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From Laggard to Leader: How CETA Transforms Canada's Trade Agenda

By Ross Hornby

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Prime Minister Harper called the Canada-EU Comprehensive Economic and Trade Agreement "historic" when he initialed it in October 2013 in Brussels. Many Canadians must be wondering: why such rhetoric? CETA will hardly have the impact of NAFTA, which at the time it entered into force covered 80 percent of Canada's international trade. Even at its pre-recession height, Canada-EU trade accounted for only 9 percent of Canada's trade and just 1.8 percent of EU external trade.

But CETA is in fact historic. It represents a leap into the 21st Century for Canadian trade policy. The scope of tariff elimination is broader and faster than in previous trade agreements, or in the Canada-Korea agreement finalized in March 2014. It contains a new approach to transatlantic economic relations in the way it liberalizes trade in services and the temporary mobility of workers. And potentially it begins the long process of eroding Canada's costly supply management system in agriculture by chipping away at quotas. CETA is also historic because of the unprecedented inclusion of the provinces in the negotiations and the very fact that Canada was able to bring a reluctant European Commission to the negotiating table.

CETA is the most comprehensive trade agreement in decades for Canada and gives it preferential access to the world's largest trading block. It makes progress on behind-the-border issues that constitute the true obstacles to trade: the use of regulations to discriminate against imports, local content requirements, lack of harmonized product standards, restrictions on investment and labour mobility. CETA is a "next generation" agreement that will address these barriers and establish a precedent for other trade negotiations, notably the EU-US Transatlantic Trade and Investment Partnership (TTIP) and the Transpacific Partnership and potentially even a next stage NAFTA. When it enters into force, Canada will be the only G7 country with preferential access to the world's two largest markets, the EU and the US.

The Scope of the Agreement

CETA is a transformative trade agreement. Agriculture is a case in point. Up until its conclusion, Canada was viewed by Australia or New Zealand and even the US as a free trader who had lost its way. Canada played a leading role in the Kennedy and Uruguay Rounds of trade liberalization in the 1960s, and the 1980s-1990s. But during the ill-fated Doha Round of the WTO Canada became a laggard. It was no longer a central player in the contact group of contracting parties that drove the Round and it was marginalized by the so-called Cairns group of agricultural free traders because of its protectionist supply management policies. Canadian trade officials were distraught but politicians were not able or willing to "put everything on the table" because of domestic electoral considerations. CETA is changing all that. Canada has moved from laggard to leader in trade liberalization.

The agreement forces the government to buy access for non-supply managed pork and beef by eroding the quota protection for dairy. Such a tradeoff brings into sharp focus the cost of supply management. Trading partners legitimately see this as the first modest erosion of protectionism in the area of supply management.

Looking forward, Canada's TPP partners will also demand a greater share of our supply managed markets in return for opening their markets to the non-supply managed sector. Ultimately, it is conceivable that more efficient Canadian dairy farmers will ask why they should not be allowed to export if they no longer control the entirety of the Canadian market. Freely traded agricultural sectors will increase the pressure to have quota restrictions lifted so they can take full advantage of liberalization. Governments will say the opposite, but the long-term sustainability of supply management is now in question. The protection of supply management in the recently concluded Canada-Korea agreement should be seen as an anomaly in the trend to liberalization that had more to do with the Korean diet and its own protectionist policies than any reversal in the path to free trade in agricultural products.

The services agreement is similarly unprecedented. Services account for 70 percent of Canada's GDP and CETA will liberalize trade in all services except those specifically excluded. This is the so-called negative list approach. In the past, the EU's FTAs only liberalized specified services, a positive list, which was necessarily restrictive and automatically excluded new services as they were developed. Pushed by Canada, and desirous of expanding its own jurisdiction over services, the Commission agreed to the negative list approach over much skepticism from the Member States. The negative list approach has now set the bar higher for other trade negotiations. The EU will adopt such an approach in TTIP and the negative list approach will be the likely outcome in the TPP.

Of course, it remains to be seen what services will be excluded by the Member States. If leading countries in the EU exclude key services, the negative list approach will have proved of little use. However, placing the liberalization of trade in services at the centre of CETA, equal to or more important than tariff elimination, is evidence of the importance trade negotiators attach to updating trade agreements to reflect the actual role of services in the economy.

