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Changing Canada: Canada-European Union Free Trade

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Canada and the European Union (EU) are engaged in an under-the radar trade negotiation which, for Canada, will lead to the most important economic agreement since the North American Free Trade Agreement (NAFTA). What NAFTA did for opening Canada to the rest of North America in the 1990s, the Comprehensive Economic and Trade Agreement (CETA), proposes to do with the 27-member European Union; the world's largest and richest market.

This is Canada's third attempt to strengthen its economic relationship with the EU, an effort that has spanned almost four decades and three prime ministers starting with Pierre Trudeau in 1976, followed by Jean Chrétien in 2002 and now Stephen Harper. It recognizes Canada's strong European roots and secures its second largest trading and investment relationship. The first two attempts were not successful. Canada will not get a fourth chance. CETA must succeed for three reasons.

First, it can bring the existing economic relationship to its full, and as yet unrealized, potential by providing significant opportunities to improve trade and investment flows.[1] It can start to reverse Canada's slowly growing trade deficit in goods; open new opportunities for its important trade in services and protect and expand its considerable European investments. Over the long term, a European Union study sees the Agreement leading to "gains in welfare, real Gross Domestic Product (GDP), total exports, the balance of trade and wages in both Canada and the EU…".[2]

Second, it will make Canada a more competitive player on the international scene. The CETA negotiations are historic for Canada. For the first time, all Canadian provinces are fully engaged and matters such as provincial government procurement, which falls under provincial jurisdiction, are on the table. If the

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provinces are open to free trade with the EU, can they continue to refuse to bring down trade barriers between themselves? Competition is one of the Union's founding strengths and it has thrived under the principle of freedom of movement of goods, capital, services and labour within the EU. CETA goes beyond trade, foreseeing the establishment of a forward-looking, cooperative network at the Canada-EU level, but also between EU member states and Canada as well as between the provinces/territories and member states or their component parts.

Lastly, it will underline to trading partners around the world that Canada is a strong, open North American nation with secure trading relationships on both sides of the Atlantic and ready to embrace globalization. This far-reaching trade and economic agreement goes beyond the scope of NAFTA. In any such agreement, there will be winners and losers and, as the smaller partner, Canada will have to make greater internal adjustments than the larger EU. While most Canadians are unaware of the negotiations, alarm bells are already starting to sound from some provinces and protected Canadian sectors—what *Globe and Mail* columnist Jeffrey Simpson calls the "parochialism of Little Canada."[3] He asks whether Canadians are prepared "to dilute Canada's ability to act alone in exchange, in theory, for economic benefit?"[4]

Canada and Europe have been players on each other's continents for a very long time. While Canada's languages are English and French and our governmental structures largely British, the third largest ethnic group is of German origin. In addition, one and a half million Canadians claim Italian heritage. It is therefore not surprising that in 1959 Canada was the first industrialized country to sign an agreement with the then European Economic Community (EEC), the treaty on Cooperation in the Peaceful Uses of Atomic Energy. In the early 1970s, Prime Minister Pierre Trudeau was concerned that Canada was becoming too dependent on the United States economy. His government put forward three options for the future: maintain the status quo, enhance and secure trade with the US, or open up other markets to reduce Canada's dependence. The government chose the "Third Option" and looked to the expanding EEC as its chosen trading partner.

The result was the 1976 Framework Agreement for Commercial and Economic Cooperation; again, the first such treaty the EEC had signed with any other industrialized state. The Agreement created a structure for a high level dialogue with a Joint Cooperation Committee (JCC) and a variety of subcommittees on trade and investment, agriculture and energy. While the JCC and the subcommittees have now met annually for 35 years, the Third Option has been recognized as a failure. As our trade with the US went on increasing, eventually hitting 85% of our overall commerce, the Government soon recognized that one could not will a change in trade patterns. The Trudeau Government did not engage the private sector, except for one trade mission after the agreement was signed. Companies continued to trade where the easiest and richest market was – right across the border. Certainly, governments can influence trade patterns by making trade in goods and services easier, by removing tariff and non-tariff barriers, engaging in regulatory cooperation and facilitating the movement of people. This is what the EU has been doing since its inception, what Canada, the US and Mexico did under NAFTA and what Canada and the EU are now currently negotiating under CETA.

