CANADA-EUROPE TRANSATLANTIC DIALOGUE:

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The Launch of Negotiations for an Encompassing EU-Canada Economic Partnership

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The EU-Canada Summit held in Prague on May 6, 2009, marked the end of preparatory talks between Canada and the EU on a closer economic relationship. What hitherto had sailed under various flags was in Prague finally christened the *Comprehensive Economic Partnership Agreement* (CEPA). Let no one be fooled by the name game, though. Canada and the EU seem determined to move forward on a truly deep and encompassing economic agreement that some observers see as possibly surpassing NAFTA. This would be quite a feat. First, the current environment seems unfavourable to international agreements that include such far-reaching steps towards complete liberalization. Second, the EU has thus far not been very keen on negotiating trade agreements with developed market economies. The prevailing view has been to approach such relations through multilateral treaties or agreements. Third, Canada was until recently not known to be an active trade policy party in relation to the EU, focused as it was on the US. Finally, it is not immediately clear why the current efforts to forge an economic partnership with the EU should be more successful than the failed attempts of the past.

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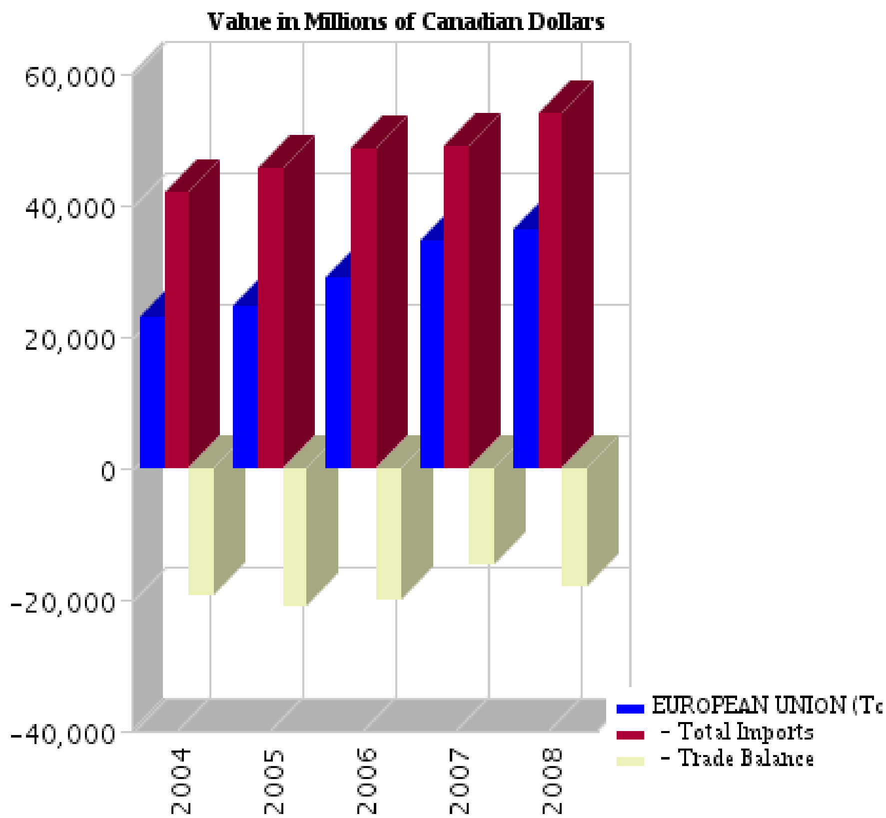
Canada FTAs

Agreement Partners and Link to Detail	"In Force" Date / Status
North American Free Trade Agreement (NAFTA)	01-Jan-1994
Canada - U.S. Free Trade Agreement (CUSFTA) **now NAFTA*	12-Oct-1987 *(superseded by NAFTA, which includes Mexico)*
Canada - Jordan Free Trade Agreement (FTA) NEW	Signed 28-June-2009
Canada - Colombia Free Trade Agreement	Signed 21-Nov-2008
Canada - Peru Free Trade Agreement	Signed 29-May-2008
Canada - European Free Trade Association (EFTA)	Signed 26-Jan-2008
Canada - Costa Rica Free Trade Agreement (CCRFTA)	01-Nov-2002
Canada - Chile Free Trade Agreement (CCFTA)	05-Jul-1997
Canada - Israel Free Trade Agreement (CIFTA)	01-Jan-1997

