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# BACKGROUND

INTERNATIONAL ECONOMIC POLICY

## Go Big or Go Home: Priorities for the Canada-EU Economic And Trade Agreement

Daniel Schwanen



### **In this issue...**

Why it is important for Canada and the EU to reach an ambitious agreement, and how it can be achieved.

## THE STUDY IN BRIEF

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A comprehensive economic and trade agreement (CETA) between Canada and the European Union (EU) is both desirable and possible. For Canada, an agreement with the EU is a strategic opportunity to significantly diversify the market for its high-value-added goods, services and skills, to increase the attractiveness of its economy for investors, and to make a statement that it is ready to engage with other important trade partners on reducing barriers to mutually beneficial trade and investment. This is important in light of both the failure of the Doha round of WTO talks and the existence of other important trade negotiations undertaken by Canada's key trade partners.

A meaningful and mutually beneficial agreement will require bold steps on the part of Canada and the EU. This is due to the nature of the Canada-EU relationship, which is more intensive in services, investments, and sophisticated manufactures than that between Canada and other economic partners. In this context, key issues include better mutual access to public procurement contracts, protection of intellectual property rights, enhanced mobility of skilled personnel, and non-discriminatory regulation, in addition to the more traditional trade issues such as agricultural and industrial tariffs.

Many of these issues involve provincial and territorial governments, who are for the first time at the negotiating table with the federal government. These issues can all be addressed in the CETA in a way that opens valuable opportunities for EU and Canadian businesses and individuals in each others' marketplace, while improving access by Canadian businesses and governments to EU goods and services that could help reduce their costs, and thus become more competitive or offer better services.

These objectives can be achieved without compromising the ability of Canada and the EU to pursue public policy objectives or to regulate for the benefit of their constituents. In addition, talks with the EU on issues such as government procurement and mobility of personnel will support Canadian provinces and territories in meeting their past commitments to streamline Canada's own internal market. For these reasons, Canada should seize the strategic opportunity presented by the CETA negotiations to produce a meaningful agreement across the range of issues under negotiation. Inability to do so would risk confining Canada's economic horizons increasingly to home.

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**N**egotiations towards a Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union (EU), under way since 2009, are the most far-reaching trade talks commenced by Canada since the signing of the North American Free Trade Agreement in 1992. This report assesses the importance of the negotiations, reviews key issues under discussion, and proposes approaches that would be beneficial to Canada and the EU as they strive to meet their early 2012 target for an agreement.

A comprehensive and leading-edge trade agreement between Canada and the EU is desirable and possible. Indeed, the size and sophistication of the market represented by the EU – whose GDP exceeds that of the United States – and the importance of services and investments in the Canada-EU relationship suggest that a comprehensive agreement would open new doors for Canada beyond its traditional resource and manufacturing base. The agreement would also benefit Canadian consumers, governments and their agencies, as well as firms that use EU inputs in their Canadian operations, by increasing the availability of EU goods and services in the Canadian marketplace.

But getting there will require some bold steps on Canada's part. Trade negotiators are contemplating a progressive agreement, in which both parties remove or begin to remove most remaining barriers to fruitful bilateral economic relations.

The main advantages of the proposed agreement will only materialize if the EU, the Canadian federal government and the provinces, who are for the first time taking part in international trade negotiations, can open doors in important areas that have traditionally been closed, smooth out unnecessary differences in standards that hinder beneficial exchanges, and, in the process, remove some impediments to trade within Canada's own economic union.

Below, I review key issues in the negotiations and establish criteria that will enable an evaluation of whether the ambitious objectives enunciated by Canada and the EU are ultimately achieved. Canada's need to complete this ambitious agenda is particularly evident in light of (i) the failure of the Doha round of World Trade Organization (WTO) negotiations and (ii) the progress the EU is making on other trade fronts. The EU has signed advanced trade liberalizing agreements with other trading partners of importance to Canada (Mexico, South Korea, Caribbean), and is seeking deals with others (such as India, and eventually the United States). As it is, Canada has a significant backlog of unfinished trade negotiations and is currently not at the table of the important Trans-Pacific Partnership (TPP) negotiations.<sup>1</sup>

Many of these existing or proposed agreements among important Canadian trading partners aim to facilitate trade in high-value-added manufactures and services and foster mutually beneficial cross-border investments between them. The danger for Canada in this context is that failure to reach an agreement with the EU – or reaching an agreement that might look comprehensive in the range of topics it addresses but only make shallow progress in each – would end up reducing Canada's influence and attractiveness in global trade outside the resource sector.

