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Tiger by the Tail? Canada's Trade with South Korea

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Tiger by the tail? Canada's Trade with South Korea

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Summary

Asian 'tiger' now an important trading partner for Canada

The signs of Canada's trade with South Korea, one of the "Four Tigers" of East Asia, are easily recognizable as you drive down the highway: Hyundai, KIA, GM Daewoo. Motor vehicles and auto parts are the number one item that Canada imports from South Korea, now the world's 12th largest economy (OECD).

Canada's trade with South Korea pales in comparison with our transactions with the United States, just across the border. However, over the last decade, South Korea has become increasingly important as a trading partner for Canada, although in fairness Canada hardly has the tiger by the tail.

As in the case of China, the growth in Canada's imports from South Korea during the past decade has far outpaced the growth in our exports to South Korea. As a result, Canada's merchandise trade deficit with South Korea has increased 10-fold.

Worldwide, South Korea was Canada's seventh largest source of merchandise imports in 2003, up from 11th place a decade earlier. With respect to exports, South Korea was Canada's eighth largest customer last year, down from sixth largest in 1994.

Within the Pacific Rim group of countries, South Korea ranked as Canada's third largest trading partner of the region, behind China and Japan. In 2003, South Korea accounted for 11% of Canada's exports and nearly 12% of Canada's import trade to this area.

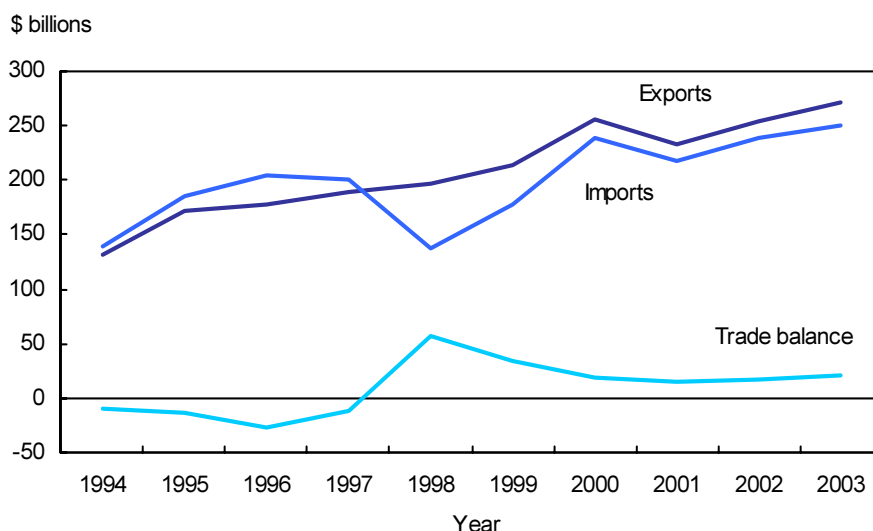
South Korea's expanding market is of great importance to our economy, carrying the promise of opportunities for Canadian businesses.

This article examines the trends in merchandise trade¹ flows between Canada and South Korea between 1994 and 2003, and the importance of this trade for Canada in terms of commodities. It also examines the differences in trade statistics that became apparent during the 2001 and 2002 merchandise trade reconciliation study between the two countries. This study pinpointed reasons for the differences in our trade statistics and increased our understanding of each other's trade reporting practices.

Incredible integration into the world economy

South Korea has achieved incredible economic growth and integration into the world economy. It has emerged as the world's 12th largest trading nation, with total trade in 2003 reaching \$522 billion, double the level from a decade earlier (KITA).

¹ Merchandise trade includes trade in goods and excludes trade in services. Throughout this article customs based merchandise trade statistics are used. These data are derived from the administrative records of the Canada Border Services Agency, the US Customs and Border Protection and Korea Customs Service.

Figure 1. South Korea's world trade, 1994 to 2003

Data Source: Korea International Trade Association, 2004.

