SENATE SÉNAT

CANADA

The CANADA-USA Price Gap

Report of the Standing Senate Committee on National Finance

February 2013

The Hon. Joseph A. Day, Chair
The Hon. Larry Smith, Deputy Chair
The Hon. Richard Neufeld, Deputy Chair (until May 8, 2012)
The Hon. Irving R. Gerstein, Deputy Chair (until February 7, 2012)

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41st Parliament – 1st Session

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MEMBERS OF THE COMMITTEE

The Honourable Joseph A. Day, Chair of the Committee
The Honourable Larry Smith, Deputy Chair of the Committee
and

The Honourable Diane Bellemare
The Honourable JoAnne L. Buth
The Honourable Catherine S. Callbeck
The Honourable Maria Chaput
The Honourable Pierre DeBané, P.C.
The Honourable Doug Finley
The Honourable Irving R. Gerstein
The Honourable Céline Hervieux-Payette, P.C.
The Honourable Thomas McInnis
The Honourable Nancy Ruth

Ex-officio members of the Committee:
The Honourable Senators Marjory LeBreton, P.C., (or Gérald Comeau) and James Cowan (or Claudette Tardif).

Other Senators who have participated from time to time in the study:
The Honourable Senators David Angus, Art Eggleton, P.C., Linda Frum, Leo Housakos, Ghislain Maltais, Fabian Manning, Elizabeth Marshall, Yonah Martin, Percy Mockler, Grant Mitchell, Richard Neufeld, Pierre-Claude Nolin, Pierrette Ringuette, Michel Rivard, Bob Runciman, Carolyn Stewart-Olsen, Robert W. Peterson, John D. Wallace.

Parliamentary Information and Research Service, Library of Parliament:
Terrence Thomas and Édison Roy-César.

Clerk of the Committee:
Jodi Turner

Senate Committees Directorate:
Louise Pronovost, Administrative Assistant

ORDER OF REFERENCE

Extract from the Journals of the Senate of Thursday, December 13, 2012:

The Honourable Senator Day moved, seconded by the Honourable Senator Moore:

That, notwithstanding the order of the Senate adopted on Thursday, October 6, 2011, and Monday, June 11, 2012, the date for the presentation of the final report of the Standing Senate Committee on National Finance on its study of the potential reasons for price discrepancies in respect of certain goods between Canada and the United States, given the value of the Canadian dollar and the effect of cross border shopping on the Canadian economy, be extended from December 31, 2012 to March 28, 2013; and

That the committee retain all powers necessary to publicize its findings until 90 days after the tabling of the final report.

The question being put on the motion, it was adopted.

Gary W. O'Brien

Clerk of the Senate

Extract from the Journals of the Senate of Monday, June 11, 2012:

With leave of the Senate,

The Honourable Senator Day moved, seconded by the Honourable Senator Moore:

That, notwithstanding the order of the Senate adopted on Thursday, October 6, 2011, the date for the presentation of the final report of the Standing Senate Committee on National Finance on its study of the potential reasons for price discrepancies in respect of certain goods between Canada and the United States, given the value of the Canadian dollar and the effect of cross border shopping on the Canadian economy, be extended from June 30, 2012 to December 31, 2012; and

That the committee retain all powers necessary to publicize its findings until 90 days after the tabling of the final report.

After debate,

The question being put on the motion, it was adopted.

Gary W. O'Brien

Clerk of the Senate

Extract from the Journals of the Senate of Thursday, October 6, 2011:

The Honourable Senator Gerstein moved, seconded by the Honourable Senator Martin:

That the Standing Senate Committee on National Finance be authorized to examine and report on the potential reasons for price discrepancies in respect of certain goods between Canada and the United States, given the value of the Canadian dollar and the effect of cross border shopping on the Canadian economy;

That, in conducting such a study, the committee take particular note of differences between Canada and the United States including, but not limited to, market sizes, transportation costs, tariff rates, occupancy costs, labour costs, taxes and fees, regulations, mark-up; and

That the committee submit its final report to the Senate no later than June 30, 2012, and retain all powers necessary to publicize its findings for 180 days after the tabling of the final report.

The question being put on the motion, it was adopted.

Gary W. O'Brien

Clerk of the Senate

EXECUTIVE SUMMARY

It is our sincere pleasure to present this final report of the Standing Senate Committee on National Finance on the potential reasons for price discrepancies in respect of certain products between Canada and the United States, given the value of the Canadian dollar and the effect of cross-border shopping on the Canadian economy.

When the Finance Committee undertook this study, we resolved to hear all perspectives in order to develop a better understanding of this complex issue. We invited government officials, consumer groups, retailers, manufacturers, importers, exporters, experts from the academic sector, accountants and independent economists. Although not everyone we invited to appear before us accepted our invitation, we did hear from witnesses in every category mentioned above, and the testimony we heard shed light on the causes of price discrepancies between the two countries.

The Committee examined the pricing of numerous products, from ice skates and jeans to automobiles and books. Each product was found to have many factors influencing its pricing, and, although some products share some factors (e.g., transportation costs, the relative size of the Canadian market or tariff rates), the Committee cannot offer an explanation as definitive as it would have liked for the price discrepancies for products between Canada and the United States.

It is hoped that this report will improve Canadians' knowledge of the causes of the price discrepancies for certain products between Canada and the United States, and will provide the federal government with four recommendations to narrow these price discrepancies.

Committee members are indebted to the staff of the Senate Committees Directorate and the Library of Parliament for helping to bring this report to fruition. We applaud their professionalism and commitment to public service.

Senator Joseph A. Day
Chair

Senator Larry Smith
Deputy Chair

RECOMMENDATIONS / OBSERVATIONS

Please note that these recommendations are best understood in the context of the reasoning presented in the body of the report. To locate the section of the report relevant to each recommendation, please see the page number in parentheses following the recommendation.

The Standing Senate Committee on National Finance recommends the following:

Recommendation 1:

The Committee recommends that the Minister of Finance conduct a comprehensive review of Canadian tariffs, keeping in mind the impact on domestic manufacturing, with the objective of reducing the price discrepancies for certain products between Canada and the United States. (page 19)

Recommendation 2:

The Committee recommends that the Government of Canada, through the Canada-United States Regulatory Cooperation Council, continue to integrate the safety standards between Canada and the United States with the intent to reduce the price discrepancies without compromising the safety needs of the two countries. (page 27)

Recommendation 3:

The Committee recommends that the Government of Canada analyse the costs and benefits of increasing the *de minimis* threshold for low-value shipments in Canada in order to narrow the price discrepancies for certain goods between Canada and the United States. (page 29)

Recommendation 4:

The Committee recommends that the Minister of Canadian Heritage study the costs and benefits of reducing the 10% mark-up that Canadian exclusive distributors can add to the U.S. list price of American books imported into Canada, adjusted for the exchange rate, as stipulated in section 5(1)(a)(iii) of the Book Importation Regulations. (page 53)

Observation 1:

As more Canadian consumers become aware of smartphone applications and Internet sites for price shopping and comparison, and become price-savvy consumers, competitive pressures in Canada will increase and the price for products in Canada will converge to U.S. prices (page 59).

CHAPTER ONE: INTRODUCTION

Canadian consumers are feeling ripped off. When the Canadian dollar is at parity with the U.S. dollar, Canadian consumers notice that prices here are typically higher than in the United States. When buying books or magazines, they notice two prices on the covers, and usually the price in Canada is higher. Numerous newspaper articles point out that list prices of many identical automobiles are thousands of dollars higher in Canada than in the United States. When Canadians window-shop, on a visit to the United States or online, they notice price gaps, especially on brand-name goods, from Aspirin to running shoes.

Naturally, Canadians wonder why these price gaps exist when the dollar is at parity, and wonder: “Are we being gouged?”

In light of these concerns, the Minister of Finance wrote to the Chair and Deputy-chair of the Standing Senate Committee on National Finance and asked that the Committee study price discrepancies for certain products between Canada and the United States. On 6 October 2011, the Senate referred the following mandate to this committee:

> Study the potential reasons for price discrepancies in respect of certain goods between Canada and the United States, given the value of the Canadian dollar and the effect of cross-border shopping on the Canadian economy.

The committee held meetings from October 2011 to June 2012 and heard from 53 witnesses; information on the meetings and the witnesses is in Appendix A at the end of this report. Appendix B contains written submissions received without the appearance of the author.

This report focuses on goods, not services. Services, it was felt, could be harder to compare – the "apples and oranges" problem – although, as will be seen below, the comparison of goods is not always straightforward. The goods studied are associated with the manufacturing and retail sectors; supply-managed goods, which include eggs, poultry and dairy products, are associated with the agricultural sector and were not part of this study.

This report first examines aspects of the exchange rate between the two currencies, including the recent move to parity, the volatility and the influence of movements of the exchange rate on cross-border shopping. The report then examines the impact of country pricing and market segmentation, the relative size of the Canadian market, customs tariffs, the volatility of the exchange rate, the price of fuel, product safety standards, the *de minimis* threshold for postal shipments and the level of competition on the price discrepancies for certain products between Canada and the

United States. An important, if less than satisfying, finding is that there is no single explanation for the price differences between the two countries.

The report ends with three major sections: automobiles, books, and charging what the market will bear. The first two sections look into sectors that have attracted considerable attention regarding price gaps between list prices in Canada and in the United States. The last major section examines whether the government should intervene, perhaps using the *Competition Act*, if the Canadian price for a specific product is out of line with the price of that product in the United States.

CHAPTER TWO: EXCHANGE RATE

In June 1970, Canada stopped operating under a fixed exchange rate system, which set the value of one Canadian dollar at US$0.925 and returned to a flexible exchange rate system.[1]

Under Canada's flexible exchange rate system, the value of the Canadian dollar compared to the U.S. dollar – or any other currency, for that matter – is based on the rules of supply and demand. Any factor that increases (or decreases) demand for Canadian dollars, or decreases (or increases) demand for a foreign currency, pushes the exchange rate upward (or downward).

Factors that Influence the Exchange Rate

Economic theory and empirical data have shed light on factors known to influence exchange rate movements (e.g., world prices for commodities, relative inflation rates, relative interest rates, productivity differences between countries, and short-term capital flows).[2] In isolation, these factors have a predictable effect on currency values.

However, because many economic variables are closely interconnected, they rarely, if ever, act separately from one another. This makes anticipating or explaining movements in short-term exchange rates notoriously difficult, a problem exacerbated by the fact that many factors known to affect currency values are evident only in hindsight. Furthermore, these factors are often themselves affected by movements in exchange rates. In other words, while the Canadian dollar responds to prevailing economic conditions, it influences those conditions as well.[3]

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1 Canada also operated under a flexible exchange rate system from 1950 to 1962; it was the only major industrial country to do so during this period.

2 Bank of Canada, Backgrounders, *The Exchange Rate*, http://www.bankofcanada.ca/wp-content/uploads/2010/11/exchange_rate.pdf.

3 Michael Holden, *Explaining the Rise in the Canadian Dollar*, Publication no. 03-26E, Parliamentary Information and Research Service, Library of Parliament, Ottawa, 22 November 2007, p. 3, http://www.parl.gc.ca/Content/LOP/ResearchPublications/prb0326-e.pdf.

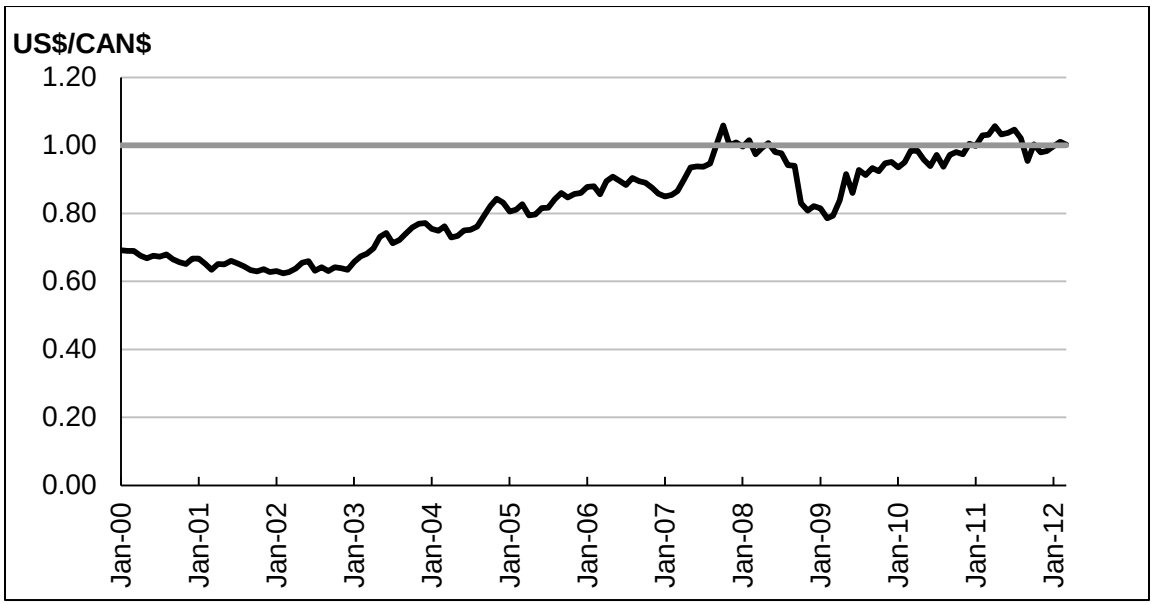
Move to Parity

From February 2002 to October 2007, the value of the Canadian dollar rose from a record low of US$0.62 to US$1.06 as a result of rising commodity prices and surging demand for Canadian exports.

Responding to the financial crisis of 2008, international investors sold some of their assets denominated in Canadian dollars and other major currencies to buy U.S. assets, mainly dollars and government bonds, considered the safest assets during crises because of the status of the dollar as the world's reserve currency. Consequently, the Canadian dollar fell from US$1.01 in May 2008 to US$0.79 in March 2009.

However, this downward trend was reversed in late 2009 because of rising commodity prices caused by strong economic growth in emerging countries, strong demand for Canadian exports and higher demand for Canadian assets by international investors, given Canada's sound fiscal position and the resilience and stability of the Canadian financial system during the financial crisis. All these factors pushed up the Canadian dollar, from US$0.79 in March 2009 to US$1.01 in December 2010. The Canadian dollar remained at or near parity since then.

Figure 1 - Exchange Rate between the Canadian Dollar and the U.S. Dollar, January 2000 to March 2012



Source: Figure prepared by the Parliamentary Information and Research Service of the Library of Parliament using data from Statistics Canada, CANSIM, Table 176-0064.

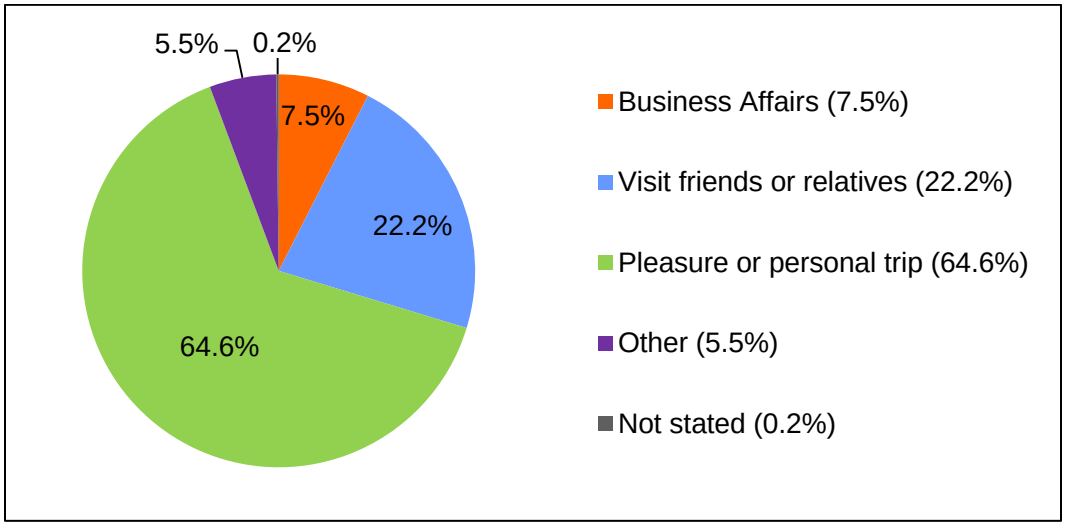
Cross-Border Shopping and the Exchange Rate

In 2011, an average of 3.4 million Canadian travelers crossed the border into the United States by automobile each month, including 2.4 million Canadian travelers (69.7% of all Canadian travellers) who made same-day trips.[4]

Despite the United States population being about ten times the size of Canada's population, the monthly average number of American travelers to Canada by automobile was only 1.1 million in 2011.