Total trade in goods between Canada and the EU has grown each year totalling $82 billion in 2010.[5] Canada has been running a constant trade deficit with the EU ($13.5 billion last year) as it has done with its other main trading partners except the US.[6] While the overall trade numbers might look impressive, both Canada and the EU have recognized for many years that our bilateral trade is below its potential. Total trade between the two is almost the same as total trade between the EU and India, even though the Canadian economy is one and a half times larger than that of India.[7] Likewise, Canada's GDP is one and a half times larger than that of South Korea. Yet the EU's trade with Canada is 24% lower than its trade with South Korea.[8]

In 2001, the House of Commons Committee on Foreign Affairs published a report entitled "Crossing the Atlantic: Expanding the Economic Relationship between Canada and Europe." The report recommended: "that the Government of Canada rapidly develop a business case for a free trade agreement with the EU and undertake an aggressive campaign both in Canada and in Europe to promote its findings to key decision makers."[9] In 2002, Prime Minister Chrétien instructed his Ministers of Foreign Affairs and International Trade to pursue the proposal. There was little enthusiasm within the European Commission, however, which argued such a negotiation with another developed trading partner would undermine the World Trade Organization's Doha Round of multilateral trade negotiations. Instead, the two sides launched the Trade and Investment Enhancement Agreement (TIEA), which was short on obligations and long on hortatory commitments to "explore", "study" and "consider" issues such as regulatory cooperation and trade and investment facilitation.[10] Negotiations came to an end in 2006.

Sometimes good ideas just take time. In 2006, the Conference Board of Canada published a study, supported by the Canada Europe Roundtable for Business (CERT), entitled "Lost over the Atlantic: The Canada-EU Trade and Investment Relationship."[11] The study found that "while Canada-EU political bonds are close … both sides seem to be taking the economic relationship largely for granted ... Barriers to trade and investment … continue to impede economic cooperation between the two sides."[12] The report underlined that it would be in Canada's national interest to enhance trade with the EU since Canada is clearly more dependent on the EU as a trade and investment partner than the EU is on Canada. In 2007, 105 Canadian and European CEOs issued a Declaration in Support of a Canada-EU Trade and Investment Agreement. They urged the two sides "to design a new type of forward-looking, wide-ranging and binding bilateral trade and investment agreement, including free trade, covering new generation issues and outstanding barriers."[13]

After years of declarations and studies, the impetus to actually launch free trade negotiations came from an unexpected source: a provincial premier. In early 2008, Quebec Premier Jean Charest toured the EU calling for a Canada-EU Free Trade Agreement (FTA) and convinced the leader of the only country that could make it happen — France. While all the 27 EU members would have to agree, France would either be a helper or a hindrance. Previously, France had tacitly opposed free trade with Canada on the basis that this would open the door to free trade with the US — a much more complex undertaking given the size and clout of the US economy. French president, Nicolas Sarkozy, gave the project his blessing.

The Harper Government embraced what had become Premier Charest's very public initiative. A reluctant Commission was won over through Canada's advocacy with member states and by a 2008 Joint Study, which demonstrated the benefits to the EU of a comprehensive FTA with Canada. Canada made particularly good use of the EU's rotating presidencies, in particular the French presidency, which championed the accord. Canada also demonstrated its openness to a very broad accord, going beyond a simple FTA. The slow progress on the Doha Round helped too as compared to ten years ago. At the Canada-EU Summit held on May 6, 2009, in Prague, Czech Republic, the Canadian and EU leaders agreed to negotiate a "comprehensive" and "ambitious" economic partnership[14] agreement" with everything on the table including trade in goods, services, investment, government procurement, food safety, regulatory co-operation, intellectual property, competition policy, dispute settlement and sustainable development.[15]

To assure the EU that Canada's provinces would not be impediments, all of the provinces signed on to the negotiations and Canada, for the first time, gave the provinces seats at the negotiating table. This is a major step in "functional federalism" going beyond the strict Constitutional provisions of the federal "trade and commerce" power to include the provinces in the negotiation of trade and investment issues with a direct impact on them. Prof. Christopher Kukucha identifies six potentially challenging sub-federal issues: alcohol; agriculture; sanitary measures, technical barriers to trade and regulatory co-operation; government procurement; services and the protection of foreign investment.[16] While strict constitutionalists might decry what they see as an erosion of a federal constitutional power, the pragmatic result will be a comprehensive Agreement of benefit to a large number of Canadians with, hopefully, all of Canada's federal and sub-federal actors on board.