Table source: Statistics Canada, 2004, *Canadian Trade Review. "Tiger by the Tail? Canada's Trade with South Korea."* Catalogue number 65-507-MIE.

With an estimated population of 48 million, South Korea is the largest of the four 'tigers'. It has more than twice as many consumers as Taiwan, a little over six times more than Hong Kong, and 12 times more than Singapore.

In 1997, the Asian financial crisis, commonly referred to as the 'Asian Flu', created a severe downturn in South Korea's economy. The South Korean Stock Exchange began to fall, and this was followed by a sudden drop of the South Korean won against the U.S. dollar.

As a consequence, the South Korean government took out an emergency loan from the International Monetary Fund (IMF) and launched various comprehensive reforms to all key sectors of their economy.

The country's rapid economic recovery has been remarkable. South Korea's robust domestic market has provided growing opportunities to foreign firms and Canada is positioned to be part of this expanding market.

Canada and South Korea: Over 40 years of diplomatic relations

Canada and South Korea have maintained over 40 years of official diplomatic relations dating back to 1962. There has been a long history of interaction between the two countries. During the past decade, shifts in our economic connections have changed noticeably.

At the 1993 summit of the Asia-Pacific Economic Co-operation (APEC), the Canada-South Korea 'Special Partnership' was created to develop closer co-operation between the two countries in areas of trade, investment and political dialogue. Both nations recognized the potential for expanded relations and pledged to make every effort to help two-way exports.

In April 1994, the Canada-South Korea Special Partnership Working Group was launched to increase co-operation in areas such as trade, investment, and technology transfer.

The collaboration has led to various changes including, for example, an agreement by South Korea to remove some of the restrictive labelling requirements on imports of Canadian ozonated bottled water and a reduction of tariffs on Canadian canola oil (DFAIT).

Trade flows with South Korea: imports tell the story

Prior to the Asian financial crisis of 1997, Canada's trade with South Korea – imports plus exports – was basically flat. The volume of transactions with South Korea peaked at just over \$5.9 billion in 1995 and fell to about \$5.1 billion in 1998.

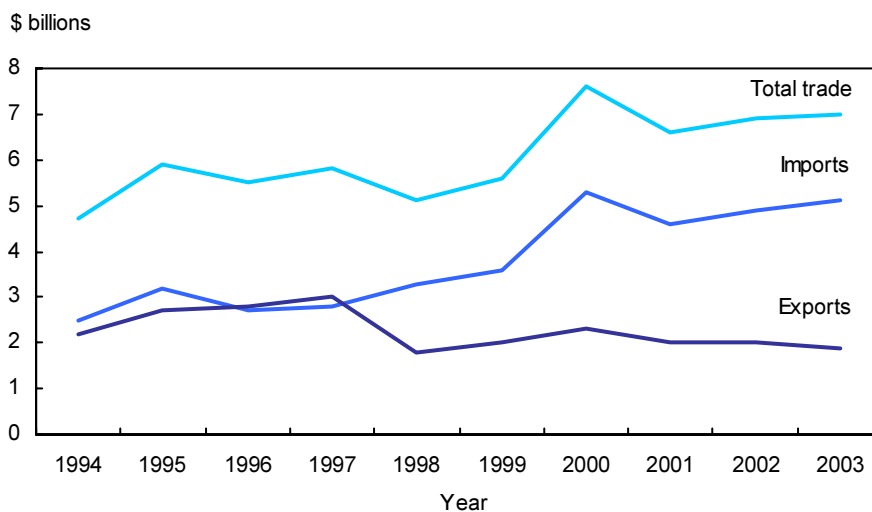
In 1999, however, South Korea's economy picked up steam. The nation's real gross domestic product that year soared 10.9%, and in 2000, the gain was 9.3% (APEC).

After a setback in 2003, South Korea has rebounded sharply, and in 2004, real GDP is forecast to grow by 6.3% and by 4.8% in 2005 (The Economist).