According to the authors of a recent university study titled *Consumer Arbitrage Across a Porous Border*, most Canadians travel to the United States by automobile for pleasure or personal reasons, which includes shopping trips.[5] As shown in Figure 2, 64.6% of Canadian travelers cross the border for pleasure or personal reasons, 22.2% to visit friends or relatives, 7.5% for business affairs, 5.5% for other reasons.

Figure 2 – Reasons for Crossing the Border, 24-Hour Trip, 1990-2010



Source: Ambarish Chandra, Keith Head, Mariano Tappata, *Consumer Arbitrage Across a Porous Border*, December 2011, p. 4, http://strategy.sauder.ubc.ca/head/papers/crossings.pdf.

[4] Statistics Canada, CANSIM, Table 427-0005.

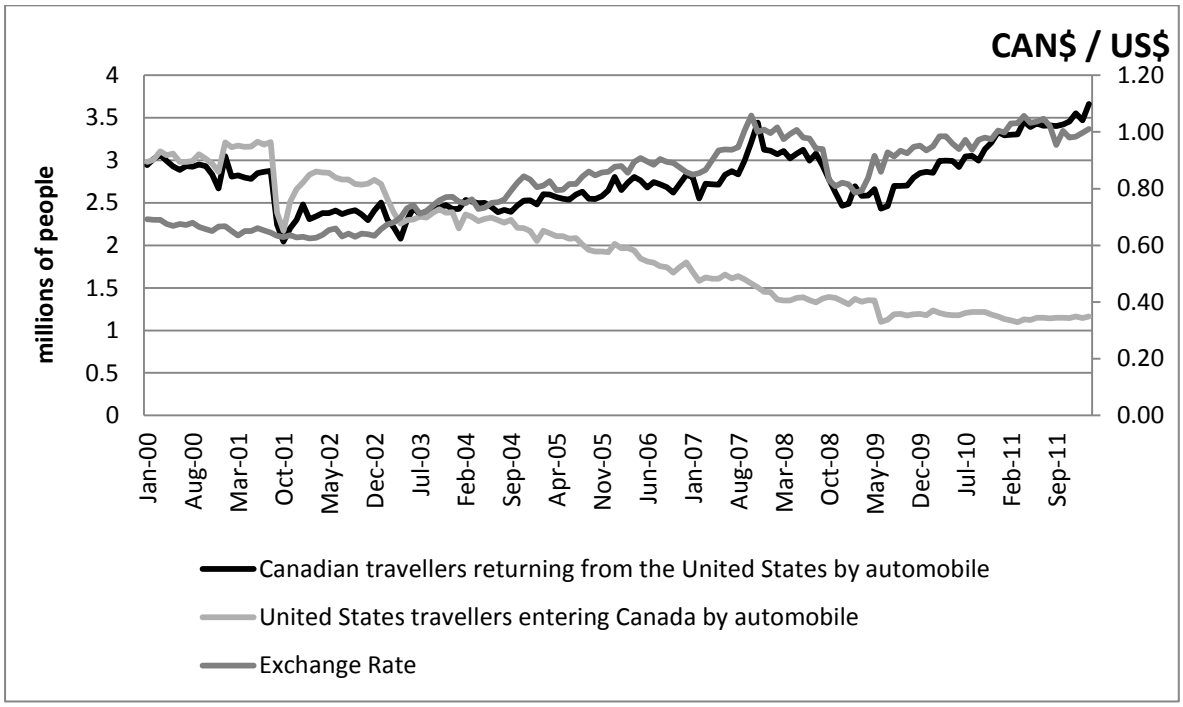
[5] Ambarish Chandra, Keith Head, Mariano Tappata, *Consumer Arbitrage Across a Porous Border,* December 2011, p. 4, http://strategy.saunder.ubc.ca/head/papers/crossings/pdf.

Because Canadian travellers who go to the United States by automobile for pleasure or personal reasons are potentially the most likely to respond to the movements in the exchange rate and because they represent the majority of all Canadian travellers, the total number of Canadians travelling to the United States by automobile should fluctuate with the movements of the exchange rate.

Figure 3 confirms this. For example, when the exchange rate increased by 58.7% from US$0.63 in January 2002 to US$1.00 in January 2011, the monthly number of Canadian travellers returning from the United States by automobile increased by 32.8%, from 2.5 million to 3.3 million. During the same period, the monthly number of American travellers returning to the United States from Canada by automobile decreased by 58.6%, from 2.7 million to 1.1 million.

Interestingly, the monthly number of American travellers returning from Canada by automobile was higher than the monthly number of Canadian travellers returning from the United States during the January 2000-to-May 2003 period, when the exchange rate between the Canadian dollar and the U.S. dollar was below US$0.74. When the value of the Canadian dollar reached a trough of US$0.63 in March 2002, the number of American travellers exceeded the number of Canadian travellers by more than 525,000 people per month.

Figure 3 – Cross-Border Shopping and the Exchange Rate, Monthly Number of Canadian Travellers and American Travellers by Automobile, January 2000 to February 2012



Source: Figure prepared by the Parliamentary Information and Research Service of the Library of Parliament using data from Statistics Canada, CANSIM, Table 427-0005 and Table 176-0064.

Canadian travellers returning from the United States may bring back goods and they may also return with a sense of the relative prices of goods sold on both sides of the border. But observations on prices may be misleading, as actual transaction prices are needed to make useful shopping comparisons. A Canadian who buys a product in the United States may remember the list price of that product in Canada, but this recollected price may ignore possible discounts or sale prices available in Canada.

Moreover, what appears to be the same product offered for sale in Canada and the United States might not be the same. Professor Tony Hernandez, Director of the Centre for the Study of Commercial Activity (CSCA), Eaton Chair in Retailing, Ryerson University, offered the Committee anecdotal evidence that 80% of the products in factory outlets were manufactured specifically for those stores. This makes price comparisons difficult, as two brand-name shirts, for example, may be made of different quality cotton and are, in effect, different goods.

In addition to actual trips to the United States, Canadians can now make virtual trips to the United States and other countries via the Internet. Canadians use the Internet to shop and to window-shop. In 2010, according to a survey by Statistics Canada, more than half of Canadian Internet users shopped online, placing 114 million orders valued at $15.3 billion.[6]

The e-retailers from whom the Canadian online shoppers purchase goods represent a competitive threat – and a growing one – to traditional Canadian retailers. This report does not attempt a full analysis of the cross-border online shopping. Online shopping is mentioned later on in sections dealing with the *de minimus* threshold for postal shipments and with books.

CHAPTER THREE: REASONS FOR THE PRICE DISCREPANCIES

Country Pricing and Market Segmentation

Four witnesses told the Committee that the segmentation of the Canadian and the American markets could allow some manufacturers to practice **country pricing** — that is, to maximize profits by selling their products at different prices in the two markets.

The segmentation of the Canadian and American markets refers to the different commercial practices, government regulations and all other factors that prevent Canadians and Americans from

[6] Statistics Canada, Individual Internet use and E-commerce, 2010, The Daily, 12 October 2011, http://www.statcan.gc.ca/daily-quotidien/111012/dq111012a-eng.htm.

eliminating price differences by purchasing goods that are cheaper in a country to sell them in the other country until the prices for goods in both countries converge.

Ambarish Chandra, Professor, University of Toronto, Rotman School of Management, explained how the segmentation of the Canadian and American markets allows manufacturers to price identical goods differently in the two markets:

> *For example, Transport Canada has regulations over and above what U.S. specifications of cars are. Also, and this is something that is just coming out of our research, U.S. manufacturers are not transferring warranties any longer for Canadians who buy cars in the U.S. and bring them back. I am not surprised because they like to see this situation of segmented markets. They like to be able to price products differently in different markets. All the theories suggest that is exactly what is profit maximizing for them. Cars are problematic because we have this issue of warranties, and if firms want to segment the market, they can do so. It is hard for government or public policy to change that.*[7]
>
> Ambarish Chandra, Professor, University of Toronto,
> Rotman School of Management, as an individual

Regarding **country pricing**, a representative from the Retail Council of Canada explained to the Committee that some manufacturers charge Canadian retailers 10% to 50% more than U.S. retailers for identical products. According to the Retail Council of Canada, its members were told by manufacturers that there are three main reasons for these discrepancies: 1) Canadians are used to paying more for products in Canada; 2) the higher prices charged to retailers in Canada subsidize the costs of maintaining suppliers offices and operations in Canada; and 3) the higher prices are necessary to compensate Canadian distributors and wholesalers, which face higher costs in Canada.

The Retail Council of Canada then added that not all manufacturers charge more to Canadian retailers than U.S. retailers for identical products, but the manufacturers that carry recognized brands and thus have significant market power for their brands:

> *If I am a sporting goods retailer in this country and I do not carry Reebok or Nike, chances are that I will not have too much retail traffic in my store. God bless those manufacturers because they have built that brand recognition. That explains why*

[7] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/07issue.pdf, p. 7:36.

they also sometimes have the ability to tell a Canadian retailer or a subsidiary of a North American retailer how much they will sell a product for if the retailer wants it in their store.[8]

Diane J. Brisebois, President and Chief Executive Officer,
Retail Council of Canada

One observation that can be drawn from this testimony is the importance of recognized brands on a manufacturer's pricing. If some consumers want a particular brand of a product, they increase the ability of the manufacturer of that brand to price its product differently in Canada and the United States, based on the demand.

The Retail Council of Canada presented a list of 15 identical consumer products that shows what Canadian retailers must pay their suppliers compared with U.S. retailers. As shown in Table 1, retailers pay anywhere between 11% more than U.S. retailers for an electric toothbrush to as much as 114% more for products such as a pack of low-dose Aspirin.

Given the discrepancies between the prices paid by Canadian and U.S. retailers for identical products, the Retail Council of Canada argued that it was unfair to blame retailers for not adjusting their retail prices to account for the higher Canadian dollar. According to the Retail Council of Canada, the majority of products purchased by Canadian retailers are bought in Canadian dollars through Canadian distributors, wholesalers and headquarters of multinational companies in Canada. Consequently, the retail prices can adjust to the appreciation of the Canadian dollar only if the manufacturers, the wholesalers and the distributors change the price they charge to retailers.

[8] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/16issue.pdf, p. 16:11.

Table 1 – Price paid by the Canadian and U.S. retailers for 15 identical consumer products

Item Description	Price paid by U.S. Retailers	Price paid by Canadian Retailers	Difference
Soap – 16 pk	$6.99	$8.98	28%
Shampoo – 1.5L	$9.33	$12.46	34%
Conditioner – 1.18L	$6.23	$10.00	61%
Automobile Tires	$128.21	$169.69	32%
46in LED TV	$888.75	$1,001.00	13%
Printer	$116.65	$171.99	47%
Water Filters – 6 pk	$22.77	$26.76	18%
Coffee Maker	$127.76	$167.19	31%
Electric Toothbrush	$91.29	$100.99	11%
Ibuprophen 200mg – 250ct	$10.76	$18.29	70%
Aspirin 81mg low dose – 350ct	$10.16	$21.78	114%
Ketchup – 2.5 L	$3.92	$6.90	76%
Freezer bags– 150 pk	$6.10	$9.24	51%
Laundry Detergent – 5L	$11.27	$13.94	24%
Orange Juice – 7.56L	$10.01	$12.66	26%

Source: Submission provided by the Retail Council of Canada on April 24, 2012.

An official from Department of Finance suggested that the fact that Canadian consumers tend to consume more differentiated goods – goods that have some unique qualities, perceived or real, that distinguish them from competing goods – could increase the market power that some manufacturers have for their goods and allow them to exercise some price discrimination between the Canadian and the American markets:

> *With respect to the first question, namely, why exchange rate changes sometimes do not show up in import prices, there are a number of possible explanations. One is the argument that as our economy and other advanced economies have matured and we have become wealthier, we consume more and more goods that are differentiated as opposed to basic commodities. The significance of this fact is that with differentiated goods, the manufacturer of those goods may be able to exercise some degree of*

market power in terms of pricing the same good in different markets, in effect, exercising some degree of price discrimination.[9]

Patrick Halley, Chief Tariffs and Market Access,
International Trade Policy Division, International Trade & Finance

Mark J. Carney, Governor, Bank of Canada, added that the segmentation across the Canadian and American markets could allow businesses to lower their prices in the United States, where the consumers' demand for goods is weaker than in Canada, and to keep their Canadian prices higher:

First, cyclical issues may be responsible for some of the differences between Canada and U.S. prices. Unexpected economic weakness in one country, in this case the U.S., could lead to an undesirable build-up of inventories and result in local discounting of prices. In addition, as long as markets are partially segmented across international borders, market power may enable firms to respond to local demand conditions, possibly resulting in lower prices in areas with weaker demand.[10]

Mark J. Carney, Governor, Bank of Canada

The testimony heard by the Committee suggests that the segmentation of the Canadian and U.S. markets reduces competition and allows some manufacturers — even some Canadian ones — to practice **country pricing** between the Canadian and the American markets, which may contribute to the price discrepancies between the two countries.

According to the results of a 1992 Ernst & Young's study titled *Responding to Cross Border Shopping: A Study of the Competitiveness of Distribution Channels in Canada*, manufacturers would be responsible for about 37% of price discrepancies for goods between Canada and the United States compared with 9% for retailers.[11]

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9 http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/05issue.pdf, p. 5:55.

10 http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/07issue.pdf, p. 7:48.

11 Ernst & Young, Responding to Cross Border Shopping, A Study of the Competitiveness of Distribution Channels in Canada, The Task Force on Cross-Border Shopping, March, 1992, p. 1-6.

Relative Size of the Canadian Market

Many witnesses told the Committee that Canada's small size relative to the United States explained some of the price discrepancies.

Mr. Carney, Governor, Bank of Canada, said that Canadian importers may pay a higher price than American importers because of the smaller volume of goods they purchase from foreign manufacturers. He also noted that American businesses may have higher potential for economies of scale than Canadian businesses, which may reduce their costs and allow them to sell their goods at lower prices than Canadian businesses can.[12]

Ken Wong, Professor, Queen's University, explained the impact of Canada's smaller size relative to the United Sates on prices discrepancies:

> *..., with size comes certain advantages and cost efficiencies but also comes enormous buying power. It is like the difference between me walking into a car dealership and asking how much for a particular car, and then asking how much it would be if I bought six. Clearly I would expect a better price if I was buying six. Big U.S. retailers will get better prices than even big Canadian retailers and, as a consequence, they will reflect those buying advantages in having lower prices.*[13]
>
> Ken Wong, Professor, Queen's University, as an individual

Other witnesses told the Committee that foreign manufacturers might not sell their goods at the same price to Canadian and American importers. For example, Ian Gordon, President, Convergence Management Consultants Ltd., argued that some foreign manufacturers sell their goods at a lower price in the United States than in Canada because they see the U.S. market as strategically important because of its enormous size:

> *My exposure to manufacturers is they view the United States market as a market in which they must succeed to succeed globally. They have to do whatever is necessary to succeed in the U.S. Sometimes we here in Canada characterize that as the 10-to-1 rule and feel diminished by our relatively smaller scale. For the most part, I believe it is a function of the fact that to succeed globally you have to win in America, particularly for many of the well-known brands we are considering. When*

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12 http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/07issue.pdf, p. 7.49.

