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CETA: Stumbling Blocks in Ongoing Negotiations

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**Interview with Christopher Kukucha, Associate professor of political science at the
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This policy brief examines the issue of public procurement in the context of the negotiations between Canada and the European Union (EU) on a Comprehensive Economic and Trade Partnership Agreement (CETA). The brief outlines Canadian political and economic concerns regarding the opening up of public procurement to foreign competition. The paper then traces the evolution of public procurement policy within the EU.

I The Broader Picture

Since the start of negotiations between Canada and the EU on a Comprehensive Economic and Trade Partnership Agreement (CETA), the global economic and political situation has changed fundamentally. Two changes are of particular significance for the ongoing negotiations. First, the financial and economic crisis has altered the dynamics of growth on both sides of the Atlantic. The crisis led to a permanent loss in output and a lowering of the growth potential due to weak investment and productivity improvements. It is doubtful that the original assumptions made about the benefits of free trade between Canada and the EU-27 remain realistic in the post-crisis world. The economic benefits of the CETA are likely smaller today than they were when originally outlined in the 'Joint Study' released in October 2008.¹ This new reality should not

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diminish the political importance of the negotiations but may take away some of the initial euphoria.

Second, in order to limit some of the social and economic fall-out from this crisis, governments around the globe adopted a broad range of protectionist measures. The (in)famous Bush/Obama Buy-American campaign was in many respects just the tip of the iceberg.



The financial and economic crisis of 2008-2010 triggered a wave of protectionism around the globe. Some observers feared that there would be a rerun of the protectionist wave of the 1930s. According to data from the independent monitor Global Trade Alert (GTA), there were around 100 new discriminatory measures introduced per quarter in 2009. Ranked according to the absolute number of discriminatory measures imposed, the number of sectors affected by those measures, and the number of trading partners affected, the EU-27 topped the global ranking.² However, this ranking needs to be put into context. The EU-27 also ranks second behind China as a *target* of other governments' protectionist measures. It is difficult to establish whether the EU was merely responding to or actually started the 'protectionist war'. It is clear, though, that the EU acts as a determined defender of its global trade interests. Canada while not as active as the EU still defended its national interests with vigour. For 2009, the GTA database registered 21 cases where Canada imposed protectionist measures against trading partners (http://globaltradealert.org/measure?tid=All&tid_1=305&tid_3=All).

The second change works against a quick return to the stalled Doha Round -- the current trade-negotiation round of the World Trade Organisation. This may benefit the ongoing CETA negotiations. Canada, alongside the EU, should have a strong incentive to conclude a bilateral agreement in a world where multilateralism is waning. The change in the global economic environment, however, may work against successful negotiations, as the Canadian government (and in this respect perhaps also the EU) recognizes that current and probably also future economic growth may come from the emerging economies of Asia, and thus governments may refocus their political efforts towards this critical region of the global economy. Given its status as an Atlantic as well as a Pacific economy Canada's trade policy is surprisingly underdeveloped. Only recently the minority Canadian government tried to join a trade negotiation round which included eight Pacific economies (including Australia, China, and the US) for a free trade arrangement in this critical region. The Canadians were unsuccessful in their attempts to join these negotiations. It remains to be seen whether this rebuff will result in an increase in Canadian efforts vis-à-vis the trade negotiations with the EU or if it will divert attention towards the Pacific in order to persuade those parties to include Canada in that trade round after all. Thus far, Canada has continued its participation in CETA negotiations in an effective and ambitious manner. A strong incentive for Canada to successfully conclude the talks is a real need to diversify their trading partners as well as a desire to build up a sample of coherent bilateral trade agreements which would in turn establish a clear trade strategy profile. Even though the EU-27 is Canada's second largest trading partner, it can be argued that EU-Canada trade relations are

underdeveloped. The importance Canada has given to CETA can be seen by the fact that for the first time in Canada's external trade policy history the provinces and territories are full partners in negotiations sitting at the table alongside the federal government. It makes sense for the EU to continue to dedicate all its efforts to the negotiations as CETA would mark the first comprehensive agreement with an OECD country and could establish a model for future agreements. France and Germany as well as some other leading European trading economies are strong supporters of a deal with Canada.