South Korea's trade with Canada mirrors this growth. In 1999, our total trade with South Korea picked up, and by 2000 had peaked at more than \$7.6 billion.

But this gain was largely the result of Canada's heavy imports from South Korea, especially of motor vehicles. Canada's exports to South Korea were hit hard by the economic crisis that gripped South Korea starting in 1997, and have not recovered.

Figure 2. Canada's trade with South Korea, 1994 to 2003



Data source: Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review. "Tiger by the Tail? Canada's Trade with South Korea." Catalogue number 65-507-MIE.

In total, during the past 10 years, the value of Canada's two-way trade with South Korea increased 49%.

During this period, our exports to South Korea fell 15%, while in comparison, our total exports to the world rose 69%. On the other hand, our total imports from the world rose by 65%, while those from South Korea more than doubled (+104%).

Canadian imports from South Korea, 1994 to 2003

Imports of cars mushroom in just 10 years

Canada was ranked as South Korea's 11th largest destination of exports in 2003, up from 13th place a decade earlier (KITA).

In 2003, Canada imported \$5.1 billion worth of goods from South Korea, slightly more than double the amount in 1994. Imports of motor vehicles accounted for the vast majority of the increase.

During this decade, Canada's imports of motor vehicles and parts from South Korea surged five-fold. In 2003, they accounted for 30% of total imports from South Korea, three times the proportion in 1994.

In 2003, South Korean companies shipped more than \$1.5 billion worth of vehicles and auto parts to Canada.

Automobiles, semiconductors, televisions, VCRs and appliances accounted for almost three-quarters of Canada's imports from Korea last year. A decade earlier, they accounted for about 62%.

Table 1a: Leading Canadian imports from South Korea, 1994

Rank	Commodity	Value in millions of dollars	Percentage of total imports
1	Electrical machinery and equipment	761	30
2	Machinery and mechanical appliances	516	21
3	Vehicles and parts	267	11
4	Clothing and accessories, not knitted or crocheted	156	6
5	Rubber and articles	102	4
Total (top five)		1,802	72
Total imports		2,504	

Data source: Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Table 1b: Leading Canadian imports from South Korea, 2003

Rank	Commodity	Value in millions of dollars	Percentage of total imports
1	Vehicles and parts	1,531	30
2	Electrical machinery and equipment	1,377	27
3	Machinery and mechanical appliances	834	16
4	Rubber and articles	146	3
5	Primary and semi-manufactured iron and steel	141	3
Total (top five)		4,029	79
Total imports		5,106	

Data source: Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Canadian exports to South Korea, 1994 to 2003

Canada well positioned to supply natural resources

As a country with limited natural resources, South Korea depends on imports for primary goods such as crude oil, coal, timber, wood pulp, and organic chemicals. The bulk of their imports are from the United States.

However, South Korea's expanding domestic market will provide growing opportunities to foreign firms, and Canada is well positioned to supply this expanding market.

Since the economic crisis in 1997, our exports to South Korea have fallen and have not recovered to previous levels.

In 1998, our total exports to South Korea were \$1.8 billion, a 19% decrease from four years earlier. By 2003, our total exports to Korea reached \$1.9 billion, a 15% decline from a decade earlier.

In 1994, Canada was ranked as South Korea's 8th largest source of imports. Ten years later, Canada had dropped to 23rd place (KITA). Competition from emerging markets, specifically China, has played a major part in Canada's weakening position in the South Korean market.

With virtually no raw materials and a large industrial base, South Korea could be a significant market for a wide variety of primary commodities that Canada is able to provide. Our three principal exports to South Korea are wood pulp, coal and aluminium. In 2003, Canadian exports of these three leading commodities accounted for 44% of our total exports to South Korea.

The type of goods that Canada exports to South Korea has remained relatively homogeneous over the past decade, except for our grains. In 1994, almost one-fifth of our total exports to South Korea consisted of grains. Ten years later, this commodity had dropped to a mere 2%. Increased competition from Australia, China and Ukraine have dramatically decreased Canada's share of South Korean grain imports.