Under CETA, one can anticipate that Canadian engineers, architects, business consultants, to name only a few professions, will have better access to the EU than their competitors in other countries. Added to this, is a framework for the mutual recognition of professional qualifications to be negotiated by professional associations. Together with enhanced labour mobility providing for the temporary entry or relocation of intra-company transferees, expert staff, business people and investors, the stage is set for an increase in trade in services between Canada and the EU. The mutual recognition provisions are enabling. It will be up to service providers and professional associations to give them maximum effect.

The investment chapter is another innovation. Investment is a new jurisdiction for the European Commission under the Lisbon Treaty, which entered into force in 2009. Member States are jealous of their authority and, in the current economic and political climate, reluctant to transfer additional powers to the Commission. The inclusion of an investment chapter is in and of itself progress, eliminating the need for individual Foreign Investment Protection Agreements (FIPAs) with Member States. Canada has agreed to raise the threshold for Investment Canada review of EU investment into Canada from $1 billion to $1.5 billion. The EU has agreed to an investor-state dispute settlement chapter, with a provision for public interventions. The inclusion of investor-state dispute

settlement could turn out to be a lightning rod for opponents to trade liberalization in the EU Parliament for the same reason that similar provisions in NAFTA have attracted opposition in Canada from environmentalists and social policy advocates, who argue (with very little evidence) that investor-state clauses encumber the policy initiatives they promote.

The chapter on government procurement represents a departure for Canada in trade agreements. Provincial and state procurement was specifically excluded in NAFTA; a situation Canadian provinces have come to regret as the US Congress brings forward more and more blatantly protectionist Buy America provisions in funding bills. Eliminating the right of provinces to sole source or include local content requirements in major procurement initiatives, such as urban transportation or power generation, was a major "offensive interest" of the EU. The Commission required the binding of sub-national entities in Canada to set the precedent for the TTIP negotiation with the United States, where the elimination of Buy America will be a major objective. In this way, CETA corrects a major problem by limiting, the ability of sub-national governments to force suppliers to source locally for major procurement initiatives. It will be important to watch that local knowledge requirements or local economic benefits in future requests for proposals do not erode the benefits gained for taxpayers and Canadian exporters through CETA and the trade agreements that it will influence.

Updating Canada's intellectual property laws under the pressure of CETA represents another policy departure for Canada. Although the distinction between brand name and generic manufacturers of pharmaceuticals is blurring as patents expire on block buster drugs, Canada's patent laws have implicitly favoured the producers of generic drugs over brand-name manufacturers. The EU required as a minimum that Canada adopt patent-term extension to account for the delays inherent in the approval process for new products. Canada also undertook to improve enforcement against counterfeit goods and implement international standards for the protection of copyright in the age of the internet. Under CETA, Canada has recognized, for the first time outside the field of alcoholic beverages, the EU system of geographic indications (GIs). The compromise on GIs, grandfathering existing Canadian trademarks on some EU geographic indications, will be another item of controversy in the European Parliament and national legislatures with opponents arguing Brussels compromised too much.

CETA contains a number of interesting transitional provisions for trade in goods, in particular with respect to the rules of origin. This is important as Canada's manufacturing sector is highly integrated into North American supply chains. Canadian automobiles and other goods frequently have 50 percent and more US and Mexican content, and would not qualify for tariff elimination under previous EU trade agreements. To get around this problem, Canada will have a quota allowing it to export, tariff-free, 100,000 vehicles to the EU per annum on the basis of current supply chains, and an unlimited quantity of vehicles with higher Canadian content should they be produced. Moreover, the EU has agreed in CETA that if the TTIP negotiations are successful with the US, a single NAFTA rule of origin will apply to the automotive sector. The inclusion of such transitional provisions on rules of origin was a major objective for Canada as first mover with the EU.

It is important to remember that, as of the time of writing, Canada and the EU still have only made public a "political agreement." The translation of the political agreement into a legal text remains to be finalized. But it is fair to say the scope of CETA, in particular the services and labour mobility provisions, the special quotas for automobiles and sensitive agricultural products, the rapid tariff elimination on goods, and behind-the-border measures , represent a new departure for Canada's trade policy.

We are still a long way from entry into force. The ratification process in the EU is cumbersome. It requires the final text to be approved by the European Commission, the Council and the European Parliament. Moreover, if the EU's lawyers find the agreement to cover matters falling under both EU and Member State jurisdiction, ratification by all 28 Member States will be required. This is the likely outcome because subjects such as services, labour mobility and investment fall under concurrent Commission and Member State power. Realistically, apart from the tariff matters falling exclusively under Commission jurisdiction, which can enter into force provisionally with the consent of the European Parliament, it could be two to three years before the entire agreement enters into force.