Canada is one of the few EU trading partners that does not enjoy some preferential access to its internal market. While the tariffs on traded goods between Canada and the EU are, on average, low, a number of sectors, including agriculture, processed food, textiles, clothing and automotives, still face significant levels of tariff protection.[17] Canada's average tariff on agricultural goods is almost 22% and it maintains "tariff peaks" of 313% on some dairy products. Imports of cheese are restricted to 20,412 tonnes a year with a duty of 245.6% on "out of quota" imports inhibiting EU cheese exports to Canada, "despite consumer demand."[18] Similarly, EU restrictions mean that Canada, the world's third largest pork producer, exports hardly any pork to the EU. A range of identified non-tariff barriers related to differing regulatory approaches also inhibit bilateral trade.

Canada's potential to increase its trade, including its agricultural trade, with the EU is significant. The Joint Study simulation of tariff elimination indicated that two-way bilateral trade could expand by $26 billion.[19] An independent EU study indicates that major levels of liberalization would increase Canada's exports of both beef and pork,[20] something of importance to Alberta, Ontario and Quebec. Atlantic Canada would benefit from the elimination of EU tariffs on frozen fish and seafood. Both sides would benefit from the elimination of duties on processed agricultural products. There are also benefits for Central Canada in the industrial products sector. The elimination of tariffs in the automotive industries can lead to increased output and exports although, for Canada, the yet-to-be agreed rules of origin will be a key factor determining the level of benefit.[21] Tariff liberalization is also expected to have a positive economic impact on the textiles industries of the EU and Canada over the long-term.[22]

In developed economies such as Canada and the EU, the services sector is the main source of economic activity.[23] In Canada, services account for over 70% of employment and 63% of employment in the EU.[24] Liberalization within the services sector therefore offers the potential to generate the greatest gains for both partners.[25] It is, however, a harder sector to quantify than trade in goods. The EU estimates that the services trade within the Union is 35% higher than it would be without a single market. The Canada-EU Joint Study believes that reducing trade costs by 2% to 10% could achieve the same result in the Canada-EU services trade.[26] Liberalization of transport services would result in "significant benefits"[27] with Atlantic Canada again being a principle beneficiary. Moreover, the liberalization of feeder services in Canada (i.e. allowing EU registered ships to transport goods between Canadian ports) would lower costs, increase efficiency and increase EU investment in Canada's maritime transport sector.[28]

The services sector is dependent on people and improvements in the temporary movement of labour could serve to benefit both trade and investment.[29] The EU is a very large and attractive market for architectural and engineering services, areas of particular Canadian expertise. One of the greatest gains would come from temporary movement of professionals with CETA opening the door to the recognition of engineers' and architects' qualifications in both Canada and the EU.[30]

Canada and the EU are surprisingly significant investment partners. While it might be expected that the 500 million people living in the EU would be Canada's second largest investment partner, it is surprising that Canada, with 33 million people, is the fourth and close to third largest investor in the EU. Canada's investment stock there is $149 billion[31] — more than 80% higher than it was in 2006.[32] The EU direct investment in Canada is $164 billion[33] — more than 35% higher than in 2006 and an eight-fold increase since 1995.[34] The most important component of this relationship is foreign affiliate sales from Canadian companies in the EU and vice versa.[35] These provide an important source of revenue for Canadian firms and trade diversification for Canadian and EU companies — in fact Canadian firms sell more in Europe than they export to Europe.[36] These investments also contribute to the development of increasingly important "global value chains" allowing for the international sourcing of components and services.[37]

These affiliate sales are a major component of what the Conference Board calls "Canada's Missing Trade with the European Union."[38] The Board urges the two sides to take an "integrative trade policy approach" in the CETA negotiations which would eliminate barriers to services trade, people movements, digital trade, trade in technologies and investment. The Conference Board maintains that using this "integrative approach" to include uncalculated sales from affiliates, services and digital sales shows the massive amount of "missing" bilateral trade. They calculate that, using this approach, overall bilateral Canada-EU trade in goods and services would be about $590 billion instead of the $118 billion reported in 2008.[39] The Board readily acknowledges that these numbers are hard to calculate with certainty but, even if a percentage of the missing trade were correct, the numbers would underline even more the size and importance of Canada's economic relationship with the EU.

If investment is indeed the driving force of bilateral trade,[40] it is in Canada's interest to ensure that its sizeable investments in the EU are protected and their expansion ensured. The Canada-EU Joint Study notes "Canada has one the highest Foreign Direct Investment (FDI) restrictiveness coefficients among OECD countries".[41] EU member states, by contrast, record low restrictions reflecting the absence of formal barriers to intra-EU FDI and more openness to non-EU countries.[42] The removal of regulatory barriers and regulations, easing visas for temporary workers and recognizing professional qualifications are all-important steps to attract and retain foreign investment. In a submission to the two sides, the Canada-EU Mining Council underlined the problems Canadian mining companies have had in obtaining approvals and permits to develop, expand and rehabilitate mining projects in the EU. The Council proposes that CETA give Canadian investors the same protection within the EU that domestic investors enjoy when faced with arbitrary or discriminatory treatment.