Table 2a: Leading Canadian exports to South Korea, 1994

Rank	Commodity	Value in millions of dollars	Percentage of total exports
1	Wheat, oats, rye and barley	467	21
2	Wood pulp	379	17
3	Coal	333	15
4	Aluminium	162	7
5	Organic chemicals	109	5
Total (top five)		1,450	65
Total exports		2,239	

Data source: Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Table 2b: Leading Canadian exports to South Korea, 2003

Rank	Commodity	Value in millions of dollars	Percentage of total exports
1	Wood pulp	458	24
2	Coal	209	11
3	Aluminium	174	9
4	Organic chemicals	148	8
5	Electrical machinery and equipment	142	7
Total (top five)		1,131	59
Total exports		1,911	

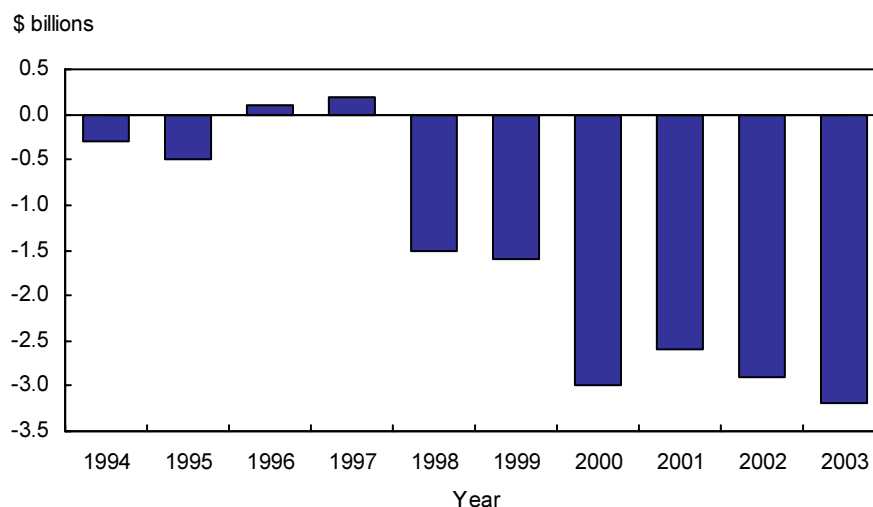
Data source: Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Trade balance

Deficits in 8 of last 10 years

Because Canada's imports from South Korea have soared, and our exports have fallen, Canada has recorded merchandise trade deficits with South Korea in eight of the last 10 years.

Figure 3. Canada's trade balance with South Korea, 1994 to 2003

Data Source: Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review. "Tiger by the Tail? Canada's Trade with South Korea." Catalogue number 65-507-MIE.

In 1996 and 1997, Canada had small trade surpluses with South Korea. This changed with the recovery in South Korea's economy following the Asian financial crisis. The trade deficit has doubled from about \$1.5 billion in 1998 to \$3.2 billion in 2003.

As a proportion of the value of total merchandise trade with South Korea, both imports and exports, our trade deficit rose from 6% in 1994 to 46% in 2003.

Still, this was a far cry from our trade deficit with China, which exploded from \$1.2 billion in 1995 to nearly \$13.8 billion in 2003.

Trade reconciliation

Understanding conceptual differences

To obtain a better understanding of our trade with South Korea it is important to understand the conceptual differences in how each country counts trade, as well as possible errors in the published data.

Trade statistics collected by countries frequently differ from the statistics published by their trading partner(s). In theory, for example, Canada's recorded exports to South Korea should equal South Korea's reported imports from Canada and vice versa. However, this is not the case.

For example, in 2001, reported Canadian import trade exceeded South Korea's reported exports by \$1.5 billion. The following year, the gap was \$1.2 billion. Similarly, in 2001, South Korean reported imports exceeded Canada's reported exports by \$835 million. In 2002, the gap was \$900 million.

