive or negative position? Because currently we have a trade imbalance.

Mr. Ian Burney: Yes, that's correct.

On the question of trade balances, the reality is that Canada has a trade surplus with about a hundred countries of the world, and we have a trade deficit with about a hundred countries in the world and we have an overall surplus that works out to about \$40 billion. The idea of our trade policy is not to establish a balance with every country or with every—

Hon. Navdeep Bains: I'm not saying that's an overarching objective; I just want to know if that analysis was done. Because you talk about the growth in exports, but you don't necessarily indicate the imports.

Mr. Dan Ciuriak (Acting Director and Deputy Chief Economist, Policy Research and Modelling Division, Department of Foreign Affairs and International Trade): We analyze the impact of the free trade agreement on both Canadian imports from Korea and from the world and on our exports to Korea and to the world.

In terms of the bilateral trade balance with Korea, there is an improvement in this particular analysis largely because, as Ian mentioned, Korean tariffs are higher than Canadian tariffs. So the impetus to Canadian exports from tariff elimination in the Korean market is greater than vice versa.

• (1655)

Hon. Navdeep Bains: You also indicated in your analysis that you've looked at the impact on jobs. You've indicated and the minister was here a few days ago indicating that according to the analysis done by the department and the individual from U of T, Johannes Van Biesebroeck, the job losses will range between 5,000 and 23,000. Then we have the CAW report saying 33,000 job losses. That's a fairly large discrepancy. Can you comment on why the discrepancy? Because that's not even remotely close: we're talking about 5,000 to 23,000 jobs versus 33,000 jobs.

Mr. Ian Burney: I'd be happy to comment on that.

First of all, the job figure that was referred to was from the study by Industry Canada. I believe the range of jobs was 5,000 to 35,000 and it was specific to the auto sector. This was the detailed drill-down we did on the auto sector.

Hon. Navdeep Bains: Sorry, all sectors.

Mr. Ian Burney: It covers all sectors, that's correct.

We have fundamental misgivings about the methodology used in the CAW report. The minister spoke to it the other day when he was here. I think the primary difference is that our study is focused on the realities of Canada-Korea trade. The CAW report looked at the trade patterns with our existing five FTA partners extrapolated over ten years and attached those numbers to current Canada-Korea trade.

Hon. Navdeep Bains: Have you done any analysis on the quality of jobs versus the number of jobs being lost in manufacturing? Based on the study, you only project between 5,000 and 35,000. What are they being replaced by? Where do the additional job opportunities come from that will offset some of the job losses?

Mr. Ian Burney: I think I went through a long list in my identification of the sectors where we see the jobs.

I just want to address the point about value because there seems to be a perception that in this FTA we're going to be trading high-value manufacturing jobs for low-value jobs in agriculture and resources. I think that's an unfair characterization. Based on the number of statistics I've seen, jobs in the oil and gas and mineral sectors can often be higher-paying and of higher value than in many manufacturing sectors. It's useful to avoid making judgments about the quality of jobs on the basis of sector.

Hon. Navdeep Bains: You mention the dispute settlement mechanism. One question I had is with respect to snapback tariffs. Is that something that's currently being discussed in the negotiations?

Mr. Ian Burney: I have to be careful about getting too specific in terms of things that are under negotiation. What I can say is that we are looking for a comprehensive package of non-tariff provisions in the FTA pertaining to the auto sector, and what we're looking for is an overall package that's commensurate with what the U.S. got in the KORUS agreement.

The Vice-Chair (Mr. John Maloney): Thank you, Mr. Bains.

Mr. Cardin.

[*Translation*]

Mr. Serge Cardin: It's my colleague's turn.

Mr. Guy André (Berthier—Maskinongé, BQ): Good afternoon.

I'm going to continue along somewhat the same lines as my colleague. Of course, as you know, this Canada-Korea trade is a concern for a lot of people, particularly those working in the manufacturing and automotive industries.

In 2005, the automotive industry produced statistics showing that Korea had sold 130,000 vehicles in Canada, whereas Canada had sold 400 vehicles in Korea. That's a very different profitability ratio.

There are also other elements. They managed to conduct quite a detailed assessment of the impact of the bilateral agreement with Korea. But I didn't see any documents in your report clearly showing our gains and losses on balance. You gave some figures on the subject—I heard them—but we're lacking details and perspective to reassure the public.

Our manufacturing sector is currently in crisis. We mustn't enter into an agreement that would put that sector at an even greater disadvantage. So there's major concern in that regard.

In addition, Minister Emerson told us that, if there were an agreement between Korea and the United States, we'd have trouble subsequently securing an agreement with Korea. The agreement would be less warranted, less useful or less important, because the needs would already have been met.