The background studies prepared by Canada and the EU underline the importance of increasing competition. From the European Union's inception, competition has been at its core. Bringing down barriers and simplifying rules has led to the creation of the world's richest single market spanning 27 countries with 500 million people. It is paradoxical that a federal state such as Canada has not yet achieved the single market in goods and services the EU has achieved. In an analysis, the Macdonald-Laurier Institute estimates that inter-provincial trade barriers cost Canadians $8 billion a year.[43] There are restrictions between provinces on the free flow of labour (there are over 440 occupational regulatory bodies in Canada), on provincial government procurement reserved for provincial companies and on the transport of alcohol across provincial boundaries. Even selling Alberta hay in BC is forbidden unless it is unloaded and repacked. With the provinces as an integral part of the negotiations, CETA offers the possibility of not only bringing down trade barriers between Canada and the EU but between the provinces.

Increasing competition benefits Canadian consumers. Canada has some of the highest mobile phone and Internet charges among the countries of the Organization for Economic Cooperation and Development (OECD) and it is one of the few of its members that have foreign ownership restrictions for telecommunications operators. Canada's investment restrictions make EU telecommunications operators wary of investing in Canada,[44] reducing competition. The EU predicts that if these restrictions are removed "it is likely the impact in Canada will be pronounced with sizeable increases in inward FDI, output and exports….Canadian consumers would likely benefit substantially from reduced prices."[45] European companies see great business prospects in the federal and provincial government procurement markets. Competition there too will reduce costs.

In an agreement of this scope covering all levels of government in Canada and the EU and its member states there will be gains and losses. The independent EU study sees liberalization providing the greatest gains in the services sector but with a potential impact over the long term on some industrial or agricultural producers as resources move from one sector to the other.[46] The danger is protectionism of "Little Canada" coming to the fore led by provinces defending their parochial interests and protected industries fearing liberalization. In the 1990s Canada began free trade negotiations with the European Free Trade Association (EFTA), composed of Norway, Switzerland and Iceland. Switzerland and Norway are in the top tier of Canada's economic partners accounting for more than $15 billion in two-way annual trade. Yet, this agreement was stalled for ten years because Newfoundland and Nova Scotia charged that Norway was subsidizing its ship and oil platform building industries. Norway maintained this was untrue.

In addition, there are the protected, and potentially vulnerable interests, in financial services, publishing, telecommunications, agriculture, pharmaceuticals and airline services. An economist from the Canadian Autoworkers Union announced, with little supporting evidence, that a CETA would mean a loss of 150,000 Canadian jobs.[47] A generic pharmaceutical study has predicted that Canadians would pay $1.5 billion more in drugs annually if their patent protection were changed to suit the EU. While the EU sees the potential that competition would bring to lower prices and increase choice in the provincially controlled sale of alcohol as well as the federally controlled sale of dairy products, its hopes are not high that CETA will change these regimes (except perhaps to open the restrictive cheese import quota). Some provincial premiers are already announcing what will *not* be on the table regarding provincial procurement. As the negotiating endgame approaches, more expressions of concern from provinces and protected industries can be expected.

It is only natural that those interests that might be affected express concerns and lobby to maintain the status quo. But the overriding question has to be: "what is good for Canada?" In considering the national interest, all stakeholders should also remember that CETA is a political as well as an economic venture cementing ties with longstanding Canadian allies which are part of the world's largest, and one of its most dynamic, markets. Canada and the EU have identified a range of co-operative activities, to be undertaken by different levels of government including the provinces and member state regions to improve the lives of Canadians and Europeans. The areas examined include science and technology, energy (including renewable energy), electronic commerce, the environment, transportation (where the EU is a world leader in rail transport), immigration and asylum and education (including student mobility) and training.