The Negotiating History

In addition to its scope and complexity, CETA is historic for another reason. It represents a real coup for Canadian diplomacy. It has made Canada the envy of other advanced G20 economies such as the US, Japan, Australia among others. How Canada, with a spotty record of trade liberalization and entrenched protectionism in key agricultural sectors, could achieve a ground-breaking FTA with the world's largest trading block is a story in and of itself.

Canada sought and failed to bring the EU and its predecessors to the bargaining table at least three times since the end of World War II. A closer trade and political relationship with Europe was seen by political elites as a way to counterbalance the enormous influence of the United States. Most recently, in the early 2000s, the Chrétien government attempted to negotiate a modest trade and regulatory cooperation agreement with the EU, the Trade and Investment Enhancement Agreement (TIEA). The Europeans suspended the negotiations arguing that Canada was not serious about closing a deal. The reality is that TIEA was too small, had little business support, and ran into the problem that it is harder to conclude a small deal where the focus is on the losers than a big deal where the winners vastly outnumber the losers.

A number of factors combined to make CETA possible. Political and business leadership in Canada and in the EU was crucial. Driven by former Quebec Premier Jean Charest, and adopted as a key part of the government's economic platform by Prime Minister Harper, Canada was able to convince the EU that it was serious about free trade and would make the political decisions necessary to close a deal.

The European Commission was reluctant to negotiate with Canada. In 2008, EU Trade Commissioner Peter Mandelson summed it up in a meeting with Ontario and Quebec trade ministers, business associations and diplomats: "Nobody is asking me for free trade with Canada." His officials in the Commission, led by Director General of Trade, David O'Sullivan, told the Canadians, including this author, that Canada-EU tariffs were generally low, negotiating with Canada would eat up a lot of bureaucratic resources that could be better spent negotiating with countries with high barriers to EU goods and services like India or Brazil, and that the EU doubted the ambition of the federal government to put everything on the table, including supply management and subjects falling under provincial jurisdiction.

The latter point was key. Several of the EU's so-called "offensive interests" fell under provincial jurisdiction, such as provincial government procurement. The EU didn't think the federal government could ever convince the provinces to sign on to a trade agreement that would limit the ability to prefer local suppliers. Finally, they argued that the right place to negotiate trade with advanced economies such as Canada was in the Doha Round of the WTO, not in bilateral deals that could erode multilateralism.

Mandelson mistrusted these arguments. It was clear the WTO talks were going nowhere. And the provinces, led by Ontario and Quebec, told him they were open to an ambitious agreement that would bind them. What clinched the deal for Mandelson was the urging of key EU business sectors in favour of free trade with Canada. In international trade negotiations, it helps to have something your trading partners want. The EU automotive, energy and transportation sectors wanted an end to tariffs and local content rules. The pharmaceutical sector wanted Canada to bring its patent protection up to international standards. And in the back of their minds, several European businesses and US multinationals operating on both sides of the Atlantic saw free trade with Canada as opening the way to a Trans-Atlantic FTA with the US. Business Europe, the Canada-EU Roundtable on Business and the Canadian Council of Chief Executives all called for an agreement. The commitment by the federal government to put everything on the table and its precedent-setting inclusion of the provinces in the negotiations helped convince EU politicians that this time Canada was worth the effort.

Despite being over-ruled by the Trade Commissioner, Commission officials were still disinclined to negotiate with Canada. In a two-step manoeuvre, subsequently copied by Japan, Prime Minister Harper proposed in 2008 at the Canada-EU Summit in Prague that there be first a study on the economic benefits of free trade, followed by negotiations if the study showed that both sides would gain from opening their markets. As *demandeur*, Canada had to do the bulk of the work on the study. It was conducted by the Export

Development Corporation's international trade unit then led by current Bank of Canada Governor Stephen Poloz. The European Commission trade officials knew they had been finessed. The study confirmed that free trade would lead to a substantial increase in trade and investment. There was no avoiding the launch of negotiations in 2009 at the next summit.

The resulting CETA is the culmination of a diplomatic effort over two generations, extraordinarily talented negotiators, and strong leadership from the Prime Minister and the provinces. For this reason and its scope it merits the term historic. Canada has indeed moved from laggard to leader in trade liberalization.

Ross Hornby is Vice-President, Government Affairs & Policy, GE Canada, and was Ambassador of Canada to the European Union, 2006-2011, during the launch of the CETA negotiations. He is a member of the C.D. Howe Institute's International Economic Policy Council. The opinions in this article do not necessarily represent the views of the General Electric Company.