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1 The Trans-Pacific Partnership negotiations between Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, the United States and Vietnam seek to produce a comprehensive agreement covering many of the issues also at stake in the Canada-EU CETA, such as regulatory issues, government procurement and intellectual property.

## *The Nature of the Canada-EU Economic Relationship*

The key issues at stake in this agreement can be appreciated by highlighting important qualitative differences between the Canada-EU relationship and Canada's trade with many of its other economic partners. Overall, the total value of Canada's bilateral trade with the EU each year is \$104 billion, accounting for just over 10 percent of Canada's international trade flows. However, trade in services accounts for a larger part of this total than for trade between Canada and the United States, and between Canada and all other countries on average (Table 1). This is true even when one removes transportation and travel services and looks only at commercial services such as R&D, financial, computer, management or engineering services – a broad category encompassing a number of relatively high-income jobs and which accounts for a small but steadily growing share of world trade.<sup>2</sup> As well, a relatively high share of Canada's merchandise trade with the EU is comprised of machinery and equipment and consumer goods.<sup>3</sup>

Furthermore, relative to the size of their cross-border trade flows, Canadian and EU firms have made sizeable direct investments in the other's market (Table 1). Indeed, the EU is the second-largest source of foreign direct investment in Canada, after the United States.<sup>4</sup> A large amount of Canada-EU business is thus conducted through affiliates on the ground (see Table 1), providing

employment both in the host market and in head offices in the home country.<sup>5</sup>

This economic relationship explains why negotiations now under way cover far more than tariffs and other barriers imposed at international borders. Success in foreign markets for services, public procurement contracts, or sophisticated consumer goods often requires personal contacts and a keen understanding of standards, regulations and other in rules of the domestic marketplace. In turn, this often requires a corporate presence in the market being served, and ease of movement of key personnel and information between the home office and affiliates abroad.

In this type of relationship, difficulties that firms and persons can encounter in meeting the host jurisdiction's standards, in protecting their property rights, in participating in services and public markets on similar terms as those afforded domestic firms, or in sending their key personnel abroad, can become important barriers to the realization of mutually advantageous opportunities. Thus, the CETA negotiations are aimed not only at border measures but more generally at reducing the barriers beyond the border that unnecessarily limit the ability of nationals of one party to seek opportunities in the other party's market.

Because of these issues, Canadian provinces are, for the first time, actively involved with the federal government in a number of Canada-EU negotiating groups.<sup>6</sup> This major innovation will test whether provinces are willing to support the expansion of global opportunities for individuals and businesses located within their jurisdiction,

2 The share of these commercial services in the value of imports worldwide has risen from 5.1 percent in 1980, to 6.7 percent in 1990, 7.4 percent in 2000, and 9.0 percent in 2010. Source: WTO Statistics database, retrieved at <http://stat.wto.org>, and author's calculations. Canada registered a global trade surplus in commercial services for the first time in 2010 (Canada 2011, p.41).

3 Non-auto machinery and equipment and consumer goods together accounted for 28 percent of Canada's merchandise exports to the EU and 51 percent of merchandise imports from the EU in 2010, in both cases higher than comparable numbers in our trade with the United States and with the rest of the world.

4 EU direct investments in Canada are valued at C\$148.8 billion, compared to \$306.1 billion from the US and \$106.7 billion from all other countries combined (Canada 2011b, Table 10).

5 See Alejandro et al. (2011) for the positive impact of foreign affiliate sales on head office employment.

6 The EU had requested a "meaningful" provincial role in the negotiations, based on the fact that many issues involve areas under provincial jurisdiction, including of course provincial and municipal procurement. See Kukucha (2010), p 5.

Table 1: Broad Patterns of Trade and Investments between Canada and Selected Regions

2010 data, except where noted	European Union	United States	Rest of World
	<i>Percent</i>		
<b>Share in Total Canadian Exports (Goods + Services)</b>	10.3	70.4	19.3
<b>Share in Total Canadian Imports (Goods + Services)</b>	10.9	61.8	27.3
<b>Services Exports as percent of Total Exports to Region</b>	25.8	11.5	18.5
<b>Exports of Commercial Services</b>	12.6	7.5	10.8
<b>Canada FDI to Region as percent of Canadian Exports to Region</b>	296.6	74.6	240.7
<b>FDI in Canada from Region as percent of Total Canadian Imports from Region</b>	229.9	97.5	48.6
<b>Canada Foreign Affiliate Sales as percent of Total Canadian Exports to the Region (2009)</b>	167.3	68.2	158.4

Source: Statistics Canada CANSIM tables 376-003, 376-0061, 376-0037, accessed September 13, 2011 at <http://cansim2.statcan.gc.ca>; and author's calculations.

by reciprocally allowing greater access to public procurement opportunities or provincially regulated markets for EU entities or persons.