An agreement of this scope opens the doors not just to the benefits that can be seen and quantified but also to the unexpected returns brought about by information exchange and collaboration. The "modelling" undertaken by both Canada and the EU estimates billions of dollars in annual increases in GDP ranging from between $5.4 and $11.5 billion for Canada and $5.7 and $15.2 billion for the EU.[48] The Joint Study notes that a large part of these gains will come from the Agreement's "induced" increase in productive resources through new capital investment and what is called the "dynamic effect" of trade and investment policy.[49] In a globalized economy, increasingly dependent on global value chains, trade and investment liberalization under CETA will open the way to improved access to lower-cost production making both jurisdictions more globally competitive.[50]

The Canadian federal election and intra-EU consultations have delayed CETA's concluding rounds, although the negotiators have narrowed the issues to the more sensitive ones. Final offers on tariffs, services, investment, and procurement remain to be made. Both sides will then analyze the various offers to determine where the balance between them is and whether the agreement is "saleable" on both sides of the Atlantic. With five provincial elections this fall, it is not expected CETA will be signed until early 2012.

The world around us is rapidly changing. In the past, Canada has been adept at developing allies and creating organizations to advance its political and economic interests. CETA can be seen in this light. With the Agreement in place Canada can look to free trade negotiations with India and Japan and the hopeful conclusion of the one with South Korea. Success with the EU should give impetus to the negotiations with the United States on Perimeter Security and minimizing border restrictions. CETA offers an important new dimension for Canada but it will require change. The unanswered question is whether Big Canada or Little Canada will prevail.

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[1] A Joint Study by the European Commission and the Government of Canada, "Assessing the costs and benefits of a closer EU-Canada economic partnership", 2008 p. 179
[2] EU-Canada Sustainability Impact Assessment (SIA). May, 2011 at p. 14
[3] Simpson, Jeffrey, "The Parochialism of Little Canada is killing us", *The Globe and Mail*, December 17, 2010
[4] Simpson, Jeffrey, "Canada, the Junior Partner", *The Globe and Mail*, February 16, 2011
[5] Statistics/Industry Canada, *www.ic.gc.ca/eic/site/tdo-dcd.nsf/eng/Home*
[6] id and op cit supra n1 at p. 22
[7] ibid at p. 18
[8] id.
[9] Government Response to the Fifth Report of the Standing Committee on Foreign Affairs and International Trade, October 31, 2001 at p. 11
[10] see *www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/eu-ue/index.aspx*.
[11] Wengno Cai and Daniel Lemaire, "Lost Over the Atlantic. The Canada-EU Trade and Investment Relationship", Conference Board of Canada, Ottawa May 2006
[12] ibid at p. 1
[13] see *www.canada-europe.org/.../CERT_Canada-EU_Trade_Investment_ Declaration.pdf*
[14] Canada-EU Summit Declaration, May 6, 2009 at www.canadainternational.gc.ca/eu-ue/bilateral_relations_bilaterales/2009_05_06_statement-declaration.aspx?lang=eng
[15] see Press Release from Prime Minister Stephen Harper, May 6, 2009 www.pm.gc.ca/eng/media.asp?id=2560
[16] Christopher J. Kukucha, "Provincial Pitfalls: Canadian Provinces and the Canada-EU Trade Negotiations", www.cpsa-acsp.ca/papers-2010/Kukucha.pdf, at pp. 16-18.
[17] op cit supra n1 at p. 33
[18] ibid at p. 34
[19] ibid at p. 167
[20] op cit supra n2 at p. 15
[21] ibid at p.16
[22] id.
[23] ibid at p. 196
[24] id.
[25] id.
[26] op cit supra n1 at p. vi
[27] op cit supra n2 at p. 17
[28] id.
[29] ibid at p. 18
[30] id.
[31] op cit supra n5
[32] op cit supra n1 at p. 26
[33] op cit supra n5
[34] op cit supra n1 at pp. 26-27 (note EU investments increased 7 times from 2006 and 8 times by 2010)
[35] op cit supra n1 at p. 24
[36] ibid at p. 32
[37] ibid at p. 45
[38] Danielle Goldfarb and Louis Theriault, "Canada "Missing" Trade with the European Union" Conference Board of Canada, Ottawa, September, 2010
[39] id at p. ii
[40] op cit supra n1 at p. 32
[41] ibid at p. 46
[42] id
[43] Macdonald-Laurier Institute, "Citizen of One, Citizen of the Whole", June 2010
[44] op cit supra n1 at p. 49
[45] op cit supra at n2 at p. 17
[46] ibid at p. 15
[47] Jim Stanford, A Canada-EU Free Trade Agreement: Public Good or Private Interest   October 28, 2010, Carleton University and Patrick Leblond: Free trade with Europe will not destroy 150,000 jobs (November 2010) at http://canada-europe-dialogue.ca/events/archive/canada-eu-free-trade-agreement/#Standford
[48] op cit supra n1 at p. vi and op cit supra n 2 at 14-15
[49] op cit supra n1 at p. 56
[50] id