13 http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/06issue.pdf, p. 6.42.

there are price discrepancies in Canada, it is a function of the fact that Canada, for the most part, does not matter to them as much.[14]

Ian Gordon, President, Convergence Management Consultants Ltd., as an individual

A representative from Option Consommateurs who appeared before the Committee questioned the validity of the economies of scale argument comparing Montreal to Plattsburgh:

The parity of the dollar has been there for at least a year or two. What about Plattsburgh and Detroit? Plattsburgh has 20,000 people. Many people near the border in Montreal go there because it is much cheaper, and, as a matter of fact, in Montreal, there are 2 million people. How can a city with such a little market have prices that are so much cheaper, whereas prices are higher in a huge urban area like Montreal?[15]

Jean-François Vinet, Business Practices and Financial Services File Analyst, Option Consommateurs

Several witnesses suggested that the costs of entering or operating in Canada may be higher than in other countries. In a presentation made available to the Committee, Professor Tom Vassos of the University of Toronto (appearing as an individual) provided a partial list of the costs facing companies entering Canada; the list comprises 20 items, from provincial and federal taxes to the exchange rate. Other witnesses mentioned that real estate prices and minimum wage rates were higher in Canada. Because some of the numerous costs of entering or operating in a country are fixed, the per item costs will be higher in a country, such as Canada, that has a relatively small market.

Overall, the testimonies heard by the Committee suggest that Canada's smaller size relative to the United States may contribute to price discrepancies for two main reasons. First, Canadian businesses that buy smaller volumes of goods may have less bargaining power with foreign manufacturers than American businesses. Second, American businesses, which tend to be bigger than Canadian businesses, may have more potential for economies of scale that can lower their production costs and lead to lower retail prices in the United States.

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14 http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/06issue.pdf, p. 6:13.

15 http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/11issue.pdf, p. 11:62.

Customs Tariffs

Officials from the Department of Finance told the Committee that there are 8,192 tariff categories in Canada, and that each category has 18 tariff treatments. In 2010, 90% of the goods imported into Canada entered duty-free, and of the 10% of goods subject to a tariff, 70% had a tariff rate of zero.

The customs tariffs generated $3.6 billion in 2010-2011, representing 1.5% of the total government budgetary revenues collected that fiscal year. In 2010-2011, about 60% of tariffs revenues were collected on apparel and textile products, autos and auto parts, and footwear.[16]

The officials from the Department of Finance said that, although there are some examples of differences in tariff rates between Canada and the United States that could contribute to price discrepancies for certain products, most tariffs rates are low. They also highlighted the fact that tariffs rates apply only on the landed value price of imported goods, which is often significantly lower than the retail price of goods, which according to them means that differences in tariff rates between Canada and the United States can have only a small impact on the price discrepancies.[17] As shown in Table 2, the most-favoured-nation[18] average Canadian tariff rates can be higher, lower or equal to U.S. tariffs depending on the sector.

[16] Submission provided by the Department of Finance on October 19, 2011.

[17] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/05issue.pdf, 5:56.

[18] The most-favoured-nation tariff rates are the rates that apply to all countries that are not covered by some type of concessionary tariff rates.

Table 2: Canadian and U.S. Simple Most-Favoured-Nation Average Tariff Rates by Sector

Chapters	Sector	Tariff Rates in Canada	Tariff Rates in the U.S.
41-43 & 50-64	Leather, Textiles, Apparel and Footwear	4.9%	6.8%
25-27 & 72-83	Minerals, Metals and Products thereof	0.8%	1.8%
65-71 & 91-97	Miscellaneous Manufactured Goods	4.0%	3.3%
44-49	Forestry and Products thereof	1.0%	1.2%
86-89	Vehicles, Aircraft & Other Transport Equipment	6.7%	1.9%
84-85 & 90	Machinery and Equipment	0.8%	1.5%
28-40	Chemicals, Plastics, Rubber	2.3%	2.3%

Source: Submission provided by the Department of Finance on October 19, 2011.

Almost all the other witnesses who appeared before the Committee disagreed with the opinion expressed by the officials from the Department of Finance according to which tariff differences between Canada and the United States are not a major factor contributing to prices discrepancies between the two countries.

The representative from the Retail Council of Canada argued that although only 10% of all products imported into Canada carry tariffs, the percentage of products sold by Canadian retailers that are subject to tariffs is much higher and represents between 10 and 100% of the products sold by individual retailers. This is why the customs tariffs generated $3.6 billion in 2010-2011.

The Retail Council of Canada also explained that it is misleading to compare the average tariff rates for different sectors between Canada and the United States and to conclude that these small differences in the average tariff rates do not contribute to price discrepancies between the two countries. According to the Retail Council of Canada, the spikes in duty rates for certain products can contribute significantly to the price discrepancies for some products.

As shown in Table 3, the differences in tariff rates between Canada and United States for some hockey-related products vary between 5% for helmet facial protection to as high as 15.1% for ice hockey pants.

Table 3 – Tariffs Rates in Canada and in the United States for Different Hockey-Related Products

Products	Tariff Rates in Canada	Tariffs Rates in the United States
Ice Hockey Pants	18.0%	2.9%
UP/Pant	15.5%	0.0%
Gloves	16.5%	0.0%
Hockey Helmet TH	5.0%	0.0%
Hockey Helmet CN	8.5%	0.0%
Helmet Facial Protection TH	5.0%	0.0%
Helmet Facial Protection CN	7.5%	0.0%

Source: Submission provided by the Retail Council of Canada on April 24, 2012.

The Retail Council of Canada also highlighted the fact that other mainstream consumer products are subject to high tariff rates for no reason other than the fact that they have never been challenged by free trade negotiations. Examples of such consumer products include cotton T-shirts and cotton trousers and shorts, sports footwear, bed linen and ice skates, which carry an 18% tariff in Canada.[19]

Canadian Tire Corporation Limited sent the Committee a submission which presents the results of their internal study on the impact of tariffs on a sample of 15,697 imported products in 2011. According to Canadian Tire Corporation Limited, 78% of the dutiable products imported in

[19] Submission provided by the Retail Council of Canada on April 24, 2012.

2011 had a higher tariff rate in Canada than in the United States, 3% had the same tariff rate in both countries and 19% had a lower tariff in Canada than in the United States. Of the 12,271 imported products that had lower tariff rates in the United States, 3,231 had tariffs rates that were between 5% and 18% lower while 9,040 products resulted in a difference ranging from 0.1% to 4.9%.

Overall, Canadian Tire Corporation Limited paid $8.4 million in higher customs tariffs in 2011, which increases the prices for Canadian consumers. These results suggest that Canadian retailers and consumers are disadvantaged by the high tariff rates imposed on consumer products in Canada.

Canadian Tire Corporation Limited suggested that the government of Canada consider reducing Canadian tariffs for the imported consumer products that are not produced by domestic manufacturers because these tariffs hurt the Canadian economy by raising prices and encouraging Canadian consumers to shop in the United States.

Assessing the impact of tariffs on the price paid by consumers

Regarding the impact of customs tariffs on retail prices, a representative from Reebok-CCM Hockey said that high tariffs on some products in Canada increase the retail prices to Canadian consumers by more than the value of the tariffs because the wholesalers and the retailers also apply their respective gross margin on the cost of the imported product including the tariff.

For example, a 15% tariff on a $100 product generates $15 in government revenues, but it increases the price to consumers by $27.30 after the 40% gross margin of the wholesaler and the 30% gross margin of the retailer are applied. In this example, the tariff after the gross margins of the wholesaler and the retailer accounts for 75.8% of the retail price discrepancy between Canada and the United States.[20] The remaining price discrepancy is explained by other factors such as the difference in the demand for the product and differences in the cost of doing business between the two countries.

Although the numbers used in this example might not apply to all products, two interesting observations can be made on the impact of tariffs on retail prices. First, because wholesalers and retailers apply their respective gross margin above the tariff, a tariff generally increases the retail price of a product by more than the value of the tariff collected by the federal government. Second, wholesalers and retailers both benefit from applying their gross margin on the tariff rate.

[20] Submission provided by Reebok-CCM Hockey on April 24, 2012.

In response to questions from senators regarding the identity of the wholesaler, a representative from Reebok-CCM Hockey answered that his organization was both the manufacturer and the wholesaler of its products. Through its hearings, the Committee noticed that it is common for the manufacturer to also act as the wholesaler for its product.

The representatives from the Canadian apparel industry and a representative from Deloitte & Touche LLP told the committee that differences in the method used in Canada and in the United States to determine the value of a product on which a tariff is applied could generate retail price discrepancies between the two countries even when tariff rates are the same.

For example, when a product is imported into the United States through a series of sales among multiple parties, the value of the product on which a tariff is applied can be based on the price of the first sale between the foreign manufacturer and a foreign middleman provided that the U.S. importer can establish that this was an arm's length sale and that at the time of the sale the product was clearly destined for export to the United States.[21] Canada's product valuation method for customs tariffs differs from the U.S. method in that the value of the imported product on which a Canadian tariff is applied is equal to the price paid by the Canadian importer rather than the first sale price between the foreign manufacturer and a foreign middleman.

Given that the price paid by the Canadian importer is higher than the price paid on the first sale between the foreign manufacturer and the foreign wholesaler, which acts as a middleman for the Canadian importer, the revenues collected by a given tariff rate in Canada are higher than those collected by the same tariff rate in the U.S.

Additionally, representatives from the Canadian apparel industry told the Committee that the retail prices paid by Canadian consumers for clothes manufactured in Canada would jump if the federal government did not extend the duty remission program for Canadian clothing manufacturers, which is scheduled to end in 2012. The program was established in the 1980s to help domestic clothing manufacturers.

The majority of witnesses are calling for a comprehensive review of customs tariffs

Representatives from the Retail Council of Canada, the Canadian apparel industry, the Canadian Federation of Independent Business, the Canadian Association of Importers and Exporters, the academic sector, Reebok-CCM Hockey, Canadian Tire Corporation Limited and

[21] http://www.iecanada.com/ienow/2008/08_vol.119.18.pdf, p. 4.

Deloitte & Touche LLP who appeared before the Committee all suggested that the federal government consider lower tariffs on finished products where there are clear benefits to consumers such as lower prices and minimal negative impact on domestic manufacturers. A representative from Deloitte & Touche explained the rationale for a comprehensive review of Canadian customs tariffs:

> *The tariff rates in Canada are antiquated, and the Canadian manufacturing landscape has changed significantly since the last major overhaul of the tariff in 1998 with the Tariff Simplification initiative. While there have been sweeping revisions to the tariff rates over the past couple of years, these have been focused entirely on the manufacturing industry, i.e., machinery and equipment, raw materials, et cetera. We are not aware of any comprehensive review recently undertaken to consider the benefits to Canadians of reductions in the tariff rate on consumer or retail goods.*[22]

Lisa Zajko, Senior Manager, Indirect Tax,
Deloitte & Touche LLP

The president of a Canadian apparel company questioned who the Canadian tariffs on apparel were protecting given that almost all domestic apparel producers moved production overseas over the past few decades to remain competitive:

> *The theory of protecting the domestic manufacturer is a theory, because the domestic manufacturer has had to adapt, change, and do things differently in order to continue to exist.*[23]

Robert Silver, President, Western Glove Works,
as an individual

Regarding the impact of tariff reductions on retail prices, a representative from the Association of International Automobile Manufacturers of Canada admitted to the Committee that if the federal government reduced tariffs on certain products, some businesses that operate in less competitive markets might increase their profits rather than pass along the tariff reductions to Canadian consumers:

> *I think it is a possibility, at least, that a company will say, "Look, this tariff reduction has been passed along; I have choices. I can pass this along to the consumer, or I*

[22] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/16issue.pdf, p. 16:27.

[23] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/13issue.pdf, p.13:14.

can keep some of it." To the extent that they want to be highly competitive in the marketplace, a company may choose to pass it all on. To the extent that there are other things driving their motivation, that may not be the case. That is all I can answer to that question.[24]

David C. Adams, President,
Association of International Automobile Manufacturers of Canada

The testimony suggests that differences in tariff rates for certain products between Canada and United States contribute to the price discrepancies and that the federal government could eliminate a part of these price discrepancies by further harmonizing Canadian and U.S. tariffs.

Given the possibility that some businesses might not pass along all the savings associated with the tariff reductions to Canadian consumers, the Committee believes that the federal government should focus its tariff harmonization efforts only on the products for which a tariff reduction is more likely to be passed along to Canadian consumers.

Recommendation 1:

The Committee recommends that the Minister of Finance conduct a comprehensive review of Canadian tariffs, keeping in mind the impact on domestic manufacturing, with the objective of reducing the price discrepancies for certain products between Canada and the United States.

Volatility of the Exchange Rate

We are living currently in unprecedented economic times. Swings of 1 or 2 per cent of the value of the currency within just one day are not uncommon, but this was unheard of in the past. Within this environment firms face a lot of uncertainty, both in terms of future exchange rates as well as in their more general economic outlook.[25]

Ambarish Chandra, Professor, University of Toronto,
Rotman School of Management, as an individual

[24] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/16issue.pdf, p. 16:52.

[25] http://www.parl.gc.ca/content/sen/committee/411/NFFN/pdf/07issue.pdf, p. 7:31.

Some witnesses told the Committee that the Canadian dollar's appreciation relative to the U.S. dollar was accompanied by higher volatility. The volatility of the Canadian dollar refers to the size and the frequency of changes in its value relative to the U.S. dollar.

One of the most common statistical measures of volatility is the coefficient of variation (CV)[26], a measure of dispersion of the value of a variable around its mean.[27] The higher the coefficient of variation of a variable, the greater is the dispersion of the variable around its mean and hence the greater its volatility.

To verify whether the volatility of the exchange rate between Canada and the United States had increased in recent years, the Committee calculated the annual coefficient of variation of the daily exchange rate between the Canadian and U.S. dollars between 1990 and 2011.

As shown in figure 4, the volatility in the exchange rate between the two currencies increased from a coefficient of variation of 1.2% in 1990 to a peak of 7.6% during the 2008-2009 financial crisis, and decreased to 1.3% in 2011. These statistics suggest that the volatility of the exchange rate was unusually high during the 2007-to-2009 period compared with the levels experienced in the 1990s.

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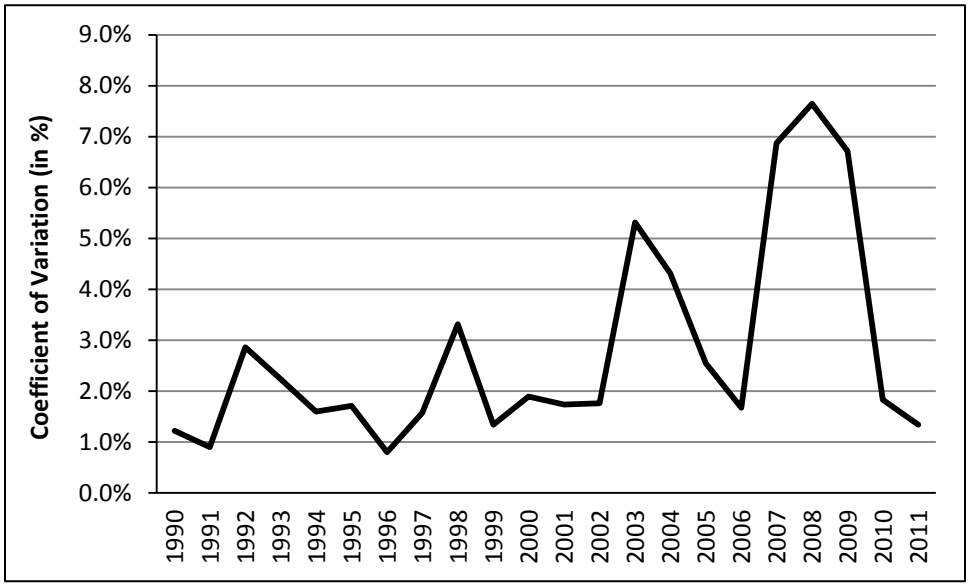
[26] The coefficient of variation provides a way to compare the dispersion of variables around their means. The coefficient of variation is the ratio of the standard deviation to the mean.

[27] Bank of Canada, *Evaluating Measures of Core Inflation,* p. 26, http://www.bankofcanada.ca/wp-content/uploads/2010/06/lafleche.pdf.

Figure 4 – Volatility in the Exchange Rate between the Canadian Dollar and the U.S. Dollar, 1990-2011



Source: Figure prepared by the Parliamentary Information and Research Service of the Library of Parliament using data from Statistics Canada, CANSIM, 176-0067.

Gary Rabbior, President of the Canadian Foundation for Economic Education, attributes the recent increased volatility of the exchange rate between the Canadian and U.S. dollars to the volatility of the world prices for commodities, which are important determinants of the Canadian dollar's value.[28]

The testimonies heard by the Committee suggest that the high volatility of the exchange rate could contribute to price discrepancies for two main reasons.