Table 3a: South Korean exports compared with Canadian imports, 2001 and 2002

	2001 Value in millions of dollars	2002 Value in millions of dollars
South Korean exports to Canada	3,152	3,676
Canadian imports from South Korea	4,604	4,861
Difference	-1,452	-1,185

Data sources: Korea Customs Service, 2004, and Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Table 3b: Canadian exports compared with South Korean imports, 2001 and 2002

	2001 Value in millions of dollars	2002 Value in millions of dollars
Canadian exports to South Korea	1,985	1,998
South Korean imports from Canada	2,820	2,898
Difference	-835	-900

Data sources: Korea Customs Service, 2004, and Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Both Canada and South Korea derive their trade statistics from the administrative data provided by their respective Customs agencies. Customs offices are generally more attentive to goods entering the country rather than leaving because of the requirement for tariff assessment and the application of trade agreements. Consequently, import data are usually more reliable than export data.

To improve our understanding of the actual trade flows between these economies, a merchandise trade reconciliation study was undertaken between Canada and South Korea.

The study identified the major differences in the trade statistics, and calculated estimates to better reflect the actual trade occurring between the two countries. It discovered that the principal causes for the discrepancies in trade data between Canada and South Korea were indirect trade and export undercoverage.

The reconciliation study revealed that Canada's merchandise trade deficit was actually just over 30% less than was reported in 2001 and 2002. In 2001, Canada's reconciled trade deficit with South Korea was \$1.8 billion. The following year, it was \$2 billion.

On the other hand, South Korea's trade surplus with Canada was actually higher than published. It was nearly \$2 billion for both 2001 and 2002.

Table 4a: Canada's trade balance: published versus reconciled results, 2001 and 2002

	Published value in millions of dollars	Reconciled value in millions of dollars	Difference (percent)
2001	-2,619	-1,784	32
2002	-2,863	-1,963	31

Data sources: Korea Customs Service, 2004, and Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Table 4b: South Korea's trade balance: published versus reconciled results, 2001 and 2002

	Published value in millions of dollars	Reconciled value in millions of dollars	Difference (percent)
2001	332	1,784	437
2002	778	1,963	152

Data sources: Korea Customs Service, 2004, and Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

The results from this reconciliation study confirm that the major contributing factor to the discrepancies between the Canadian and South Korean published trade data are that exports are often understated in both directions of trade. Non-filing of export documents and misallocated trade due to differences in the way in which indirect trade has been reported have also had an impact on Canada's trade balance with South Korea.

Canada's merchandise trade deficit using the reconciliation based data was less than that determined using the published data. The same situation occurs with South Korean merchandise trade statistics.

The usefulness of this reconciliation study in identifying differences has also resulted in an agreement between Canada and South Korea to continue discussions and perhaps undertake further reconciliation work.

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Reconciliation study: Canada–South Korea merchandise trade, 2001 and 2002

The first-ever trade reconciliation study between Canada and South Korea began early in 2001 and covered trade for the years 2001 and 2002.

The study investigated the main causes of differences in the trade data, for both eastbound and westbound directions, and estimated the impact of these differences on imports and exports.

Because of the nature of the available data, new trade estimates calculated by the study were not sufficiently robust to permit adjustments to the officially published numbers of either country.

It is important to note that the results of this study do not constitute revisions to either country's official statistics. However, the additional information helps both nations recognize limitations of the published data.

The study determined that the two major differences in the trade data between Canada and South Korea in 2001 and 2002 were due to indirect trade and export undercoverage. Re-exports and valuation differences also played minor roles.

Indirect trade main source of discrepancy

The main source of discrepancies in trade figures between Canada and South Korea was indirect trade.

In 2001, the reconciliation indirect adjustment explained 82% of the adjustments in the eastbound trade statistics and 37% of the adjustments in the westbound trade statistics. In 2002, indirect trade accounted for 90% of the eastbound adjustments and 38% of the westbound.