Following two successful rounds of negotiations, the meetings have reached a critical point. Now they may hit a hurdle or two. It is rumoured that the agreement -- which would in many ways open up markets in the EU and Canada more widely than was the case for Canada-US markets under the North American Free Trade Agreement (NAFTA) -- may be stumbling over the issue of public procurement. Interests in the agricultural sector may also lead to a clash as the Europeans look critically at Canada's supply management and Canada is among a number of critics of the EU's agricultural subsidy policies. For the moment, however, all attention is on public procurement.

II Political Economy Aspects of Public Procurement

Generally, private companies as well as state agencies have a make-or-buy option. They can either decide to produce particular goods or services themselves or to buy them from third parties. In terms of cost efficiency such a choice is straightforward as actors only need to compare market prices for clearly defined standard products and services and to opt for the lowest price. It is the job of complete and perfect external as well as internal markets to produce this outcome. The world, though, is not perfect, and private as well as public procurement may have a range of (sometimes conflicting) goals which arise during the process of the procurement of particular products and services. In the case of public procurement, it is a well-established practice around the globe that governments use public procurement as a substitute for (or in addition to an already existing) industrial policy, innovation policy, or a regional policy. There can be many social consequences of public procurement thus it may also act as a tool to build and sustain clientalistic relations. It is no surprise that the public sector and related spending are often attached to projects that serve narrowly defined political interests and which are not primarily targeted towards increased efficiency and innovation. Public procurement, in other words, has the potential to operate outside regular market processes.

Economists see liberalization of public procurement, nationally as well as internationally, as best practice and as a guaranteed way to achieve efficiency. Opening up procurement which has formerly been restricted to national bidders is seen as the most efficient way to make responsible use of taxpayers' money. Simultaneously, such liberalization adds a huge array of economic activities to private markets. Governments may agree with such a view in terms of efficient spending behaviour but disagree with regard to other goals connected to public procurement. If public procurement is, at least partially, being used to generate regional or local circuits of production of goods and services and to create regional and local jobs, a liberalization strategy that creates economic efficiencies without targeting one or all of the other intended benefits of public procurement practices, takes away control from state agencies and transfers it to private market actors.

Given the global scale of public procurement it is no surprise then that the EU sees the liberalization of public procurement as a huge opportunity: "Public procurement is an area of significant untapped potential for EU exporters. EU companies are world leaders in areas such as transport equipment, public works and utilities. But they face discriminatory practices in almost

all our trading partners, which effectively close off exporting opportunities.”³ This view is offered by the Canadian government: “Foreign government procurement markets are worth hundreds of billions of dollars annually and offer significant potential opportunities for Canadian exporters.”⁴ EU negotiators have made it clear from the outset that access to Canadian government purchases on all political levels is a *sine qua non* for signing the deal. At first glance this should not be a problem for Canada, assuming that the political will to take this step exists. As a signatory state to the WTO Agreement on Government Procurement (GPA), Canada should allow foreign suppliers to compete on a non-discriminatory basis for federal contracts.⁵ However, this obligation comes with a caveat as Canada has exempted the provincial public procurement markets. Canadian provinces, in other words, are not covered by the GPA. This is one key reason why, from the very start, the EU asked that the Canadian provinces be included in the negotiations. History shows that in a federal system such as Canada’s a CETA cannot work without the open support of provinces (and territories). The devastating effects of the economic crisis already brought some movement in the Canadian position. In order to benefit from US government fiscal injections Canada on February 2010 signed an agreement with the US that will allow Canadian companies to compete for US public infrastructure projects financed by the American Recovery and Reinvestment Act. In exchange Canada agreed to make provincial (and territorial) procurement commitments that go beyond GPA regulations. However, even this agreement does not open Canadian public procurement markets at all levels of government or for all types of projects. It seems that overall Canadian provinces are proving themselves reluctant and unprepared in public procurement negotiations with the EU. According to insiders EU negotiators highlighted Ontario’s Green Energy Act as a bad example of public procurement practices as it would be biased towards provincial job creation and offer subsidies to local suppliers of energy-efficient products and services.⁶