A Department of Finance representative who appeared before the Committee said that volatility may contribute to price discrepancies for goods because of the costs associated with changing prices:

> *If we have very volatile exchange rate movements, people may say, "I will not change prices because changing prices will incur a so-called mark-up cost." There is a physical process of changing prices and that act has costs. If you think an exchange rate movement is temporary, you may not change the price.*[29]

[28] The Globe and Mail, *Why the Canadian dollar has been bouncing higher,* November 2009, http://m.theglobeandmail.com/globe-investor/investor-education/why-the-canadian-dollar-has-been-bouncing-higher/article1343674/?service=mobile.

[29] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/05issue.pdf, p. 5.56.

Jim Haley, General Director, Economic and Fiscal Policy Branch,
Department of Finance

The representative from the Canadian Federation of Independent Businesses who appeared before the Committee mentioned that volatility could contribute to price discrepancies through a risk premium built into prices of imported products:

> *Another crucial factor is volatility. Exchange levels are not the villain when we are talking to our members. It is the inability for them to safely predict where they will be six months into the future. There is almost a risk premium built into prices on products that are imported.*[30]

Ted Mallett, Vice-President and Chief Economist,
Canadian Federation of Independent Business

For his part, Douglas Porter, Deputy Chief Economist, BMO Capital Markets, argued that the volatility of the exchange rate was the most important factor contributing to price discrepancies between the two countries:

> *The biggest factor causing the relatively wide price differential is the rapid and volatile moves in the exchange rate in recent years. Underlying prices simply cannot be expected to fluctuate nearly as rapidly as movements in the exchange rate, which have been unprecedented in recent years. For example, in one 24-hour period in October 2008, the Canadian dollar saw a bigger move (7%) than it witnessed in an entire four-year stretch in the mid 1990s.*[31]

Douglas Porter, Deputy Chief Economist,
BMO Capital Markets

Given the high volatility of the exchange rate between the Canadian and U.S. dollars, businesses that sell goods in Canada face a lot of uncertainty about the future value of the Canadian dollar. Consequently, they could find it impractical to change their prices to reflect all exchange rate movements because of the costs associated as well as the risk of losing money on the imported goods they sell in Canada.

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30 http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/11issue.pdf, p. 11:78.

31 Letter sent by Mr. Porter to the committee on November 2, 2011.

To the extent that the high exchange rate volatility between the two currencies experienced during the 2007-to-2009 period may have made it harder for Canadian businesses to price their products in an economic environment in which they could not accurately predict the future value of the Canadian dollar, it is possible that the volatility of the exchange rate contributed to the price discrepancies for goods during that period.

But the price discrepancies for goods caused by the high exchange rate volatility during the 2007-to-2009 period should narrow over time if the volatility remains around the low level seen in 2011, which was similar to the one experienced in the 1990s.

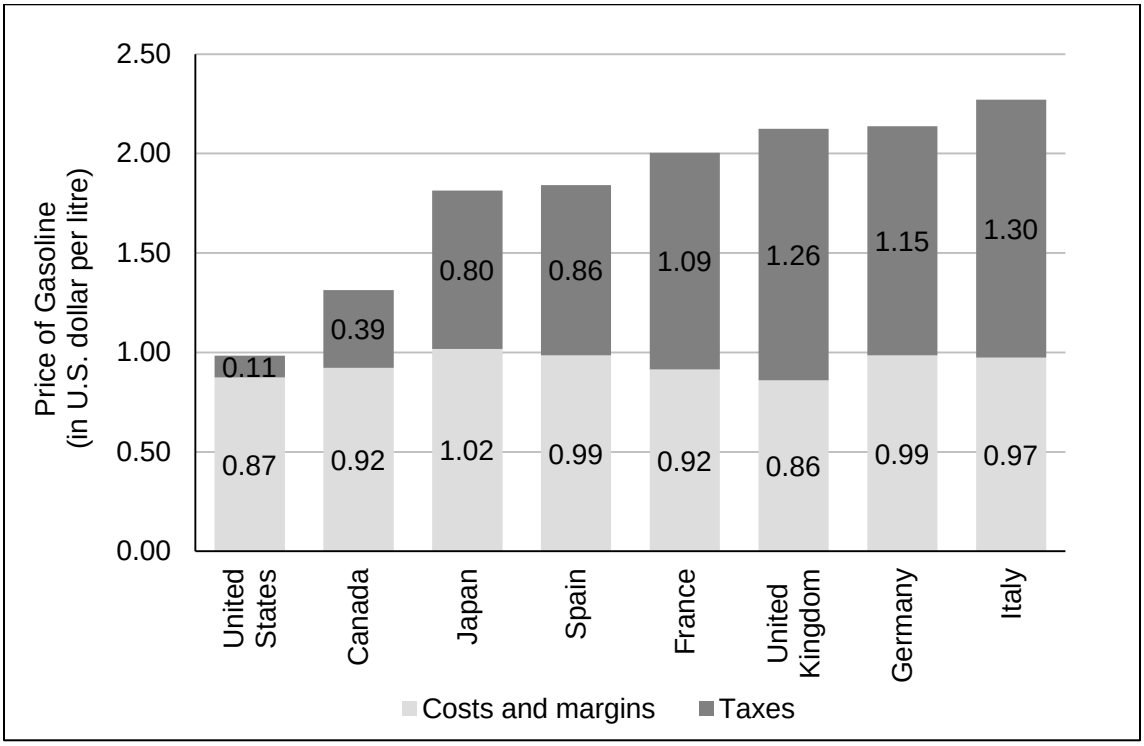
Price Discrepancy in Fuel Costs for the Transportation Sector

Some witnesses blamed higher fuel costs in Canada for price discrepancies between the two countries.

As shown in Figure 5, the average price of a litre of gasoline was US$1.31 in Canada in August 2012 compared with US$0.98 in the United States, a 33.7% difference. Most of this difference is due to the higher gasoline taxes in Canada – the federal excise tax, the goods and services tax (GST) or the harmonized sales tax (HST), the provincial fuel taxes, and the municipal transportation taxes – US$0.39 per litre in Canada in August 2012 compared with US$0.11 in the United States.

While Canadians pay substantially more for gasoline than Americans, gasoline is significantly cheaper in Canada than in Japan, Spain, France, the United Kingdom, Germany and Italy.

Figure 5 – International Gasoline Price, in U.S. dollars per Litre, August 2012

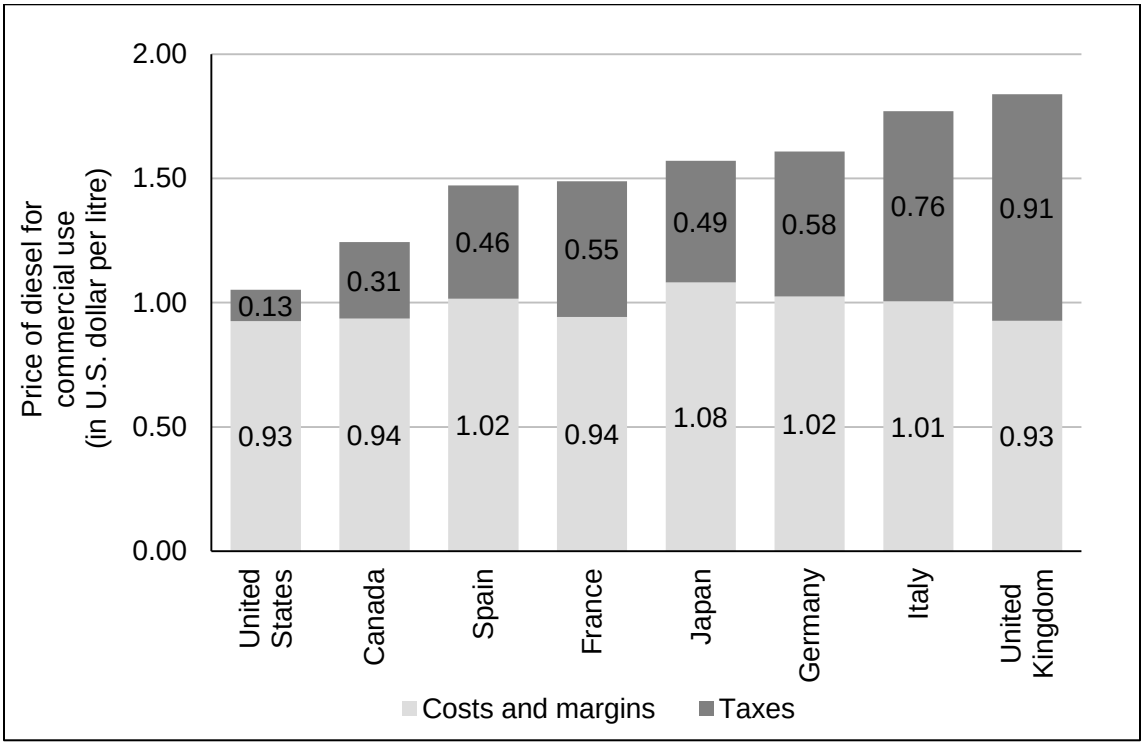


Source: Figure prepared by the Parliamentary Information and Research Service of the Library of Parliament using data from the International Energy Agency, p. 3-4, http://www.iea.org/stats/surveys/mps.pdf.

Most witnesses who appeared before the Committee spoke of the difference in the price of gasoline between Canada and the United States. However, it is important to note that the majority of trucking companies that deliver goods across Canada rely on diesel fuel. Thus, the differences in the price of diesel should have a bigger impact on price discrepancies for goods between the two countries than the price of gasoline.

As presented in Figure 6, the average price of a litre of diesel was US$1.24 in Canada in August 2012 compared with US$1.05 in the United States, an 18.1% difference. Most of this difference is due to the higher taxes on diesel in Canada — US$0.31 per litre in Canada in August 2012 compared with US$0.13 in the United States.

Figure 6 – International Price of Diesel[32], in U.S. dollars per Litre, August 2012



Source: Figure prepared by the Parliamentary Information and Research Service of the Library of Parliament using data from the International Energy Agency, p. 3-4, http://www.iea.org/stats/surveys/mps.pdf.

Mark J. Carney, Governor, Bank of Canada, explained how the higher fuel price in Canada increased the transportation costs per item in Canada relative to the United States:

> *Transportation is another factor on the cost side. While fuel costs are only a portion of total transportation costs, the difference in gasoline taxes between the two countries makes gas more expensive in Canada. Lower population density in Canada may also contribute to higher transportation costs on a per-item basis.*[33]
>
> Mark J. Carney, Governor, Bank of Canada

A representative from the Retail Council of Canada argued that the higher Canadian gasoline price relative to the United States exacerbated the already large difference in the transportation costs between the two countries:

[32] The value added taxes are excluded from prices for automotive diesel when refunded to businesses. For example, in Canada, businesses and unincorporated businesses are allowed to claim full input tax credits for the Goods and Services Tax (GST) paid on inputs used in making taxable supplies (e.g., GST paid on diesel).

[33] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/07issue.pdf, p. 7:49.

We are a large country, and when you are shipping to the next market, you are not shipping 60 miles away but usually 600 miles away, and there are costs associated with that, the cost of gasoline being one.[34]

Diane J. Brisebois, President and Chief Executive Officer,
Retail Council of Canada

This testimony suggests that higher Canadian taxes on diesel and, to a lesser extent, gasoline partly contribute to the price discrepancies for goods between the two countries by increasing transportation costs in Canada.

Product Safety Standards

Most people recognize that tariffs can affect the movement of goods between countries and the prices of traded goods. Non-tariff barriers can also affect trade and prices. These barriers may be unintentional in that they were not put in place to raise revenue or protect a domestic industry. Different safety standards provide an example of a potential – and unintentional – non-tariff barrier. The next sections examine safety standards for apparel and automobiles.

Representatives from the Canadian apparel industry told the Committee that small differences in apparel safety standards between Canada and the United States increased the price for Canadian consumers while offering little or no additional benefit.

A representative from the Canadian Apparel Federation gave an example:

Flammability — how quickly a garment burns — is subject to regulation. You do not want something that will burst into flame if you are near an open fire, for example. There is no disagreement that that is a bad thing, but, in reality, we have the same performance or the same specification. Yet, the testing for that is different in Canada than in the United States.[35]

Bob Kirke, Executive Director, Canadian Apparel Federation

Because most apparel businesses produce for the U.S. market, forcing them to do another flammability test to sell their apparel in Canada increases their costs, leading to higher prices for Canadians.

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[34] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/16issue.pdf, p. 16:16.

[35] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/13issue.pdf, p. 13:18.

Mr. Kirke then suggested that the Canada-United States Regulatory Cooperation Council[36], created on February 4, 2011, by Prime Minister Stephen Harper and United States President Barack Obama to better align the two countries' regulatory approaches, should study how to better harmonize their product safety standards.

The Committee agrees with the views expressed by the representative from the Canadian apparel industry about the importance of better integrating safety standards between Canada and the United States to lower the costs for businesses and consumers.

There may be good reasons why safety standards for a particular product differ between Canada and the United States. Where a product is used, under what weather conditions it is used and how a product is expected to be used may lead to different safety standards between the two countries. But there may be cases where different safety standards do not reflect different safety concerns and where the different standards merely lead to increased costs in Canada. The government should be prepared to examine other industries in which Canadian safety standards are different from those in the United States to determine whether there exists a sound rationale for the differences.

Recommendation 2:

The Committee recommends that the Government of Canada, through the Canada-United States Regulatory Cooperation Council, continue to integrate the safety standards between Canada and the United States with the intent to reduce the price discrepancies without compromising the safety needs of the two countries.

The section of this report on automobiles discusses how the differences in vehicle safety standards affects prices — sometimes substantially — between Canada and the United States.

De minimis Threshold for Postal Shipments

The *de minimis* threshold for postal shipments refers to the value of postal shipments that can be imported duty- and tax-free into a country. In most countries, the *de minimis* threshold tries to achieve a balance between the costs of assessing and collecting customs

[36] Canada's Economic Action Plan, *Regulatory Cooperation Council,* http://actionplan.gc.ca/eng/feature.asp?pageId=383.

tariffs and the revenue raised. In Canada, the *de minimis* is $20 under the provisions of the Postal Imports Remission order versus $200 in the United States.[37]

A representative from the Canadian Association of Importers and Exporters who appeared before the Committee argued that Canada's low *de minimis* threshold for postal shipments compared with the United States could contribute to price discrepancies for certain goods. The low *de minimis* threshold increases the costs and the administrative burden that Canadian consumers and businesses face when they import low-value shipments into Canada.[38]

For example, when a Canadian consumer orders a product online worth more than $20 from the United States, he pays applicable duties and taxes in Canada as well as a fee to the courier company or the customs broker who will prepare the paperwork to submit to the Canada Border Services Agency and clear the product through customs. According to the representative from the Canadian Association of Importers and Exporters, the fee charged by most courier companies or the customs brokers is about $25.

Under the current $20 *de minimis* threshold in Canada, a Canadian consumer who buys a $21 product online from the United States, when the Canadian dollar is at parity with the U.S. dollar, pays generally more than twice the U.S. retail price of the purchased product when duties, taxes and the courier or broker fee are included.

Canada's low *de minimis* threshold also increases the cost to Canadian businesses, principally Small and Medium Enterprises (SMEs), which order low-value inputs online from the United States. These higher input costs in Canada relative to the U.S. then increase the price of goods produced by businesses in Canada.

The results of studies by the Asia-Pacific Economic Cooperation and the Organization for Economic Co-operation and Development suggest that increasing the *de minimis* threshold is an effective way to increase competition, reduce overall compliance costs and lower prices to consumers.

In November 2011, the United States, New Zealand, Chinese Taipei, Singapore, Hong Kong, Japan, South Korea, Malaysia, Russia and Brunei Darussalam launched an initiative through the Asia-Pacific Economic Cooperation that seeks to increase the *de*

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37 http://www.cbsa-asfc.gc.ca/import/postal-postale/duty-droits-eng.html.