Canada, as well as the EU, has officially not given up hope on the multilateral Doha round. Both, however, have become much more realistic in their views on the stalled Doha negotiations, accepting that a quick resolution of conflicting interests on the multilateral level is not on the horizon. Whereas the EU has emerged as a highly active party in bilateral trade agreements, Canada has turned only reluctantly to this option. The EU signed bilateral trade agreements not only with non-EU countries in Europe but also with partners in Africa, Asia, Latin America and the Middle East. Until now, though, the EU had not negotiated an agreement with a G-8 economy. Canada, for their part, has added only Costa Rica, Peru, Columbia and more recently Jordan and EFTA onto its trade books -- still retaining a clear focus on the economic relationship with the US. No doubt, reaching an agreement with the EU would be a substantial addition to Canada's trade menu.

Canada's Trade Balance with the EU

The CEPA would be a big hit for Canada, reconnecting the country with the largest trading bloc in the global economy. The joint study prepared by Canada and the EU modelled fairly substantive gains from trade, in particular EU gains in the service sector. According to this model, seven years of free trade under the agreement would increase annual GDP by approximately 11.6 billion Euros for the EU and 8.2 billion Euros for Canada. It needs to be noted that this outcome depends crucially on the quality of the underlying general equilibrium model of world trade and, in particular, on the assumptions made therein. The Joint Study very much reflects the flavour of the day by assuming an 82% increase in real oil prices between 2004 and 2014 and a 68% rise in real grain prices during the same period. Given the depth and breadth of the economic and financial crisis these assumptions may turn out to be too bold and consequently the welfare effects of trade liberalization smaller than simulated. Indeed, it would have been better to devise several scenarios at the outset that covered a variety of development paths for the global economy.



The best-case scenario shows that the overall trade deficit with the EU will not disappear. The goods Canada exports to Europe are rich in natural resources whereas imports into Canada from the EU consist of mechanical machinery, mineral fuels and oil (!), pharmaceutical products and cars. Enhanced trade will not be a win-win-situation for all sectors in Canada. There will be winning sectors in winning provinces and losing sectors in losing provinces (see Table below). The Canadian winner-loser matrix looks quite astounding. According to the simulation, the winning sectors will be processed food, agricultural products and metals; the losing sectors will include minerals, oil, and gas.

Models go only so far, and the particular model used for the Joint Study was built before anybody was even talking about a global financial and economic crisis. However, negotiations — and even more so the public discourse — are built on the results of these simulation exercises. The state of the global economy and the drastic changes to the simulation's central parameters beg for a new interpretation of the results — a demand that has yet to receive a response.

Estimated Winners and Losers in Canada from a Bilateral Agreement

	Sector of the Economy	Base Value*	Export Effect	Export Effect Value*
Winners	Processed Foods	963 million	141.7%	1,365 million
	Primary Agriculture	1,892 million	41.8%	791 million
	Metals	2,935 million	29.3%	861 million
Losers	Minerals	3,670 million	-2.1%	-77 million

	Oil	27 million	-0.8%	>1 million
	Gas	2,897 million	-0.3%	-8 million
	Overall Export Gains (Services)	15,453 million	14.2%	2,194 million
	Overall Export Gains (Goods)	23,426 million	18.1%	4,233 million

***All values shown in 2007 Euros**

Source **The European Commission and Government of Canada (2008): A Joint Study by the European Commission (DG Trade) and the Government of Canada (DFAIT). Accessible Online : http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/EU-CanadaJointStudy-en.pdf**

At a recent international conference hosted by the Institute for European Studies at the University of British Columbia, Dr. Stephen Woolcock, a trade expert from the London School of Economics, identified several potential stumbling blocks to an encompassing agreement. These would-be obstacles concern the liberalization of financial services in the face of Canadian banking restrictions; services in general due to restraints on both sides; agriculture due to subsidy issues but also EU concerns about Genetically Modified Foods; and finally public procurement, where the EU made it clear that Canada needs to be open to competition if an agreement is to be reached.