Compared to the situation in Canada, there is a much longer history of liberalizing public procurement in Europe. It needs to be noted that even though access to public procurement is now a criterion for accession to the EU and a pillar of any trade negotiations with countries outside the EU, internal access to member state public procurement remains multilayered and only partially implemented. Legislation at the community level concerning public purchasing among EU member states occurred in two phases: Phase one (1971-1977) and Phase two (1989-1994). Phase one worked to create a level playing field for access to information on public tenders in the Supplement to the Official Journal of the European Communities (OJEC). Unequivocal exemptions were made for defence and utilities (transport, water, energy and telecommunications) sectors.

Phase two saw public procurement legislation expanded and textured. EU Utilities were finally opened up to all member states, distinctions were made between priority and non-priority sectors and public entities and private companies acting as public entities. To encourage further public purchasing liberalization, three types of contract procedures were devised: open competition, restricted competition and negotiated competition.

While far from perfect, EU public procurement directives have achieved positive economic results. A 2009 report⁷ on the functioning of public procurement markets in the EU revealed that public procurement directives had reduced costs and increased the number of contracts awarded to foreign companies. Of particular interest was the large number of contracts awarded to foreign companies acting through local subsidiaries. The involvement of local subsidiaries helped enormously to add to economic efficiencies and to the fulfilment of social and productivity targets for particular political sub-units. In the last couple of years, EU member states turned towards so-called *green public procurement strategies* in order to move towards sustainable

national or sub-national policies without violating EU rules on liberalized public procurement markets.⁸ There may be lessons to be learned from this move.

Public procurement will definitely be one of the sticky items during the ongoing negotiations. The Canadian federal government soon expects to learn from the provinces and territories how far they are willing to compromise with EU demands. Given the size of public procurement markets and the distribution of comparative advantages between the EU and Canada, it seems fair to expect that the EU will fight for liberalization.

III What makes public procurement such a sticking point in CETA negotiations?

Interview with Christoph Kukucha, Associate Professor, Department of Political Science, University of Lethbridge, Alberta

What makes public procurement such a sensitive issue, particularly for Canadian provinces and which provinces historically have been the most concerned about this?

If you look at NAFTA and the WTO GPA, Canadian provinces have not been eager to negotiate procurement. Ultimately, the federal government did not have the political will to push the provinces into a broad public procurement agreement especially with the US. NAFTA did contain provisions to negotiate procurement more fully in the future but it did not happen.

Ontario offers a good example of the difficulty in negotiating procurement at the provincial level in Canada. They have a very complicated procurement market, dominated by construction and services, which has significant economic implications for the province. The inclusion of a provincial procurement provision in NAFTA would have been difficult and complicated.

When the Agreement on Internal Trade (AIT) came into effect in 1995, one of its goals was to reduce barriers to government procurement between the provinces and territories. Since then the Trade, Investment, and Labour Mobility Agreement (TILMA) has been signed, is there a movement for greater liberalization of public procurement among the provinces and could this help accelerate CETA negotiations?

The internal trade agreements in Canada, the AIT, the British Columbia-Alberta Trade, Investment, and Labour Mobility Agreement (TILMA), and the recent Trade and Cooperation Agreement between Ontario and Québec (TCA), all provide an indication of where the provinces will direct procurement negotiations. Another source is the recent Canada-US agreement on procurement (in response to the *American Recovery and Reinvestment Act*). I'm actually writing a chapter for publication right now in which I argue that I think that if you want to know where the provinces are going to come down on this issue, look at where they are in the internal agreements and the recent Buy America agreements. The Europeans will not get anything substantially different than the language contained in these existing commitments. In the internal agreements you see a wide variety of construction thresholds for goods, construction, and services, criteria for which contracts are open for bidding and which are not, and at what value. Guidelines are also established for bids related to municipalities, academic institutions, school boards, and hospitals (MASH procurement). There are different rules for different institutions, such as the education and services sectors.