38 http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/12issue.pdf, p. 12:9.

minimis threshold in their countries to a minimum US$100. According to the APEC, establishing a higher, commercially useful *de minimis* is beneficial because the large volume of low-value shipments incur high processing costs that outweigh the value of tariffs collected. In addition, increasing the *de minimis threshold* reduces overall compliance costs, increases supply chain connectivity, increases competition and stimulates output by SMEs.[39]

In 1997, the OECD published a paper titled *Dismantling the barriers to global electronic commerce,* in which it recommended that its members, including Canada, simplify the arrival of lower-value shipments to increase global competition, lower prices and improve the variety and the quality of goods available to consumers.[40]

In light of the testimony it heard and the information it gathered, the Committee believes that Canada's low *de minimis* threshold compared with the United States may contribute to price discrepancies for some goods by reducing competition, increasing the prices paid for postal shipments by Canadian consumers, and imposing higher overall compliance costs on Canadian businesses, principally SMEs.

Recommendation 3:

The Committee recommends that the Government of Canada analyse the costs and benefits of increasing the *de minimis* threshold for low-value shipments in Canada in order to narrow the price discrepancies for certain goods between Canada and the United States.

[39] Asia-Pacific Economic Cooperation, http://www.apec.org/Press/Features/2012/0103_deminimis.aspx.

[40] Organization for Economic Cooperation and Development, *Dismantling the barriers to global electronic commerce, http://www.oecd.org/document/32/0,3746,en_2649_34223_1814368_1_1_1_1,00.html.*

CHAPTER FOUR: INDUSTRY STUDIES

When the Canadian dollar is at parity with the U.S. dollar, Canadian consumers notice the differences in the prices of books (and magazines) and automobiles in Canada and the United States. These price differences are flashpoints that have consumers wondering why prices differ for what is apparently the same good – and often feeling that pricing in Canada is unfair.

When the Canadian dollar hits parity with its U.S. counterpart – a fact usually trumpeted by the media – a consumer in a bookstore notices price stickers showing markedly different prices in Canadian dollars and U.S. dollars for the same book or magazine. A bestselling book, for example, may show a price of $24.99 in U.S. dollars and a price of $27.99 in Canadian dollars, a difference of 12%; the edition of a U.S. magazine in Canada may show a cover price of $4.99 in U.S. dollars and $5.99 in Canadian dollars, a 20% difference. The $3 difference for a book or $1 difference for a magazine may not be large relative to other consumer expenditures, but it is an extra charge put on Canadians.

The media are also quick to point out the large differences in automobile list prices — in some cases tens of thousands of dollars — on the two sides of the border. Even those who are not buying an automobile get the sense that Canadians are being ripped off. The sense of unfairness is intensified when Canadians discover that they can face a higher list price for automobiles assembled in Canada than American car buyers in distant parts of the United States.

Therefore, the committee studied the pricing of automobiles, books and magazines.

Automobiles

Canadians are understandably angry when the dollar hits parity and they read that the list price of an automobile in Canada is thousands of dollars more than the same car in the United States. This anger jumps up a notch when they discover that a car produced in Canada and sold here has a list price thousands of dollars above the price of the same Canadian-assembled car that is shipped to the United States.

A car buyer in Oshawa could be at a dealership within walking distance of the factory where the Chevrolet Camaro was assembled and face a list price almost $5,000 greater than the list price of the Camaro in Hawaii. The example of the Camaro was brought up at the first meeting this committee held to study price discrepancies for certain products between Canada and the United

States. In June 2012, after the final committee hearing on the study, CBC News put the article, "Canadians pay more than Americans for Canadian-made vehicles," on its website. [41]

The CBC News article looked at over 20 models made by Ford, General Motors, Chrysler, Honda and Toyota in Ontario and found that in the majority of instances "the models cost thousands of dollars more to buy in Ontario than in the United States, including Hawaii." [42]

Table 5 is based on information presented in the CBC News article. The table has added calculations of the differences in terms of dollar amount and percentage between the list prices in Canada and in the United States for the same model vehicle.[43] As footnotes to the data presented in the table in the article show, Canadians also face higher listed charges for freight and pre-delivery inspection (PDI) than do Americans shopping for the same vehicle.

The importance of freight and PDI is highlighted in the CBC News article by using the example of the Toyota RAV4.

> Based on the manufacturer's suggested retail prices, the two-wheel drive Toyota RAV4 would cost $22,650 in Honolulu, with an additional charge for freight and pre-delivery inspection (PDI) of $810.
>
> A resident in Woodstock, Ontario, however, would pay $24,865, plus a freight and PDI charge of $1,465, for the same model, despite the RAV4 being manufactured in Woodstock [Ontario].[44]

If freight and PDI are added to the calculations, the difference in price increases from $2,215 to $2,870 and the percentage difference increases from 9.8% to 12.2%. [45]

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[41] CBC News, "Canadians pay more than Americans for Canadian-made vehicles," 13 June 2012, http://www.cbc.ca/news/canada/ottawa/story/2012/06/12/ottawa-car-price-disparity-border-shopping.html.

[42] *Ibid*. The article included the Buick LaCrosse, which is now made in the United States rather than Oshawa; Table 8 shows data for 23 of the 24 models presented in the CBC News article. In five cases, the list price in Canada was lower than the list price in the United States. In one case (the Ford Edge) the price was $474 higher in Canada, rather than "thousands of dollars more."

[43] The actual differences are between a Canadian dollar list price and a U.S. list price, so an implicit assumption is that the Canadian and U.S. dollar are at parity. This assumption is made in Tables 5, 6 and 8; the tables from DesRosiers Automotive consultants have adjusted the prices for the prevailing exchange rate.

[44] CBC News, "Canadians pay more than Americans for Canadian-made vehicles," 13 June 2012, http://www.cbc.ca/news/canada/ottawa/story/2012/06/12/ottawa-car-price-disparity-border-shopping.html.

[45] The text and footnotes in the CBC News article are slightly different. The footnote to the Toyota RAV4 data in the table gives the freight in Canada as $1,565. Using this figure would raise the dollar difference to $2,970 and the percentage difference to 12.7%. The observation that the listed freight and PDI are higher in Canada than in the United States holds with either freight number for theToyota RAV4.

On the other hand, incentive programs could lower relative prices of a vehicle in Canada and the United States, if incentive programs are more generous here than in the United States. Footnotes to the CBC News article noted that there was a credit of $2,280 "available some places" in Canada for the Chevrolet Camaro and a credit of $2,000 "available some places" in Canada for the Chevrolet Impala. These credits, if not matched by incentive plans in the United States, would lower the differences between prices in Canada and the United States.

The CBC News article quoted a spokeswoman for Ford Canada who noted that the actual prices paid for a vehicle may differ from the list prices. As the spokeswoman said: "Manufacturer's suggested retail prices (MSRPs) in Canada and the U. S. are 'suggested' retail prices. What a customer actually pays for a vehicle is negotiated with the dealer."

Table 5 – Vehicle Price Comparisons, Canada and United States (June 2012)

All Vehicles Made in Canada

Vehicle	List Price (MSRP) in Canada ($ CDN)	List Price (MSRP) in the United States ($ US)	Canadian Location of Vehicle Assembly	Difference ($)	Difference (%)
Acura ZDX	$54,990	$46,120	Alliston, Ontario	$8,870	19.2%
Acura MDX	$52,690	$43,030	Alliston, Ontario	$9,660	22.4%
Chrysler Town & Country	$31,645	$29,995	Windsor, Ontario	$1,650	5.5%
Dodge Grand Caravan	$19,995	$20,995	Windsor, Ontario	-$1,000	-4.8%
Chrysler 300	$32,995	$28,670	Brampton, Ontario	$4,325	15.1%
Dodge Charger	$29,995	$24,495	Brampton, Ontario	$5,500	22.4%
Dodge Challenger	$26,995	$24,995	Brampton, Ontario	$2,000	8.0%
Ford Edge	$27,999	$27,525	Oakville, Ontario	$474	1.7%
Lincoln MKX (AWD)	$47,650	$41,395	Oakville, Ontario	$6,255	15.1%
Ford Flex	$30,499	$30,885	Oakville, Ontario	-$386	-1.2%
Chevy Camaro	$27,965*	$23,280	Oshawa, Ontario	$4,685	20.1%
Chevy Impala	$28,125†	$25,760	Oshawa, Ontario	$2,365	9.2%
Chevy Equinox	$26,445	$23,530	Ingersoll, Ontario	$2,915	12.4%
GMC Terrain	$28,395	$25,560	Ingersoll, Ontario	$2,835	11.1%
Cadillac XTS 2013	$48,995a	$44,075	Oshawa, Ontario	$4,920	11.2%
Honda Civic sedan	$14,990	$15,995	Alliston, Ontario	-$1,005	-6.3%
Civic Si	$25,990	$22,555	Alliston, Ontario	$3,435	15.2%
Civic coupe	$18,240	$15,755	Alliston, Ontario	$2,485	15.8%
Toyota Corolla	$15,540‡	$16,130‡	Cambridge, Ontario	-$590	-3.66%
Lexus RX350 (AWD)	$44,950	$40,710	Cambridge, Ontario	$4,240	10.4%
Toyota Matrix	$16,795‡	$18,845‡	Cambridge, Ontario	-$2,050	-10.9%
Toyota RAV4	$24,865n	$22,650n	Woodstock, Ontario	$2,215	9.8%
Volkswagen Routan	$28,575	$27,020	Windsor, Ontario	$1,555	5.8%

Source: CBC News, "Canadians pay more than Americans for Canadian-made vehicles," 13 June 2012, http://www.cbc.ca/news/canada/ottawa/story/2012/06/12/ottawa-car-price-disparity-border-shopping.html [The sources listed for this article were: "Manufacturers online listings."]

*$2,280 credit available some places. † $2,000 credit available in some places. ‡ Freight and PDI of $1,465 in Canada, $760 in U.S. n Freight and PDI of $1,565 in Canada, $810 in U.S. a Add $1,595 destination fee. The percentage difference uses the U.S. price as the base for the calculation.

Only five vehicles in the Table 5 show a lower price in Canada than in the United States. The lower relative prices are, with the exception of the Ford Flex, which has a list price of just over $30,000, for lower-priced vehicles. Of the six lowest-priced vehicles in Table 5, namely those with list prices in Canada below $20,000, five have a lower list price in Canada than in the United States.

This finding that relative list prices can be lower in Canada than in the United States for more affordable vehicles also holds for automobiles assembled in the United States. Low-priced vehicles assembled there can also have relative list prices that are lower in Canada than in the United States; examples are the Ford Focus sedan, assembled in Wayne, Michigan, the Honda CR-V assembled in East Liberty, Ohio, and the Chevrolet Cruze, assembled in Lordstown, Ohio.

Recent research that does not take into account the location of automobile assembly supports the findings of wide price gaps between the same automobile sold in Canada and in the United States, with the gap being lower (or even in favour of Canada) for lower-priced vehicles. The Alberta Motor Association (AMA) has produced two recent articles on automobile prices in Canada and the United States, one from 2010, which provides data for Table 6, is on its website and one from April 2012 is in *Westworld*, the AMA's member magazine.[46] Additionally, research by DesRosiers Automotive Consultants in 2007, when the Canadian dollar rose to above parity with the U.S. dollar, shows results similar to those in the AMA articles.[47]

[46]" Canada-U.S. vehicle price differences," AMA website, [2010], http://www.ama.ab.ca/automotive/canadaus-vehicle-price-differences [Last accessed 6 May 2012]; Ian MacNeill, "Wheels across the border," *Westworld*, April 2012.

[47] Dennis DesRosiers, "Canadian-U.S. Vehicle Pricing, DesRosiers Automotive Consultants, 15 September 2007, http://www.desrosiers.ca/2007%20Update/Documents%20and%20Reports/2007%20OBS/Obs%202007-9%20Canadian%20-%20U.S.%20Vehicle%20Pricing.pdf [Last accessed 9 May 2012].

Table 6 - Vehicle Price Comparisons, Canada and United States (May 2010)

Vehicle	List Price (MSRP) in Canada	List Price (MSRP) in U.S.	Difference ($)	Difference (%)
Small Cars				
Chevrolet Cobalt Sedan	$15,495	$14,900	$595	4.0%
Ford Focus Sedan	$14,999	$16,290	-$1,291	-7.9%
Mazda 3 Sedan	$15,995	$15,295	$700	4.6%
Trucks				
Ram 1500	$26,495	$24,855	$1,640	6.6%
Ford F-150	$24,599	$21,820	$2,779	12.7%
SUVs and CUVs				
Honda CR-V	$26,290	$26,810	-$520	-1.9%
Luxury Vehicles				
Acura RL	$69,500	$54,250	$15,250	28.1%
BMW 535i xDrive Sedan	$68,900	$49,600	$19,300	38.9%
Lexus GX 460 SUV	$68,500	$51,970	$16,530	31.8%

Note: The calculation of the percentage difference uses the U.S. list price as the base.
Source: "Canada-U.S. vehicle price differences," AMA website, [2010].

Whether price differences, on average, favour Canadians depends on the composition of automobile sales by price. Such a comparison has been done by DesRosiers Automotive Consultants, although the latest available comparison is for 2007.[48] This research examined 15 categories of vehicle, seven for passenger cars, such as subcompact and compact, and eight for light trucks, which includes SUVs and vans as well as pick-up trucks. Of the 15 categories, only three showed a favourable price difference for Canada (that is, the list price for the car in Canada

[48] Ibid.

was lower for the same vehicle in the United States), but the average for the fifteen categories, weighted by sales shows a gap of $1,748 in favour of Canada.This reflects the large weighting of small vehicles for sales in Canada.

As David Adams, President, Association of International Automobile Manufacturers of Canada, noted, "… the compact and the subcompact segments of the market make up about 67 per cent of all passenger car sales." For any Canadian thinking about purchasing an automobile, of course, it is the price difference of a particular car, not the weighted average of price differences between the two countries, he is most interested in.

For a Canadian wishing to buy a Chevrolet Camaro, a pick-up truck or a high-end automobile, it is small comfort to be told that lower-priced vehicles are relatively less expensive in Canada. One possible option, discussed below, is to import a vehicle into Canada, but this "solution" avoids the obvious question of why the Camaro and pick-up trucks and high-end automobiles are so much more expensive in Canada than in the United States.

Importing a vehicle into Canada: a good deal?

Most Canadians live close to the U.S. border, so it may seem that a Canadian facing a higher list price for a car in Canada could cross the border and purchase the same car at a lower price in the United States. Some Canadians do this. As officials from Transport Canada told the committee, about 180,000 vehicles, both new and used, are imported from the United States into Canada each year.[49]

There are, however, barriers and added costs to importing a vehicle from the United States. Some U.S. dealers will not sell cars to Canadians. In addition to the list price in the United States are additional costs at the dealership (such as, environmental taxes, handling fees and the cost of the manufacturer's recall clearance letter, which will be needed to cross the border); costs at the border (the fee for the Registrar of Imported Vehicles, environment (air conditioning) taxes and possibly a duty 6.1% if the vehicle was not manufactured in North America); and costs to convert the car to meet Canadian Motor Vehicle Safety Standards.

There are also other considerations to take into account when thinking of importing a vehicle from the United States, namely the possible non-transferability of warranties, the possible voiding of any roadside assistance plan that may have come with the purchase of the vehicle, and the

[49] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/07issue.pdf, p. 7:64.

likelihood that a U.S.-purchased vehicle brought into Canada will not be registered for any recall notices.

After all possible adjustments are noted, the nagging question remains: Why do lists prices for the same vehicle differ, at times by thousands of dollars, between the United States and Canada?

The significance of tariffs and safety requirements to the prices of automobiles and trucks

Two possible reasons why list prices differ between Canada and the United States have to do with differences in tariffs and safety standards.

Several witnesses mentioned the significance of tariffs on car and truck prices. For example, Canada and the United States have different tariff rates on imported vehicles. While vehicles manufactured in a North American Free Trade Agreement (NAFTA) country[50] can be shipped duty-free to other NAFTA countries, the tariff on vehicles imported from non-NAFTA countries is 6.1% in Canada compared to 2.5% in the United States.[51]

Reducing or eliminating the 6.1% tariff would make the automobile industry more competitive and benefit consumers (see Recommendation 1).

Safety compliance is the second area in which costs could be reduced in Canada. The representative from the Association of International Automobile Manufacturers of Canada accepted an estimate by Transport Canada that "probably at this time about 85 per cent to 90 per cent of the regulations are similar," but he noted that differences remain. They include daytime running lights, ignition immobilizers and metric dashboard markings, which are not required on U.S. automobiles. Moreover, some safety regulations in Canada hold for Canadian manufacturers but not necessarily for importers.