Attributing trade to a country that is not the final destination of goods results in a situation in which the two partner countries credit trade to different countries. This is known as country misallocation.

For example, Canada may ship goods through the United States to South Korea, the final destination. If these goods are landed and declared for consumption in the United States and subsequently re-exported to South Korea with no change to the merchandise, this will appear in the Canadian statistics as trade with the United States. In the South Korean figures, it will appear as trade with Canada. This creates a statistical imbalance.

The assumption is that in most cases this indirect trade results in country misallocation. The intermediate country is attributed as the trading partner in the officially published export statistics of either Canada or South Korea.

Therefore, based on the findings of this reconciliation study it can be assumed, for example, that Canada's export trade with South Korea is understated.

Instances in which import records show the country of origin as either Canada or South Korea and the country of shipment or seller as another country are shown as indirect trade. The indirect trade adjustments were derived by adding indirect import figures to the partner country's export figures. The amount of indirect trade is assumed to be the amount of misallocated trade.

Control estimate resolves problem of double counting

When determining the indirect trade adjustments in both the eastbound and westbound trade flow, an assumption was made that the import data better reflected the indirect trade between the two countries, while the export data captured only part of it.

Exports are adjusted for a number of factors. Occasionally, the adjustment values added result in sums that exceed reported imports, implying that its export adjustment is too large because of double counting. Accordingly, the adjustments are reduced by a 'control' factor to ensure that adjusted exports do not exceed imports.

In the eastbound flow, the estimates for the 'control' values were \$3 million in 2001 and \$14 million in 2002. In the opposite direction, the westbound 'control' values totalled \$11 million in 2001 and \$24 million the following year.

Goods re-exported from the partner country are not included in import statistics

In both directions of trade, adjustments for re-exports were also made. Export statistics are based on the country of final destination. This includes both domestic goods, that is, goods of country origin. It also includes re-exports, that is, goods of foreign origin that have entered a country's consumption and are then sold without any substantial transformation occurring in that country.

Import data are based on the country of origin principle; goods re-exported from the partner country are not included in import statistics. Both Canada and South Korea keep track of goods they re-export. These numbers were used for this adjustment.

In 2001, the reconciliation adjustment for re-exports explained less than 1% of the adjustments in the eastbound trade statistics and 13% of the adjustments in the westbound trade statistics.

In 2002, re-exports again accounted for less than 1% of the eastbound and 14% of the westbound adjustment respectively.

Valuation differences between countries

Another adjustment is based on valuation differences between the two countries. Goods can be reported on a Free on Board (FOB) basis or on the Cost, Insurance and Freight (CIF) basis.

FOB basis means that the cost of insurance and freight to ship the goods from the point of exit to the destination are not included in the reported value of the goods exported. CIF based refers to the incorporation of the costs of insurance and freight for transporting goods up to a specified place into the value of the traded goods.

Canadian exports are collected and published on an FOB point of exit basis which excludes insurance and freight beyond that point. On the other hand, South Korean imports are valued CIF which includes insurance and freight from factory to destination.

Therefore, an adjustment was made to compensate for the valuation differences between the two nations. In the westbound direction, the insurance and freight are removed from South Korea's import statistics. This modification accounted for 13% of the adjustment in 2001 and 9% the following year.

In eastbound trade, both Canada and South Korea report on an FOB basis, so no adjustment was necessary.

Missing export data create statistical imbalance

The final major discrepancy is the situation in which the export trade is not reported to the compiling country and consequently does not appear in the country's officially published trade statistics.

In the case of Canada, the Canada-U.S. data exchange agreement² does not require Canadian exporters to file an export document for trade to the United States if the goods are destined for U.S. consumption.

The situation is further complicated by the possibility of in-bond movements through the United States. For example, Canadian goods passing through the United States to South Korea may be placed in-bond for the portion of the U.S. travel and Canadian exporters may fail to report the outbound movement. Exporters may treat the export to South Korea via the United States in the same way they treat an export to the United States; that is, the supporting customs documents will not be filed.