The EU is so concerned about balanced negotiations, what, if anything, would Canadian provinces and territories be likely to accept as compensation for opening up their public procurement markets to EU companies?

Again, if you want a sense of what kind of deal would need to be struck, look at the Buy American agreement. If you look at that, Annexes 2, 4, and 5 particularly, outline numerous exemptions, especially in services and construction. I would think that any EU agreement would require similar flexibility. The fact that the provinces were willing to open sub-federal procurement in the Canada-US agreement, however, is a positive sign, and demonstrates a shift in thinking for some, but not all provincial governments. Ontario and Quebec, for example, have had negotiated settlements for specific procurement disputes with US states in the past, most notably New York. Other provinces, however, do not have a history of bureaucratic expertise in this issue area.

In TILMA, there are still exemptions to public procurement openness based on environmental concerns. This push for ‘green procurement’ might also be a reason for Ontario’s resistance in EU-Canada CETA negotiations.

Green procurement is relatively new. And the province of Ontario has placed a high priority on this issue area. While there is potentially a great deal of government money to be made on green procurement, it isn’t a major issue for all provinces.

I’d also like to add a couple of final comments. Several provinces are somewhat suspicious of the EU’s ambitious agenda in these negotiations. A specific concern is that CETA represents an effort by the Europeans to “export” EU standards and regulatory regimes across a wide range of trade issues. Provincial negotiators, for example, point to similar EU activity in the International Organization for Standardization (ISO), since its inception in 1947. Although the ISO is essentially a non-governmental organization, consisting of representatives from various groups responsible for defining national standards, it still provides an indication of EU objectives. The belief is that CETA is part of a much broader strategy to target existing North American standards and regulations established in NAFTA. This has obvious implications for ongoing Doha negotiations but if these fail, some provincial negotiators are worried that CETA will provide a template for future EU negotiations, especially with the United States.

A lot of companies are puzzled about why the Europeans are putting such an emphasis on it. In fact, they’re a bit suspicious of what many perceive as a mechanism to export European practices and frameworks (such as health and safety mechanisms), perhaps for leverage in Doha and with the US to get others to buy into the EU-model for trade.

Finally, in Ontario’s defence, it does have a complicated public procurement market, and its trade policy bureaucracy is understaffed. There has never been a whole lot of demand by US companies trying to access procurement. If the Europeans are seeking to negotiate an extensive agreement on procurement they need to understand that it will take time and that Ontario, and most other Canadian provinces will not do this, Ontario only has a handful of people working on this. This makes it hard for provincial negotiators to come to the table with every element of this sorted out.

¹ *Assessing the Costs and Benefits of a Closer EU-Canada Economic Partnership*, A Joint Study by the European Commission and the Government of Canada, released October 2008, http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_141032.pdf

² Simon J. Evenett (2010, 26): *The Global Overview: Has Stabilisation Affected the Landscape of Crisis-Era Protectionism?*, www.voxeu.org

³ Report from the Commission, COM (2009) 592 final:17: *Concerning negotiations regarding access of Community undertakings to the markets of third countries in fields covered by the Directive 2004/17/EC*

⁴ DFAIT: Government Procurement, www.international.gc.ca/trade-agreements-accords-commerciaux/fo/gp.aspx

⁵ To date the GAP covers Canada, EU, Hong Kong, Iceland, Israel, Japan, Korea, Liechtenstein, the Netherlands, Norway, Singapore, Switzerland, Taipei, and the US. Negotiations with China are ongoing. Recently the EU started to include public procurement in all of its bilateral trade agreements.

⁶ Doug Saunders, Globe and Mail, March 31, 2010: *Ontario's foot-dragging imperils Canada-EU trade pact, officials say*, www.theglobeandmail.com/news/world/article1518147

⁷ Report from the Commission, COM (2009) 592 final:17: *Concerning negotiations regarding access of Community undertakings to the markets of third countries in fields covered by the Directive 2004/17/EC*

⁸ See digitaleurope, *EU 'Green' Public Procurement*, 16 March 2010, www.digitaleurope.org