Some progress has been made on harmonizing regulations, but, as noted above, there may be reasons for different safety standards in Canada and the United States. However, if differences in safety standards do not reflect differences in safety needs, non-harmonized safety standards constitute an impediment to trade.

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[50] Canada, the United States or Mexico.

[51] There could also be different tariffs in the United States and Canada on automobile parts. It is more difficult to estimate the effects of any of these differentials on the final price of a vehicle. These tariffs would also be reviewed under Recommendation 1.

Bringing Canadian and U.S. automobile tariffs and safety standards in line would be a step in the direction of reducing the gap between automobile prices in Canada and in the United States. But completely harmonizing tariffs and safety standards might close the price gap in automobiles by hundreds of dollars; such harmonization, which this committee recommends in recommendations 1 and 2, would not eliminate price differences in the thousands of dollars.

Understanding automobile price discrepancies between Canada and the United States

As seen above, the gap for low-price vehicles may be low or even favour Canadian buyers, but the gap is certainly higher for high-priced vehicles. Canadians wishing to buy high-end vehicles want to know why these large price discrepancies exist between Canada and the United States for high-end vehicles.

Automobile manufacturers set prices in Canada and the United States based on numerous factors, including the expected exchange rate. Movements in exchange rates affect automobile prices. In 2002, for example, when the Canadian dollar was, on average, worth about US$0.64, automobile list prices in Canada were below those in the United States for all categories of passenger cars and light trucks. According to DesRosiers Automotive Consultants, using price differentials weighted by sales, the price differential for compact cars between Canada and the United States in 2002 was -$3,805 (in 2007 it was -$2,159) and for high luxury cars -$10,048 (in 2007 it was $4,294).[52]

For some vehicles, especially those at the high end, there are noticeable price differences between the two countries. Two questions emerge: Why do noticeable price differences exist for some vehicles but not others? And, what, if anything, can be done to narrow or eliminate the differences?

As with other goods studied by this Committee, the relatively small size of the Canadian economy and the associated, high distribution costs partly explain price differences between Canada and the United States. [53]

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[52] Dennis DesRosiers, "Canadian-U.S. Vehicle Pricing, DesRosiers Automotive Consultants, 15 September 2007, http://www.desrosiers.ca/2007%20Update/Documents%20and%20Reports/2007%20OBS/Obs%202007-9%20Canadian%20-%20U.S.%20Vehicle%20Pricing.pdf [Last accessed 9 May 2012.] and Dennis DesRosiers, "Canadian-U.S. MSRPs - 2002, DesRosiers Automotive Consultants, 15 June 2002. http://www.desrosiers.ca/pdfs/2002/2002-6.pdf [Last accessed 16 May 2012.]

[53] David Adams, President, Association of International Automobile Manufacturers of Canada, http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/16issue.pdf, p. 16:50 and Ken Wong, Professor, Queen's University, as an individual, http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/06issue.pdf, p.6:55.

The extent of competition, which can vary by vehicle type, is another factor explaining price differences. Canadians buy lighter, smaller and more fuel-efficient automobiles than do their American counterparts. Most cars purchased by Canadians are sub-compacts and compacts, so competition is keen in these categories.

Not all Canadians will be indifferent between a Chevrolet Cruze and a Ford Focus, but enough will be that the prices of the two will not be far apart, and these prices will also be close to, and perhaps below, prices in the United States.

Canadian customers are numerous and price-sensitive for sub-compacts and compacts. This is not necessarily true for high-end performance vehicles. Canadians who wish to purchase, for example, a Porsche Carrera S (and have the income to do so) may not consider any car a substitute for this Porsche and may not care that the list price is $13,600 lower in the United States. Porsche dealers in Canada are able to charge what the market will bear; dealers for the Chevrolet Cruze and for the Ford Focus must pay close attention to what competitors are charging.

The gap in prices cannot be associated with cost differences in the assembly of automobiles in Canada and the United States. As seen above, for vehicles assembled in the United States, some have a lower list price in Canada, and some have a higher list price in Canada. For vehicles assembled in Canada, some have a lower list price in the United States, and some have a higher list price.

Although comparisons based on list prices (MSRPs) are a useful starting point, these prices are not the same as the transaction prices, and the differences between the list and transaction prices may not be constant between the two countries. In other words, as suggested by some witnesses, a comparison of MSRPs might indicate that a certain vehicle is more expensive in Canada than in the United States, but dealers in Canada may offer better financial terms, higher incentives or larger discounts than in the United States, so that the negotiated transaction price for the particular automobile is actually lower in Canada.

The main explanation of the price gaps in vehicle pricing between Canada and the United States is that automobile manufacturers charge "what the market will bear". Manufacturers (of automobiles or anything) can charge a relatively high price if a buyer is not very sensitive to the price of the good (and will not demand or bargain for a lower price) and if a buyer does not have many alternatives to the good he or she wishes to buy. Again, this may be small consolation to a consumer who wishes to buy a particular car and not a different vehicle.

Some potential buyers of vehicles may be prepared to bargain quite hard for a lower price, and they may be able to arrive at a transaction price well below the list price; those who, for whatever reason, do not bargain hard will end up with a negotiated transaction price close to list price. The system of a list price with scope for bargaining gives an automobile dealer flexibility in pricing, which is not evident in fixed list prices. The dealer can charge individual customers "what the market will bear."

Canadians continue to voice concerns over the apparently excessive price differences for motor vehicles in Canada as compared to those in the United States. The gap can in theory be lessened by importing a new vehicle from the United States, although this is not an option suitable for all Canadians and may, in fact, not be possible for certain vehicles. The gap between transaction prices in Canada and the United States may be lower than the gap between list prices. Transaction prices can depend on bargaining, but not all Canadians have equal abilities in bargaining.

The Committee has examined several possible reasons for the price gap between the United States and Canada for new vehicles. These include:

- non-harmonized tariff regimes;
- non-harmonized safety standards;
- an expected exchange rate different from parity;
- differences in the cost of assembly of vehicles;
- higher distribution costs in Canada than in the United States,
- relative size of the Canadian market;
- composition of demand for vehicles in the two countries (Canadians have a relatively stronger demand for lower-priced vehicles);
- country pricing (see page 6 for a more detailed explanation); and
- charging what the market will bear (see page 54 for a more detailed explanation).

The federal government can affect the first two, and Recommendations 1 and 2 address these items. The composition of demand for vehicles helps explain whether the price gap is in favour of Canadians or Americans. Of most importance in terms of explaining large price gaps is the ability of sellers to charge what the market will bear.

Automobile manufacturers can charge what the market will bear. This is not against Canada's *Competition Act*. It does explain large gaps in the list prices of vehicles sold in Canada and the United States, especially for high-end vehicles.

For a more detailed explanation of all the points made about automobile pricing, it would have been useful to talk with the three major North American automobile manufacturers. Unfortunately, General Motors, Ford and Chrysler were named in a 2007 class-action lawsuit, filed in the Ontario Superior Court of Justice, that claims the manufacturers and a representative organization were engaged in a conspiracy to prevent imports of automobiles into Canada from the United States. The three manufacturers, on the advice of their lawyers, declined to appear before the Committee.

This Committee will not discuss the details of a lawsuit that is still proceeding through the legal system, but records its disappointment at not being able to meet with the three automobile manufacturers that produce about half the new vehicles sold in Canada.

Books

Compared with their U.S. counterparts, Canadian book and magazine publishers compete in a much smaller market. Any economies of scale in printing or distribution or any aspect of the publishing industry that U.S. publishers may tap will, in general, not be available to Canadian publishers.

Although culturally important, books form a relatively small portion of consumer spending while automobiles represent a major consumer expense. In 2011, spending on new and used motor vehicles was just over 6% of total personal expenditures on consumer goods and services, and more than four and a half times the total spent on all educational and cultural services.[54] Books are important to this report because they provide what is probably the most visible sign that Canadian and U.S. prices seem out of sync when the Canadian dollar is at parity.

Unlike most retailers, booksellers use pre-printed, dual-price covers or stickers (with suggested retail prices in the United States and Canada) for most books they sell. As one witness reminded the Committee, Canada has the most open book market in the world, and the United States, with its huge economy and a population about ten times that of Canada, supplies a large proportion of books found in Canadian bookstores.

When the Canadian dollar is at parity, shoppers notice that U.S. prices are lower. This leads to the obvious question: Why? For many in the book trade, this question seems unnecessarily focused on them. As a representative of the Canadian Publishers' Council put it:

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[54] Statistics Canada, Personal Expenditure on Goods and Services, CANSIM Table 380-0024, http://www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=3800024 [Last accessed 12 May 2012]

It is my understanding that even though we do not see dual prices on goods, the vast majority of goods that are available in Canada from the United States cost more here than they do in the United States just by virtue of getting that inventory physically over the border, cleared, here and into a retail or wholesale outlet.[55]

Jackie Hushion, Executive Director, Canadian Publishers' Council

Books are special, of course, as they are part of Canada's cultural fabric, and the cultural role of books is recognized in treaties, such as NAFTA, in legislation, such as the *Investment Canada Act*, and in support programs offered to the book industry by all levels of government. But the book industry has the same concerns as any non-cultural industry – the need to cover costs to survive; the need to face competition, whether from established or new competitors; and the need to set appropriate prices, which is linked to the first two concerns.

The Canadian book industry today faces many challenges, some shared by the book industry in other countries. The traditional industry with printed books sold in bricks-and-mortar stores is facing strong challenges from online retailers, non-traditional booksellers, such as Wal-Mart and Costco, and e-books. Not only that, the average leisure time Canadians spend reading has declined since the end of the twentieth century, a disquieting trend for publishers of books, magazines and newspapers.[56] This report cannot provide a complete study of the Canadian book industry,[57] but it notes that the challenges facing the industry can affect book prices in Canada. Table 7 provides a useful comparison of prices.

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[55] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/15issue.pdf, p. 15:64.

[56] Statistics Canada. *Table 113-0001 - General social survey (GSS), average time spent on various activities for the population aged 15 years and over, by sex and main activity, occasional (average hours per day unless otherwise noted),* CANSIM (database).

[57] See the House of Commons Standing Committee on Canadian Heritage, *The Challenge of Change: A Consideration of the Canadian Book Industry*, June 2000, for the most recent parliamentary study of the industry. http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=1031737&Language=E&Mode=1&Parl=36&Ses=2 [Last accessed 22 May 2012.]

Table 7 - Comparisons of Prices, New York Times Bestsellers (29 April 2012)

	United States (Amazon.com)			Canada (Amazon.ca)			Sales Price Difference .ca - .com
Book	**List**	**Sales**	**Discount**	**List**	**Sales**	**Discount**	
Hardcover Fiction							
The Innocent	$27.99	$17.90	36%	$29.99	$15.00	50%	-$2.90
The Witness	$27.95	$17.08	39%	$29.50	$14.75	50%	-$2.33
Calico Joe	$24.95	$14.97	40%	$28.95	$14.48	50%	-$0.49
Unnatural Acts	$26.95	$16.83	38%	$28.50	$17.87	37%	$1.04
Guilty Wives	$27.99	$18.47	34%	$29.99	$18.80	37%	$0.33
The Lost Years	$26.99	$17.81	34%	$29.99	$18.80	37%	$0.99
What Doesn't Kill You	$27.99	$18.47	34%	$29.99	$18.80	37%	$0.33
Come Home	$27.99	$18.47	34%	$29.99	$18.80	37%	$0.33
Sacré Bleu	$26.99	$17.81	34%	$29.99	$18.80	37%	$0.99
The Shoemaker's Wife	$26.99	$17.81	34%	$29.99	$18.80	37%	$0.99
Hardcover Non-fiction							
Drift	$25.00	$15.30	39%	$29.95	$18.77	37%	$3.47
Let's Pretend This Never Happened	$25.95	$14.53	44%	$27.50	$13.75	50%	-$0.78
Imagine	$26.00	$15.26	41%	$32.00	$20.06	37%	$4.80
The Presidents Club	$32.50	$19.50	40%	$37.95	$23.79	37%	$4.29
The Big Miss	$26.00	$15.60	40%	$31.00	$15.50	50%	-$0.10
Steve Jobs	$35.00	$16.85	52%	$36.99	$23.19	37%	$6.34
Mrs. Kennedy and Me	$26.00	$17.16	34%	$29.99	$18.80	37%	$1.64
Wild	$25.95	$15.25	41%	$29.00	$18.18	37%	$2.93
The Power of Habit	$28.00	$16.00	43%	$32.95	$16.48	50%	$0.48
Killing Lincoln	$28.00	$16.80	40%	$32.00	$20.06	37%	$3.26

Notes: The New York Times bestseller lists are dated 29 April 2012, but they cover sales for the week ended 21 April 2012. The Canadian-U.S. dollar exchange rate was almost at parity during the week of observed sales, fluctuating between $0.9865 and $1.0033 Canadian dollars for one U.S. dollar.

Source: Table prepared by the Parliamentary Information and Research Service of the Library of Parliament using information from the New York Times bestsellers lists and data from Amazon, http://www.nytimes.com/best-sellers-books/2012-05-06/hardcover-fiction/list.html, http://www.nytimes.com/best-sellers-books/2012-05-06/hardcover-nonfiction/list.html, http://www.amazon.com/exec/obidos/subst/home/home.html/103-9859839-0612631and http://www.amazon.ca/exec/obidos/subst/home/home.html/103-9859839-0612631.

The prices are for recent hardcover fiction and non-fiction bestsellers on the New York Times bestsellers lists. The Canadian dollar hovered around parity with the U.S. dollar during the week covered by the lists, so no exchange rate adjustment is needed for comparisons of Canadian and U.S. prices.

There are two significant points in the table. The first is that the list price in Canada is always higher than in the United States. One important reason for this – a mark-up associated with the *Book Importation Regulations* associated with the *Copyright Act* – will be discussed below.[58] The second significant point in the table is the large size of the discounts off the list price that online booksellers can offer.

Online and e-books competition

Although list prices are higher in Canada for all twenty books shown, the online price in Canada is below that in the United States for five of the books, which may reflect the competition in the market for bestsellers. Although amazon.ca is a subsidiary of amazon.com, so competition may not be fierce between them, non-traditional booksellers such as Wal-Mart and Costco focus on bestsellers and are extremely competitive and offer large discounts.

What Table 7 does not show is the competition that printed books face from electronic books (e-books). This is a relatively new phenomenon, and the book industry is still adjusting. One witness suggested that the price of e-books in Canada, like the list price of printed books, was higher than in the United States.

> *The Canadian consumer is used to seeing the two prices. Nowhere on an e-book is the price pre-printed, yet the same discrepancy occurs. The average e-book price is $9.99, which was set by Amazon in the U.S. You will see that for the same titles Canadian e-books are $10.99 on average. They are $1 more.*[59]
>
> Mark Lefebvre, President, Canadian Booksellers Association

Until quite recently, this may have been true. The standard price for an e-book for amazon's e-reader, the Kindle, was $9.99. But publishers have put pressure on amazon's pricing strategy, and e-book prices are now well above $9.99.[60] This can be seen in Table 8, which compares the e-book prices on amazon's Kindle with Indigo's Kobo for the New York Times bestsellers.[61] All the Kindle

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[58] Bill C-11, An Act to Amend the Copyright Act, is currently proceeding through parliament. Although this bill involves major changes to the existing *Copyright Act*, none of the amendments would change the current section on the importation of books.

[59] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/12issue.pdf, p. 12.22.

[60] For example, the amazon.com website states that, "This price was set by the publisher," for *The Presidents Club* the book with the highest price in Table 8.

[61] In November 2011, the Canadian bookseller Indigo sold the Kobo e-publishing platform to Rakuten Inc., the Japanese e-shopping giant, although the e-books are still sold through the Canadian Indigo website; e-books for the Kindle are sold through the U.S. website, amazon.com, even to Canadians buying for their Kindles.

prices are above $9.99. What may be more surprising, the Kobo prices are lower than the Kindle prices for eighteen of the twenty books and are equal to the Kindle prices for the other two books.