A US import document will not be needed since the ultimate destination of the goods is South Korea. South Korea will capture the import trade of the good from Canada and this will again result in a statistical imbalance; Canada's trade with South Korea will be understated in the Canadian export figures.

In other cases, goods exported directly from Canada to South Korea may not be reported at all. In either case, a rough measure of this occurrence is included in the 'export undercoverage' category³.

In the eastbound trade flow, the export undercoverage accounted for 17% of the adjustments in 2001 and 8% in 2002. Westbound, export undercoverage accounted for 36% in 2001 and 38% in 2002.

The two principal causes for discrepancies in the trade data between Canada and South Korea for 2001 and 2002 were indirect trade and export undercoverage. The following tables summarize the various adjustments that were calculated in an attempt to better reflect the trade between Canada and South Korea.

² In 1987, Canada and the United States signed a *Memorandum of Understanding* (MOU) to exchange import statistics starting with January 1990 data. Each country now uses the other country's import data to derive their export statistics.

³ This category could also include other unexplained differences including those discrepancies not fully investigated and any revisions made during the 2001/02 reconciliation study period. It is assumed that the bulk of this category is export undercoverage.

Table 5a: Reconciliation of Canada-South Korea eastbound merchandise trade, 2001

	Value in millions of dollars	Percentage of total adjustments*
Canadian published imports from South Korea	4,604	
South Korean re-export adjustment	4	0
Indirect trade adjustment	-1,204	82
Control adjustment	3	0
Export undercoverage adjustment	-255	17
South Korean published exports to Canada	3,152	
Gap (imports minus exports)	1,452	
Total adjustments (absolute dollars)	1,466	

*Totals may not add to 100% due to rounding.

Data sources: Korea Customs Service, 2004, and Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Table 5b: Reconciliation of Canada-South Korea eastbound merchandise trade, 2002

	Value in millions of dollars	Percentage of total adjustments*
Canadian published imports from South Korea	4,861	
South Korean re-export adjustment	4	0
Indirect trade adjustment	-1,102	90
Control adjustment	14	1
Export undercoverage adjustment	-101	8
South Korean published exports to Canada	3,676	
Gap (imports minus exports)	1,185	
Total adjustments (absolute dollars)	1,221	

*Totals may not add to 100% due to rounding.

Data sources: Korea Customs Service, 2004, and Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Table 6a: Reconciliation of Canada-South Korea westbound merchandise trade, 2001

	Value in millions of dollars	Percentage of total adjustments*
South Korean published imports from Canada	2,820	
Insurance and freight adjustment	-150	13
Canadian re-exports adjustment	151	13
Indirect trade adjustment	-427	37
Control adjustment	11	1
Export undercoverage adjustment	-420	36
Canadian published exports to South Korea	1,985	
Gap (imports minus exports)	835	
Total adjustments (absolute dollars)	1,159	

*Totals may not add to 100% due to rounding.

Data sources: Korea Customs Service, 2004, and Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.

Table 6b: Reconciliation of Canada-South Korea westbound merchandise trade, 2002

	Value in millions of dollars	Percentage of total adjustments*
South Korean published imports from Canada	2,898	
Insurance and freight adjustment	-115	9
Canadian re-exports adjustment	176	14
Indirect trade adjustment	-496	38
Control adjustment	24	2
Export undercoverage adjustment	-489	38
Canadian published exports to South Korea	1,998	
Gap (imports minus exports)	900	
Total adjustments (absolute dollars)	1,300	

*Totals may not add to 100% due to rounding.

Data sources: Korea Customs Service, 2004, and Statistics Canada, 2004, International Trade Division.

Table source: Statistics Canada, 2004, Canadian Trade Review, "Tiger by the Tail? Canada's Trade with South Korea," Catalogue number 65-507-MIE.