I would like to hear your comments on that subject.

• (1700)

Mr. Ian Burney: We think we have a number of studies on the impact of an initiative with Korea. We have the results I talked about in my presentation, with the economic models. We've also conducted two extremely detailed studies in the automotive industry. There is a lot of information on our Web site on each sector that will be concerned.

Mr. Guy André: But do you approve the figures I stated concerning the automotive industry, or do you dispute them?

Mr. Ian Burney: That's a projection. You must know that we don't have an agreement at this time. We're negotiating something. So it's difficult to—

Mr. Guy André: So you're not questioning the figures I gave you. Do you agree with those figures?

Mr. Ian Burney: The figures I stated in my presentation?

Mr. Guy André: No, the figures obtained by the automotive industry following the study it did of the Canada-Korea agreement.

Mr. Ian Burney: The union's study?

Mr. Guy André: Yes. I thought you agreed.

Mr. Ian Burney: No. I entirely disagree with those figures.

[*English*]

Mr. Ian Burney: I began to speak to that in my answer to the previous question. That study took the changes in our trade with our existing trading partners we have FTAs with, projected those onto our current trade with Korea, came up with an enormous trade deficit figure, and then from that assumed that there would be enormous job losses in Canada.

Let me go through some of the big problems with that.

First of all, there are many reasons for changes in our trade with countries like the United States that are not related to the FTA. That study assumed that all of the trade changes over ten years with the United States were based solely on the FTA—not the currency, not changes in terms of trade, not autonomous growth, not the rise of China and India—all because of the FTA. Moreover, it assumed that Canada is not trading with any other country. It assumes that every additional import that comes in from Korea would be necessarily at the expense of domestic production, whereas the reality, if you take the automotive sector, is that about 85% of what we produce is exported. So clearly, every additional vehicle that comes in from Korea is not going to displace domestic production; it's more than likely going to displace other imports.

Thirdly, it didn't look at the reality of Canada-Korea trade at all. It assumed that 12,000 of those jobs would be lost in the electronics and computer sector, which is already largely tariff-free between Canada and Korea. So it's illogical to assume that there would be 12,000 job losses in those sectors.

It also excluded agriculture, by the way, which is an area where we would expect to see some of the biggest gains for Canada.

I could go on and on, but the point is that from our perspective, the methodological flaws are so fundamental that the result has no bearing on the reality of Canada-Korea trade.

The Vice-Chair (Mr. John Maloney): Thank you, Mr. André.

Mr. Miller.

Mr. Larry Miller (Bruce—Grey—Owen Sound, CPC): Thank you, Mr. Chair. I'm going to split my time with Mr. Allison.

Thank you for coming, gentlemen and lady.

In your view, would a Canada-Korea free trade agreement basically allow Canadian companies to be able to better participate in that global supply chain?

Carrying that further, with Korea, what potential does it have, in your opinion, to basically start as a gateway or an avenue to bigger and better things to come in Asia? Could you comment on that?

Mr. Ian Burney: Sure. I think that's a very important dimension to it, because what we're trying to achieve with the agreement with Korea is not only an enhanced relationship with Korea, but we want to leverage a better relationship with Korea to pursue neighbouring markets in Japan and China. This is one of the most dynamic economic regions of the world.

There are a number of ways that can happen. Through the investment provisions of the agreement, we hope to make it more attractive for Canadian companies to invest in Korea and therefore use Korea as a platform to pursue opportunities throughout northeast Asia.

But it often doesn't happen through a specific provision in a trade agreement. What you see when you establish a close partnership through an FTA with another country is a lot of commercial interaction forming, and it's basically the contacts that are generated. So when you see Canadian companies teaming up with some of the big chaebols and other big companies in Korea, these companies know very well how business is carried out in China, in Japan, and elsewhere, and they have business relationships throughout. To the extent that we can have Canadian companies team up with them to pursue opportunities in the region, I think there'd be enormous advantages for Canada, and that comes directly back to your point about making better use of the gateways in Canada.

• (1705)

Mr. Larry Miller: Okay, thank you.

Mr. Dean Allison (Niagara West—Glanbrook, CPC): Thank you, Mr. Burney and all your officials, for coming again today. We apologize for keeping you waiting. We know your time is valuable, and we thank you for taking the time out this afternoon.

My thought is, along with what my colleague talked about in terms of supply chains and value chains globally, that when one enters into a free trade agreement, sometimes people just talk about what are the benefits dollar for dollar, import and export. I think one of the things this ignores is the whole notion of value chains and how they fit in, and what type of value-added we could get.

You touched on it before. You touched on it in your comments, and I know my friend from the NDP is always concerned about trading for lower-paying jobs. Their perception with any free trade agreement is that we get a bunch of hourly workers versus high-tech workers, or as you talked about, mining or oil and gas.