Table 8 - Comparisons of Prices, New York Times Bestsellers (29 April 2012)

On e-Readers (Kindle and Kobo)

	Kindle Amazon.com	Kobo Indigo.ca	
Book	**Price**	**Price**	**Price Difference Kobo - Kindle**
Hardcover Fiction			
The Innocent	$12.99	$12.99	$0
The Witness	$18.76	$15.99	-$2.77
Calico Joe	$17.27	$14.99	-$2.28
Unnatural Acts	$16.41	$13.99	-$2.42
Guilty Wives	$14.99	$14.99	$0
The Lost Years	$17.54	$14.99	-$2.55
What Doesn't Kill You	$17.60	$14.99	-$2.61
Come Home	$17.64	$14.99	-$2.65
Sacré Bleu	$13.53	$12.99	-$0.54
The Shoemaker's Wife	$13.53	$12.99	-$0.54
Hardcover Non-fiction			
Drift	$17.27	$14.99	-$2.28
Let's Pretend This Never Happened	$16.20	$13.99	-$2.21
Imagine	$17.25	$14.99	-$2.26
The Presidents Club	$24.67	$20.99	-$3.68
The Big Miss	$18.42	$15.99	-$2.43
Steve Jobs	$21.06	$17.99	-$3.07
Mrs. Kennedy and Me	$17.54	$14.99	-$2.55
Wild	$17.27	$14.99	-$2.28
The Power of Habit	$18.42	$15.99	-$2.43
Killing Lincoln	$17.61	$14.99	-$2.62

Note: The prices for the e-books were taken from the amazon and indigo websites on 22 May 2012, although the lists are dated 29 April 2012.

Source: Table prepared by the Parliamentary Information and Research Service of the Library of Parliament using data from Amazon and Indigo, http://www.amazon.com/kindle-store-ebooks-newspapers-blogs/b/ref=topnav_storetab_kstore?ie=UTF8&node=133141011 and http://www.chapters.indigo.ca/ebooks/eBooks/750061-750072-750074-750064-cat.html.

This section began by noting that it was the price stickers on books, showing American and Canadian list prices, that upset consumers when the Canadian dollar is at parity with the U.S. dollar. The obvious question was: Why do book prices in Canada differ from those in the United States? Several Committee witnesses cited the same reasons why the prices of other goods were also relatively more expensive in Canada. These reasons included the higher cost of doing business in Canada's relatively small market, the inability to tap economies of scale and higher transportation

costs, labour costs and taxes. For books in particular, the distribution and warehousing costs per item might be higher in Canada than in the United States.

The Copyright Act and the Regulatory Impact Analysis Statement

Even if all these cost differences did not exist – if the per-item costs in the Canadian book industry were the same as those for the U.S. book industry – there is still a reason why book prices would be higher here than in the United States. In 1997, the *Copyright Ac*t was amended by Bill C-32 to allow for additional restrictions on the parallel importation of books. In 1999, after two years of consultation with interested parties in the book industry, the new regulations allowed a price mark-up on most imported books sold in Canada.

As the *Regulatory Impact Analysis Statement*,[62] which was included with the regulations, although not part of the regulations, explained:

> Parallel importation refers to books which were legitimately produced in their country of origin but which have been imported into Canada without the consent of the rights owner in Canada. Bill C-32 contains provisions which greatly increase the ability of rights holders in Canada to protect their exclusive distribution rights in the Canadian market. Previously, the Act allowed only copyright owners and exclusive licensees to limit the parallel importation of printed books. Bill C-32 extends this right to exclusive distributors. Exclusive distributors are those who have received acquired rights of exclusive distribution in Canada but who do not have property right in the book, e.g. they do not have a right to authorize the reproduction of the book.

Before Bill C-32 passed (and the regulations were put in place), exclusive distributors were unable to protect themselves from parallel importation, which in the book industry is known as "buying around." After the regulations were in effect, the exclusive distributors in Canada of foreign books could protect their rights by suing any person who was buying around; the exclusive distributor could also obtain a court order to detain a shipment of parallel imports at the border.

As the *Regulatory Impact Analysis Statement* explained in the section "Benefits and Costs":

> Exclusive distributors pay for the right to distribute books in Canada, and the amount of the payment may be based on an expectation of a certain volume of sales. The provisions in the Act limiting parallel importation give exclusive distributors greater commercial certainty with

[62] Copyright Board Canada, Book Import Regulations (SOR/99-324) [Regulatory Impact Analysis Statement], 28 July 1999. http://www.cb-cda.gc.ca/act-loi/regulations-reglements/99324-e.html

> respect to the rights they have purchased. Without these Regulations, the parallel importation provisions of the Act would be ineffective, and those with exclusive distribution contracts would not in all cases derive the full benefits of their distribution contracts. This would be detrimental to the Canadian publishing sector, as a whole.

The major benefit is that the Canadian publishing industry is healthier because some of its players – the exclusive distributors – can maintain the value of the territorial distribution rights that they have purchased from the foreign rights holders. The potential cost is that exclusive distributors will be able to act as monopolists in Canada, with pricing and quality of service detrimental to others in the industry.

To limit the potential costs to the industry, which includes consumers on the demand side, the regulations include several requirements that must be met by the exclusive distributors, including terms for notification of exclusive distributor status, minimum fulfillment standards and, of most importance for the work of this Committee, price ceilings.

The price restrictions set out in the regulations cover two sets of books: those imported from the United States and those imported from other countries.

> (A) if the book is imported from the United States, the list price in the United States, plus the current exchange rate, plus 10% of the price after conversion, minus any applicable discounts, or
>
> (B) if the book is imported from a country in Europe or any other country, the list price in the country from which the book is imported, plus the current exchange rate, plus 15% of the price after conversion, minus any applicable discount.[63]

If the exclusive distributor does not meet the notification or fulfillment requirement, or prices above the allowed limits, booksellers may circumvent the exclusive distributor and buy around.

The executive director of the Canadian Publishers' Council, Jackie Hushion, described the mark-up as a "buffer against a changeable rate of exchange" and argued that this buffer "benefits everyone, not just the publishers."

The gain for all appears to be a healthier Canadian book industry that can offer more Canadian content. As Ms. Hushion put it:

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[63] Copyright Board Canada, Book Import Regulations (SOR/99-324), 28 July 1999, http://www.cb-cda.gc.ca/act-loi/regulations-reglements/99324-e.html.

The key crucial point here is that the exclusive distribution sections of the act have helped Canadian-based publishers maintain their competitiveness in their own marketplace and have helped the industry prosper. I do not mean that in financial terms necessarily, but they have fostered its growth. This works in the interests of consumers, booksellers and publishers as well, through dynamic pricing, and it provides remarkable choice and better and more efficient services relative to imports. This means an increase in the viability of original Canadian publishing. When you have greater critical mass of titles over which you can spread all of your costs, then you have more to invest in original Canadian publishing.[64]

Jackie Hushion, Executive Director, Canadian Publishers' Council

An official from Canadian Heritage provided testimony that supported this view:

Many of our largest foreign-owned publishers first began operations as the exclusive distributors of their parent companies' titles in Canada, and the revenues from distribution on an exclusive basis helped to fund the creation of Canadian publishing programs and continue to support them today.[65]

Helen C. Kennedy, Deputy Director General,
Cultural Industries, Canadian Heritage

Although the mark-up allowed in the regulations may provide a buffer for some exchange rate volatility and may provide the stability and financial health in the book industry that has allowed an expansion of Canadian content, the mark-up was described in terms of consumer protection in the *Regulatory Impact Analysis Statement*:

As a result of the Regulations, there may be additional costs to retailers and institutional buyers [the immediate customers of the exclusive distributor]. To **protect against excessive prices**, the regulation requires that exclusive distributors meet certain standards with regard to pricing, and these are based on mark-ups reflecting prevailing market conditions.

The 10% mark-up for books from the United States was intended to provide a ceiling for book prices. This mark-up on U.S. books and the 15% mark-up for books from other countries were not chosen randomly. As the *Regulatory Impact Analysis Statement* explained:

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[64] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/15issue.pdf, p. 15:39.

[65] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/12issue.pdf, p. 12:61.

These percentages correspond to the average actual costs currently paid by book importers for transportation and related expenses — including shipping, handling and receiving, inventory, financial reporting, general overhead and sales and marketing — for imports from each of the three areas. These simple percentage marks-ups ensure that importers, libraries and book retailers will have a straightforward mechanism with which to evaluate costs and that they will thereby be protected against unfair pricing practices.

An important question now is whether the ceiling has become a floor. James Reeve, Senior Vice-President and Managing Director, Higher Education Division of Nelson Education, described the permitted 10% mark-up as a guideline and stated: "Currently, we stand far below the 10 per cent, and I am only speaking on behalf of Nelson Canada." Kevin Hanson, President, Canadian Publishers' Council and President, Simon Schuster Canada, said competitive pressures would keep the actual mark-up below the permissible maximum. As he explained:

> *There is motivation not only to price to the exchange rate, but there is also competitive pricing between publishers and there are substitutes for books. If you price a cookbook too high and you can buy another cookbook at a lower price, you will not sell your book, or it will come back*.[66]
>
> Kevin Hanson, President, Canadian Publishers' Council
> and President, Simon Schuster Canada

As mentioned above, the regulations involved speaking with major interested parties over a two-year period. The *Regulatory Impact Analysis Statement* noted: "While views remained divergent on certain issues, the resulting regulations represent a reasonable compromise." Today, the divergent views are becoming more public, and some players in the book industry have come out strongly against the system set out in the regulations. Booksellers told the Committee that they do not wish to be in the position of being apologists for a system they do not control. Those who sell textbooks argue as if the mark-up were part of a price floor. They noted that the mark-up in the regulations translates into a significant cost increase to students, some of whom may be required to purchase $1,000 of textbooks for a semester.

When asked what would happen if the 10% mark-up associated with exclusive distribution were to drop to 5%, Mr. Hanson responded by talking about the unpredictability of exchange rate movements, and cited the volatility seen in 2008, a year cited by other witnesses before the Committee. He added:

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[66] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/15issue.pdf, p. 15:49.

In the context of that, I hope it gives confidence to you and to the consumers that there is this methodology that serves our industry, to serve exclusivity aspect of territoriality that manages both the health of the sector, in keeping it consistent, whole and in Canada — rather than a free for all and people bringing in books from all over the place — but also protects the consumer in that book prices do dramatically come down.[67]

Kevin Hanson, President, Canadian Publishers' Council
and President, Simon Schuster Canada

To show how prices are declining, Mr. Hanson used the example of the bestselling novelist Kathy Reichs, who has published a book every year between 2003 and 2011. Later, the Canadian Publishers' Council provided the Committee with pricing information on Ms. Reichs's books. Table 9 presents the information, with additional information from the Bank of Canada on the exchange rate.

[67] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/15issue.pdf, p. 15:65.

Table 9 - Bestsellers by Kathy Reichs, Price Comparisons, United States and Canada

Year	Title	U.S. Price	Canadian Price	Conversion Ratio	Exchange Rate
2003	*Bare Bones*	$25.00	$39.50	1.58	1.4015
2004	*Monday Mourning*	$25.00	$36.00	1.44	1.3015
2005	*Cross Bones*	$25.95	$35.50	1.37	1.2116
2006	*Break No Bones*	$25.95	$34.95	1.35	1.1341
2007	*Bones to Ashes*	$25.95	$29.99	1.16	1.0748
2008	*Devil Bones*	$25.95	$29.99	1.16	1.0660
2009	*206 Bones*	$26.99	$32.00	1.19	1.1420
2010	*Spider Bones*	$26.99	$29.99	1.11	1.0299
2011	*Flash and Bones*	$26.99	$29.99	1.11	0.9891

Notes: U.S. price is in U.S. dollars; Canadian price is in Canadian dollars. Conversion ratio is the Canadian price divided by the U.S. price, both prices in the national currency. The exchange rate is the annual average of daily noon rates; the rate shows the number of Canadian dollars needed to purchase one U.S. dollar.

Source: All material except that for the exchange rate has been supplied to the Committee by the Canadian Publishers' Council. The exchange rates come from the Bank of Canada website, http://www.bankofcanada.ca/rates/exchange/exchange-rates-in-pdf/?page_moved=1 [Last accessed 21 May 2012.]

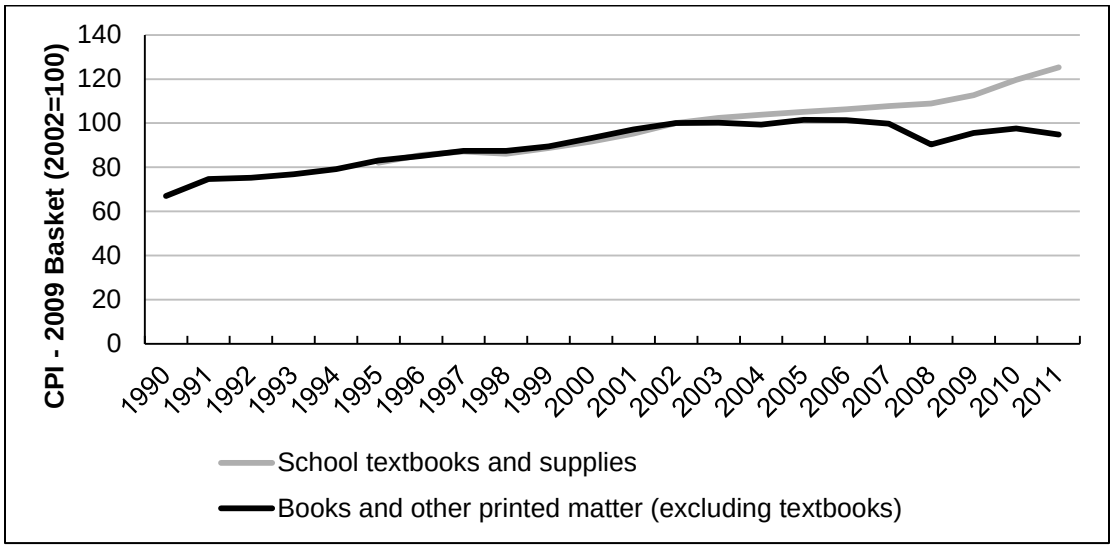
After discussing the movement of the prices of the novels of Ms. Reichs, Mr. Hanson concluded: "In real terms, we have had price deflation of about 25% in hardcover fiction in Canada over the past 10 years." What Table 9 shows is that if Canadian dollar prices are set off U.S. dollar prices and if the Canadian dollar appreciates, the Canadian dollar price will fall.[68] In this case, the purchasers of hardcover fiction in Canada have benefited, although a gap remains between exchange-rate-adjusted book prices in the United States and Canada.

On the other hand, the purchasers of textbooks in Canada might not have benefitted from such price movements. Zachary Dayler, National Director, Canadian Alliance of Student

[68] This also assumes that any price inflation in the United States is not greater than the rate at which the Canadian dollar appreciates. This was true in the period used by Mr. Hanson.

Associations, said, " …one of the things we have noticed is over 15 years or so the Consumer Price Index rose about 22% and the cost of textbooks rose 280%." The price indices shown in Figure 7 support the position that textbook prices have gone up faster than book prices in general.

Figure 7 - Yearly Consumer Price Index for Books and Other Printed Matter, and School Textbooks and Supplies, 1990-2011



Source: Figure prepared by the Parliamentary Information and Research Service of the Library of Parliament using data from Statistics Canada, CANSIM, Table 326-0021.

Chris Tabor, Manager, Queen's University Bookstore, Campus Stores Canada, argued that the regulations reflected the publishing industry in 1999, when the regulations were put in place, that the industry had changed radically since then and that the regulations should be changed.

Mr. Tabor noted that altering the regulations would not involve the lengthy process of amending the *Copyright Act* but could be done with "the stroke of a pen."

Officials from the Department of Canadian Heritage pointed out that changing regulations is not easy.

> *The reality is that changing regulations would involve a process. It is not just the stroke of a pen. Changing regulations would involve a formal process of consultations with the various parts of the industry. We talked earlier about when these regulations were first established that there was a consultation process that involved representatives from all sectors of the industry in both the French- and*

English-language markets. It is not our understanding that a stroke of the pen would be sufficient to change or to repeal the regulations.[69]

Helen C. Kennedy, Deputy Director General,
Cultural Industries, Canadian Heritage

That a regulation is not easy to change does not mean it should not be changed. As explained in the *Regulatory Impact Analysis Statement,* protection from parallel importation was provided to the Canadian exclusive distributors through the Book Importation Regulations, rather than the *Copyright Act*, because "It was decided that these criteria and standards could be best dealt with through regulations so that **they can be easily modified** and also, because they necessarily contain extensive details." (Emphasis added)

Recommendation 4:

The Committee recommends that the Minister of Canadian Heritage study the costs and benefits of reducing the 10% mark-up that Canadian exclusive distributors can add to the U.S. list price of American books imported into Canada, adjusted for the exchange rate, as stipulated in section 5(1)(a)(iii) of the Book Importation Regulations.