Given the size of the cake, it is obvious that Canada needs the EU more than the EU needs Canada. The best-case scenario adds 0.8 % to Canada's GDP on an annual basis; the effect for the EU would be less than 0.1 %. Even though if the positive trade effect for Canada would be smaller than simulated it can still be economically relevant. The more so, as it seems that Canada's neighbour in the South will no longer act as global consumer of last resort and may run towards protectionism-light practices that will hurt Canadian exporters. Putting some Canadian eggs into the European basket is an appropriate strategy.

The interest of the EU in a comprehensive economic partnership with Canada is not as obvious. Simple statistics do not reflect the interest level of the EU. We have known since the time of the work of Viner (1950) that regional free trade agreements have positive welfare effects if trade creation is larger than trade diversion. We also know from subsequent analytical and empirical work that two countries are more likely to reach an agreement if they are geographically close, similar in size and differ in terms of relative factor endowment. Based on those insights we should not expect smooth negotiations between the EU and Canada, nor even a successful end to the negotiations already underway. Moreover, rational political actors should not even have entered into negotiations in the first place. When Linder in 1961 pointed out that international trade was marked predominantly by intra-industry trade and not by inter-industry trade as was implicitly assumed in the model-building exercises of the profession, efforts were undertaken to understand this similar-similar trade pattern. It was Paul Krugman, who rose to formally support the argument that exports tend to reflect the dominant good structure of the domestic economy. In this respect it seems logical that Canada dominantly trades its resources or resource-based goods with the EU, and that the EU trades mostly manufactured products with Canada. While such a trade pattern does not result in dynamic forward and backward linkages for the Canadian economy, it does cement the inferior position of Canada in the global division of labour. Intensifying the trade relationship with a resource-based economy is a rational strategy, particularly in a long-term perspective.

Canada-EU trade has traits of similar-similar as well as of dissimilar-dissimilar trade, in particular if one looks at the geographical distribution of trade. However, even then it is in theoretical terms still puzzling why political actors on both sides of the Atlantic should aim for an encompassing economic partnership with trade liberalization at its heart -- particularly given the fact that external tariffs between both entities are already relatively low. Politics, it turns out, can help explain the part that economic theory alone cannot. The EU's efforts to access Canada's relatively small market become relevant and important due to one thing — NAFTA. The EU can use Canada as the launching pad for accessing US markets. To achieve this goal, both parties need to agree on rules of origin that allow European companies to use Canadian outlets for their exports to the US. Another possible consideration argues that the EU might be using its negotiations with Canada to devise a model agreement that may be useful for its trade strategy with other developed economies.

Trade negotiations go far beyond pure economic rationale. Efforts to strike an agreement between the EU and Canada have already generated a huge change in Canadian politics insofar as the federal government could not avoid engaging the provinces as active partners in the talks with the EU. Representatives of the EU made it clear that negotiations could not be launched without having on board the provinces that would actually implement any agreement. The strong plea from the EU was thoroughly welcomed by Prime Minister Stephen Harper's minority government, anxious to overcome the high hurdles of a free trade area *inside* Canada. These negotiations with the EU were simultaneously a tool to expedite the liberalization agenda of the Conservative Party.

The EU has also used Canada as a training camp for its lobbying efforts. Never before had a negotiation partner set up a tender process for organizing conferences in a target country for the purpose of creating public dialogue, in particular with the private business sector, in provinces that seemed a bit distanced (politically and geographically) from a potential agreement with the EU. With the help of local partners, the EU co-organized workshops and a conference in Western Canada with the sole aim of promoting the benefits of an encompassing agreement with the EU. No reciprocal efforts of any such kind from the Canadian side occurred. Ever since the tumultuous disputes surrounding NAFTA, trade policy has been very much designed and executed by bureaucracies that are heavily involved with business lobbies.

Developing a comprehensive economic partnership with Europe seems too valuable to not involve civil society. The economic and financial crisis offers a huge opportunity to start a social dialogue that combines economic, social, and ecological dimension of an international strategy for the 21st century. Given the economic and political status of the EU in such a dialogue, this partnership offers Canada splendid opportunities to reposition itself. The opportunities should not be missed.