Talk to us a bit about that. I believe it's going to help to create more prosperity through higher-value type of work that we can get into. So could you talk about the value chain and how it fits in and how we could actually benefit as Canadians from this type of agreement?

Mr. Ian Burney: Sure. I think you're exactly right that there tends to be a lot of focus only on the tariffs, but the reality is that what we're negotiating is a comprehensive trade agreement. So there will be provisions on goods, on services, financial services, investment, temporary entry, and electronic commerce. This is going to cover a lot of ground.

The result that we talked about earlier on the modelling is focused only on the impact of tariff elimination, because that's all we really have the capability to model. We know from past experience that actually the benefits to the economy are substantially greater, because they get into all those other non-tariff areas that are virtually impossible to model; and a lot of it happens during the points I was making earlier about developing commercial partnerships in areas where that then gets leveraged into wider opportunities, breaking into value chains. So all of that happens through the closer economic integration that an FTA is designed to bring about.

Generally, the theory of trade liberalization, of course, is that you specialize in your areas of comparative advantage. So, all else being equal, that moves you up the value chain into higher-paid jobs and out of the areas in which you're relatively less competitive internationally. So that's exactly part of the aim of the FTA.

Mr. Dean Allison: Could you also comment a bit on IP, intellectual property? I know there were some concerns raised about that. It would make sense that we start talking about intellectual property, certainly as we move forward with other trade agreements. I realize this may be relatively new in the last five to ten years, but do you have any quick comments on that?

Mr. Ian Burney: Yes, I am aware of some concerns that were expressed the other day on this, and I can provide some assurance to committee members. I think the concern was that Canada was pursuing a U.S.-style intellectual property chapter in our negotiations with Korea. We are not. We are pursuing an intellectual property chapter, but we are not seeking so-called TRIPS-plus provisions. These are obligations that would go beyond the intellectual property obligations that we have at the WTO.

What we're looking for is basically a chapter that would enhance the cooperation that we have with South Korea, expand dialogue and cooperate on enforcement and acquisition issues as they relate to intellectual property, but we are not looking to build in additional obligations along the lines of what's in the U.S.-model FTA.

The Vice-Chair (Mr. John Maloney): Thank you, Mr. Allison.

Go ahead, Mr. Julian.

Mr. Peter Julian: Thank you, Mr. Chair.

Thank you very much for coming before us today.

How many of you were in Korea last week? Were there any members?

Mr. Ian Burney: All of us were there except for Mr. Chiuriak, who is our deputy chief economist.

Mr. Peter Julian: How close would you say we are to signing a Canada-Korea trade deal?

Mr. Ian Burney: As I mentioned, this was our twelfth meeting, and the thirteenth is not scheduled until March. Korea is going through a period of political transition now with presidential elections, and won't have a new government until...well, the president in February, and the cabinet will probably come in about a month or so later, so it's not imminent.

Mr. Peter Julian: Thank you for that.

I'd like to come back to the five existing FTAs. I'd like to know if the department has done an analysis of the difference between the actual impacts of those bilateral agreements and what the department projected the impacts would be.

I'm raising that question because you're criticizing the one study that has gone into detail about the job impacts. It's based on the actual results from our five existing FTAs, so I'm wondering if the department itself has done an analysis of the differential between what the department estimated the economic results and the job results would be from each of those bilateral agreements and what the actual results have been.

• (1710)

Mr. Ian Burney: The basis of my criticism is that other agreements were used to project what would happen with this agreement, and the two have very little in common.

To answer your specific question, no, I'm not aware of an analysis specifically done on the difference between what we projected on the five existing FTAs and what the reality is. However, my guess is that we would have projected positive trade impacts from all of those FTAs, and certainly the result has been positive.

Mr. Peter Julian: You realize why I'm raising that question, of course. The CAW has a good track record in terms of projecting economic impacts in a variety of areas, and I think it's important for the department to do the same exercise and bring forward what was projected and what the net results have been.

That brings me to the CAW report, because it does raise valid concerns. As Mr. Bains mentioned, there were 33,000 net jobs lost in Canada: in electronics, it was over 12,000; in machinery, 5,000; in transport equipment, over 4,000. There were more in metal products, plastics, and rubber. They've detailed the job losses across the country as well: 1,000 in British Columbia, 3,000 in the prairies, over 17,000 in Ontario, 8,000 in Quebec, 500 in Atlantic Canada, and then a number they weren't able to allocate. The problem, of course, is that we export to Korea essentially unfinished products, and as a result very little job creation comes with that, while the imports we would expect from Korea would be from the high-value-added manufacturing jobs.