Magazines

The parallel importation section of the *Copyright Act* and the related regulations cover books but not magazines.

As Canadian consumers will have noticed anywhere magazines are sold, many U.S. titles have dual cover prices. At the end of May 2012, for example, *Newsweek* was priced at US$4.99 and C$5.99, respectively. The New Yorker, on the other hand, had a single price on its cover, $6.99 in Canada, but $5.99 on its U.S. cover.

Even in a period of Canadian and U.S. dollar parity, U.S. magazines cost more in Canada. Why?

As was the case with books and other goods studied by the Committee, one explanation of a price gap that favours American consumers is that distribution costs and the costs of doing business are higher in Canada.

[69] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/12issue.pdf, p. 12:64.

U.S. magazines may also be able to exploit a "brand name" effect and charge what the market will bear in Canada. At the end of May 2012, for example, the cover prices of *The Walrus* and *Maclean's* were $6.95 and $5.95, respectively, in line with the *New Yorker* and *Newsweek*, potential competitors for the two Canadian magazines.

CHAPTER FIVE: CHARGING WHAT THE MARKET WILL BEAR

It was with a sense of frustration that the representative of the Retail Council of Canada observed:

> *We have heard government officials, media and economists, misinformed I should say, suggest that retailers are gouging consumers.*[70]
>
> Diane J. Brisebois, President and Chief Executive Officer,
> Retail Council of Canada

Many Canadians believe that the price differences for certain goods between Canada and the United States prove that Canadian retailers are either gouging their customers or charging what the market will bear.

Charging what the market will bear means charging the highest price that consumers are willing to pay for a particular product, given market conditions. Businesses can charge what the market will bear and remain profitable only if they have market power and face little competition. In a competitive market, customers can buy products from different suppliers, and punish businesses whose prices are too high by buying elsewhere.

This means that businesses would be able to sell a product at a higher price in Canada than in the United States, for reasons other than the cost of doing business in Canada, only if the Canadian market were less competitive. Moreover, their ability to charge more for the same products would show up in higher margins.

The lack of competition in the Canadian retail market

Through the hearings, several witnesses mentioned the lack of competition in the Canadian retail market as an important factor contributing to higher prices in Canada than in the United States.

For example, Mark J. Carney, Governor, Bank of Canada, suggested that retailer margins could be higher in Canada than in the United States given the high level of concentration in the

[70] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/16issue.pdf, p. 16:12.

Canadian retail market. According to Mr. Carney, the top four retailers in Canada have a 28% market share, compared with only 12% in the United States.

The impact of a lack of competition on the margins of retailers was explained by Ken Wong, Professor, Queen's University:

> *Margins, of course, have to reflect competitive realities because competition has always been the great regulator, so to speak, of prices. The more competitive the market, the greater the number of competitors; typically, the smaller the margins a retailer can apply to their costs and still remain in business. Since we have fewer retailers in Canada, it stands to reason margins in Canada have tended to be a little bit higher than for comparative products in the U.S.*[71]
>
> Ken Wong, Professor, Queen's University, as an individual

While some witnesses provided anecdotal evidence about higher retailer margins in Canada, data provided by a representative from the Retail Council of Canada showed that retailers' margins in Canada were similar to U.S. margins. The operating margins in the Canadian retail sector were 3.4% in 2009 compared with 3.5% in the United States.[72] These statistics suggest that despite less competition in the Canadian retail market, Canadian retailers do not enjoy higher operating margins than their U.S. counterparts.

As explained by Tony Hernandez, Professor, Ryerson University, the price discrepancies for certain products may not necessarily arise at the retail level. Price discrepancies could arise at any point in the supply chain, from the manufacturers to the retailers.[73] As mentioned in the section on **country pricing** and market segmentation, if the price difference for a product has been heavily influenced at the manufacturing level, the other participants will carry those costs through the entire supply chain up to the retailers. Thus, the existence of price discrepancies for certain products between Canada and the United States does not necessarily mean that retailers are gouging consumers or that they are the participants in the supply chain that are charging what the market will bear.

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[71] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/06issue.pdf, p. 6:43.

[72] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/16issue.pdf, p. 16:12.

[73] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/15issue.pdf, p. 15:18.

Given that the level of competition determines the ability of each participant in the supply chain to charge more for the value they add to a particular product, increasing competition in Canada is crucial to eliminating price discrepancies between the two countries.

The representatives from the Canadian consumer advocacy groups who appeared before the Committee suggested that the Competition Bureau, the independent law enforcement agency that is responsible for the administration and enforcement of the *Competition Act,* ensure that markets in Canada are fair for consumers, retailers, manufacturers and all other participants. According to the representatives, the lack of competition in the Canadian market would place consumers at a disadvantage compared with other market participants.

Responding to questions about the perceived lack of competition in Canada, the officials from the Competition Bureau said that high prices in themselves do not mean that a particular market is uncompetitive. They said that the Competition Bureau is not a price regulator and that Canadian businesses are free to set their own prices at whatever levels the market will bear, provided that these high prices are not the result of anti-competitive conduct such as price-fixing or abuse of a dominant position.

To determine whether high prices are the result of an anti-competitive practice, the Competitive Bureau needs to show that an anti-competitive practice occurred and that, subsequently, it affected competition in the form of higher consumer prices, raised barriers to entry preventing competitors from coming in, depressed product quality, or depressed innovation in the market.

As an example of such anti-competitive practices, the Competition Bureau officials mentioned that the Commissioner of the Competition Bureau filed an application with the Competition Tribunal in December 2010 to eliminate restrictive and anti-competitive rules that Visa and MasterCard impose on merchants who accept their credit cards. According to the Competition Bureau, Visa and MasterCard's practices result in higher prices for all Canadian consumers, whether they pay by cash, cheque, debit or credit, because merchants pass along some or all of the high costs they are forced to pay. [74] The credit card fees paid by Canadian merchants are among the highest in the world, 1.5% to 3.0%, nearly twice as much as their counterparts pay in Europe, New Zealand and Australia, but slightly lower than in the United States. Hence, credit card fees should

[74] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/12issue.pdf, p. 12:39.

not explain a part of the price discrepancies for certain goods between Canada and the United States.[75]

Because it is legal for businesses to charge the highest price that Canadian consumers are willing to pay for goods, competition is the only constraint that prevents businesses from charging more in Canada than in the United States for identical products, for other reasons than the costs of doing businesses in Canada.

Travellers' Exemption Limits

A number of witnesses suggested that the federal government should increase the travellers' exemption limits, the value of goods that may be imported duty- and tax-free by Canadian residents, to the current U.S. limits in order to increase competition and help to reduce the price discrepancies for certain products between the two countries.

As shown in Table 10, before June 1, 2012, the travellers' exemption limits in Canada were $0 for Canadians returning from abroad after an absence of less than 24 hours, $50 for more than 24 hours, $400 for more than 48 hours, and $750 for more than 7 days. In comparison, travellers' exemption limits in the United States are $200 for Americans returning from abroad after less than 48 hours and $800 for more than 48 hours.

Table 10 - Travellers' Exemption Limits in Canada and in the United States

Length of Absence	Travellers' Exemption Limits in Canada (Before June 1, 2012)	Travellers' Exemption Limits in Canada proposed in the 2012 Budget (Since June 1, 2012)	Current Travellers' Exemption Limits in the United States
Less than 24 hours	$0	$0	$200
More than 24 hours	$50	$200	$200
More than 48 hours	$400	$800	$800
More than 7 days	$750	$800	$800

Source: Table prepared by the Parliamentary Information and Research Service of the Library of Parliament using data from the Department of Finance, http://www.budget.gc.ca/2012/plan/chap3-2-eng.html and the U.S. Customs and Border Protection, http://www.cbp.gov/xp/cgov/travel/vacation/kbyg/types_of_exemptions.xml.

[75] http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03466.html.

In its 2012 Budget, the federal government proposed increasing Canada's travellers' exemption limits to $200 from $50 for Canadians returning from abroad after an absence of more than 24 hours and to $800 from $400 for more than 48 hours. These measures, which came into force on June 1, 2012, bring Canada's travellers' exemption limits closer to U.S. limits, but the U.S. travellers' exemption limits remain more generous because they allow Americans returning from abroad after an absence of less than 24 hours to import $200 of goods duty- and tax-free in the United States compared to $0 in Canada.

Even though the 24-hour length of absence requirement in Canada constitutes a legislative barrier to competition that increases the prices for Canadian consumers, it may be warranted to keep this requirement in order to mitigate some of the adverse consequences of cross-border shopping on the Canadian economy.

Unlike most Americans, 75% of Canadians live within 161 kilometres from the U.S. border[76], which suggests that allowing Canadians to import $200 of goods duty- and tax-free when returning from the United States for less than 24 hours could negatively impact Canadian retailers in border communities as well as the Canadians they employ.

Consumer awareness of web-based technology

As suggested by Michael Mulvey, Professor, University of Ottawa, the price discrepancies for certain products between Canada and the United States could also be narrowed by increasing competition through greater use of price shopping and comparison tools among Canadian consumers:

> *Even more powerful than the web-based shopping are a couple of other technological trends that I think could help reduce those Canadian prices. One trend is smartphones and another is web-based shopping comparison tools.*[77]
>
> Michael Mulvey, Professor, University of Ottawa, as an individual

[76] National Geographic, Canada Facts, http://travel.nationalgeographic.com/travel/countries/canada-facts/.

[77] http://www.parl.gc.ca/Content/SEN/Committee/411/nffn/pdf/06issue.pdf, p. 6:32.

Observation 1:

As more Canadian consumers become aware of smartphone applications and Internet sites for price shopping and comparison, and become price-savvy consumers, competitive pressures in Canada will increase and the price for products in Canada will converge to U.S. prices.

CHAPTER SIX: CONCLUSION

Price discrepancies for certain products between Canada and the United States are a complex issue. They can arise at any point in the supply chain between the manufacturers and the retailers, and they are often the result of several factors.

Through its hearings, the Committee looked at the contribution of country pricing and market segmentation, the relative size of the Canadian market, customs tariffs, the volatility of the exchange rate, the price of fuel, product safety standards, the *de minimis* threshold for postal shipments and the level of competition to the price discrepancies for certain products between Canada and the United States. The Committee also studied how some of these factors explain the prices discrepancies seen in the automobile industry and the book industry.

In this report, the Committee proposes four recommendations that seek to reduce the legislative barriers to competition in Canada to narrow the price discrepancies for products between Canada and the United States.

With a more competitive market and access to better information on prices, Canadian consumers will be able to more fully benefit from a strong Canadian dollar.

APPENDIX A – WITNESSES WHO APPEARED BEFORE THE COMMITTEE

Association of Canada Book Wholesalors
Heather Bindseil, President and Owner, Library Bound Inc.
(2012-02-14)

Association of Canadian Publishers
Carolyn Wood, Executive Director
(2012-04-04)

Association of International Automobile Manufacturers of Canada
David C. Adams, President
(2012-04-25)

Bank of Canada
Mark J. Carney, Governor
(2011-11-02)

Bank of Canada
Tiff Macklem, Senior Deputy Governor
(2011-11-02)

Campus Stores Canada
Chris Tabor, Manager, Queen's University Bookstore
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Canada Border Services Agency
Brent Patten, Director, Commercial Border Programs Division
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Canada Border Services Agency
Wayne Tallack, Manager, Port of Entry Operation Division
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Canada Border Services Agency
Lily Ooi, Director, Trusted Travellers Programs Division
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Canadian Alliance of Student Associations
Zachary Dayler, National Director
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Canadian Apparel Federation
Bob Kirke, Executive Director
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Canadian Association of Importers and Exporters
Carol Osmond, Vice President, Policy
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Canadian Booksellers Association
Mark Lefebvre, President
(2012-02-14)

Canadian Booksellers Association
Christopher Smith, Vice President
(2012-02-14)

Canadian Federation of Independent Business
Ted Mallet, Vice President and Chief Economist
(2012-02-08)

Canadian Heritage
Helen C. Kennedy, Deputy Director General, Cultural Industries
(2012-02-15)

Canadian Heritage
Carla Curran, Director, Book Publishing Policy and Programs
(2012-02-15)

Canadian Manufacturers & Exporters
Martin Lavoie, Director of Policy, Manufacturing Competitiveness and Innovation
(2012-02-07)

Canadian Publishers' Council
Jackie Hushion, Executive Director
(2012-04-04)

Canadian Publishers' Council
Kevin Hanson, President (President of Simon and Schuster Canada)
(2012-04-04)

Chandra, Ambarish, University of Toronto, Rotman School of Management
(2011-11-01)

Competition Bureau
Richard Bilodeau, Acting Assistant Deputy Commissioner, Civil Matters Branch Division B
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Competition Bureau
Matthew Kellison, Acting Assistant Deputy Commissioner, Civil Matters Branch Division A
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Consumers' Association of Canada
Bruce Cran, President
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Department of Finance Canada
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Department of Finance Canada
Lucia Di Primio, Chief, Excise Policy
(2011-10-19)

Department of Finance Canada
Jim Haley, General Director, Economic and Fiscal Policy Branch
(2011-10-19)

Department of Finance Canada
Patrick Halley, Chief, Tariffs and Market Access, International Trade Policy Division, International Trade & Finance
(2011-10-19)

Department of Finance Canada
Rainer Nowak, Senior Chief, Operations, Sales Tax Division
(2011-10-19)

Department of Finance Canada
Geoff Trueman, Director, Business Income Tax
(2011-10-19)

Department of Finance Canada
Elisha Ram, Director, Microeconomic Policy Analysis
(2011-10-19)

The Honourable James M. Flaherty, Minister of Finance
(2011-10-19)

Goldfarb, Avi, University of Toronto, Rotman School of Management
(2011-10-26)

Gordon, Ian, President of Convergence Management Consultants Ltd
(2011-10-25)

Hernandez, Tony, Professor, Ryerson University
(2012-04-03)

Morante, Oliver, Chief Executive Officer, John Forsyth Shirt Company Ltd
(2012-02-28)

Mulvey, Michael, University of Ottawa
(2011-10-25)

Nelson Eduction Ltd.
James Reeve, Senior Vice President and Managing Director, Higher Education Division
(2012-04-04)

Option consommateurs
Jean-François Vinet, Business Practices and Financial Services File Analyst
(2012-02-07)

Public Interest Advocacy Centre
Michael Janigan, Executive Director and General Counsel
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Public Interest Advocacy Centre
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Reebok – CCM Hockey
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Retail Council of Canada
Diane J. Brisebois, President and Chief Executive Officer
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Retail Council of Canada
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(2012-04-24)

Silver, Robert, President, Western Glove Works
(2012-02-28)

St-Amant, René, President, Empire Shirt
(2012-02-28)

Statistics Canada
John Baldwin, Director, Economic Analysis Division
(2011-11-01)

Stroll, Susana, President, Tess Sportswear Ltd and Les Modes Sportives Valia Ltée
(2012-02-28)

Transport Canada
Gerard McDonald, Assistant Deputy Minister, Safety and Security
(2011-11-02)

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Vassos, Tom
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Wong, Ken, Queen's University
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Douglas Porter, Managing Director and Deputy Chief Economist

Canadian Cattlemen's Association
Ryder Lee, Manager, Federal Provincial Relations

Canadian Tire Corporation Ltd.
Neil Mckenna, Vice President, Transportation

Chrysler Canada
Lorraine (Lori) J. Shalhoub, Vice-President, General Counsel

Dairy Famers of Canada
Richard Doyle, Executive Director

Ford Motor Company of Canada, Ltd.
Caroline Hughes, Director, Government Relations

General Motors of Canada Limited
Neil J. MacDonald, Vice President Corporate Affairs

The Investment Funds Institute of Canada
Joanne De Laurentiis, President and CEO

The Tourism Industry Association of Canada (TIAC)
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Trade Facilitation Services
Brian Rankin Staples