I'd like to ask you what our top exports are now. Also, the scope of the CAW study and the wide variety of its sources, including the Canadian Vehicle Manufacturers' Association, have given credibility to potential job losses around this deal. Does that not make you want to go back and re-evaluate the impact studies that Industry Canada has done or to conduct your own impact studies?

Mr. Ian Burney: Taking your last question first, no. We found so many flaws in the approach taken in that study that we would certainly not want to replicate it.

That study was one of four put out by the CAW last year. Basically it just reissued that study. It was the worst-case scenario of the four and provided a provincial breakdown. This was the same study we had seen a year before; the same methodology problems we had with it then still pertained, and I went through those. It's not grounded in any analysis of Canada-Korea trade. It doesn't allow for the fact that Canada trades with anybody else. You yourself mentioned the 12,000 jobs lost in the computer and electronics sector, in which there currently aren't tariffs between Canada and Korea; how would an FTA bring about 12,000 jobs lost in that sector?

Mr. Peter Julian: I have two final quick questions, because I only have about 30 seconds, I believe, Mr. Chair.

Are there chapter 11 investor-state provisions anticipated with this proposed agreement? Second, what alternatives to stimulating trade with Korea has the department looked at? If this trade agreement is problematic, what are the other ways? For example, trade promotion is much more on the ground in supporting Korea. What are the other ways that we can actually further our economic relationship with Korea?

Mr. Ian Burney: Thank you.

On the second question, it's not an FTA or nothing. Clearly, we pursue a wide range of options in terms of promoting our relationship with Korea, and we do have active programs of trade and investment promotion. We would be pursuing air services negotiations. There are other instruments that we would be pursuing, but that won't solve the problem I mentioned in my presentation about having a competitive playing field vis-à-vis our competitors. That's the reason we're doing an FTA. If the Europeans, the Americans, and everybody else has an FTA with Korea and has tariff-free access, and Canada doesn't, it means on average we're going to face a 13% disadvantage for virtually everything we sell. So that's what we're trying to address with an FTA, and there's no other mechanism for doing that. You cannot, under WTO rules, have sectoral or product-specific agreements that liberalize tariffs. It has to be a comprehensive FTA. So that's the rationale for pursuing that. We don't see it as a situation where we can set aside an FTA and pursue other means to the same end. We aren't going to recover the competitive lost ground with any instrument other than an FTA.

We are negotiating an investment chapter with Korea, and it would be based on the standard model we have, a foreign investment protection agreement, which resembles NAFTA, but of course there have been some improvements and clarifications that have taken place over the years, in part to respond to some stakeholder concerns about chapter 11 that will be incorporated into Canada's new model and which are being pursued with Korea.

• (1715)

The Vice-Chair (Mr. John Maloney): Thank you, Mr. Burney.

We're very close to a bell, but we'll start round two.

Mr. Dhaliwal, you indicated you have a short question.

Mr. Sukh Dhaliwal: Sure, if I have time, I'll split with—

The Vice-Chair (Mr. John Maloney): You don't have much time. I think just your question will do it.

Mr. Sukh Dhaliwal: Thanks, Mr. Chair.

Non-tariff barriers are critical issues for Canadians in companies' negotiations. If I got it right, you said you have a comprehensive non-tariff barriers list prepared that you don't want to discuss. Is that true? Have you identified those non-tariff barriers?

Mr. Ian Burney: I said that we were pursuing an aggressive program of measures to address non-tariff barriers in the Korean market. I was reluctant to get into specifics of where individual issues stand in the negotiations because they're all being negotiated.

With respect to the auto sector, there are a number of specific barriers that have been brought to our attention by the auto industry,

which we're trying to seek a resolution on with Korea. There are generic provisions that we're trying to put in place. We're trying to open up the standard-setting process in Korea so Canadian companies can have earlier access before standards are presented and they become a *fait accompli*. We're pursuing a much more aggressive dispute settlement mechanism specific to the auto sector. We're pursuing a range of transparency measures. We're seeking language on an anti-import bias.

So across the board, wherever Canadian companies have identified a specific, non-tariff measure that's a problem for them in Korea, we're taking steps to try to address it. I would say that our efforts are heavily concentrated in the auto sector, but they're not limited to the auto sector.

Mr. Sukh Dhaliwal: Basically, you are consulting with the stakeholders and getting their input into the system.

Mr. Ian Burney: Absolutely. We're governed extensively by our consultations with stakeholders in sectors across the country.

Mr. Sukh Dhaliwal: Thank you.

The Vice-Chair (Mr. John Maloney): Thank you very much for your attendance today. I'm sure there are more questions around the table here. We'll continue to hear witnesses, but I would anticipate that we might have you back for perhaps another round.

Thank you very much.

The meeting is adjourned.

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