In this context, Canada and the EU have professed a high degree of ambition for their proposed CETA. But if both parties are to deliver on this ambition, a number of key issues will have to be addressed before the early 2012 target for completing the negotiations. I now turn to a brief discussion of each issue.

### *Trade in Goods*

There are significant opportunities to increase access in the EU market for Canadian grains, beef, pork, and seafood products. In exchange, the EU

will naturally look for greater access to the Canadian food market, notably in supply-managed sectors that include dairy, poultry and eggs. For Canadian consumers in particular, it would be desirable for Canada to relax its current tight controls on the supply of dairy and other supply-managed products that currently keep prices in Canada several times higher than world prices. For example, there is nothing preventing Canada, within the current system, from increasing the quantity of EU dairy products allowed in Canada at low rates of duty.<sup>7</sup> Although Canada could instead try to gain greater access to the EU market for food products by offering concessions in other areas, both partners should further open their agricultural trade in line with their respective

<sup>7</sup> This could be accompanied by the auctioning of new production quotas at home, as suggested by Busby and Robson (2010).

sectors of comparative advantage. This would benefit farmers in these sectors, consumers, and food-processing industries. Canada would also gain in credibility vis-à-vis other potential partners if it were to move towards agricultural trade liberalization in its talks with the EU.<sup>8</sup>

In general, tariffs on non-agricultural goods, of which a number remain, should be eliminated and rules of origin highly simplified between the two parties. They should be made as coherent as possible with rules that Canada and the EU each observe in their agreements with third parties, in recognition of the fact that manufactured goods are increasingly “made in the world” rather than in any one jurisdiction. Specifically, the agreement with the EU should recognize the high degree of integration of the North American automobile industry. For example, the EU could allow a tariff-free quota for cars and parts that contain significant Canadian content but that meet NAFTA, rather than strictly Canadian-EU, rules of origin.

### *Regulatory Standards*

How regulatory standards are adopted and applied is relevant to trade in goods as well as services. A key question is whether the EU should have the right to block a Canadian product from entering the EU based on the process through which it is made, rather than based on the product intrinsically posing a health, safety, or environmental hazard in the country in which it is used.<sup>9</sup> Unless the production or trade of a product is restricted under accepted international agreements, Canada and the EU should provide mechanisms for issues to be resolved in the first instance without recourse to trade restrictions, focusing on other means to address any concerns, such as agreeing on labeling and other means of informing potential

purchasers of a product. At a minimum, Canada should obtain guarantees that any restriction on the sale of a Canadian good or service in the EU, imposed as a result of concerns about the process by which it is produced, should apply proportionately to all non-Canadian products in the European market using processes that would cause a similar impact. In short, Canada and the EU need to find mechanisms to address these issues in a fact-based, non-discriminatory fashion that treats government-imposed trade restrictions as a last resort.

Finally, Canada and the EU should seek as much as possible to dovetail such cooperative mechanisms on regulatory questions with mechanisms that each has in place to improve regulatory cooperation with the United States. The aim should be to provide for mutual recognition where possible, avoid arbitrary, discriminatory decisions by regulatory authorities, and eliminate small regulatory differences that are not necessary to meeting policy objectives.

### *Intellectual Property (IP)*

The majority Canadian government elected in May 2011 should be able to pass a long overdue copyright bill that will address most of the concerns of Canada’s trade partners – and of Canadians – in the important area of intellectual property (IP). On enforcement of IP, Canada and the EU are both signatories to the Anti-Counterfeiting Trade Agreement (ACTA), which makes it the best forum to mutually address these concerns.

Patents are a challenging issue.<sup>10</sup> Many EU firms, such as pharmaceutical companies, are large patent-holders and want more protection – i.e., higher value – for these patents than is offered under the current IP regime in Canada. They are thus requesting that Canada increase the effective period of market exclusivity in Canada for

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8 Canada’s absence at the Trans-Pacific Partnership (TPP) negotiating table, for example, is widely seen as resulting in significant part from Canada’s perceived inability to provide additional market access for supply-managed commodities. See Dawson (2011 forthcoming).

9 These types of issues have affected trade in seal products and beef products and may now affect trade in petroleum.

10 For a review in the Canada-EU context, see Morin (2011).



patented products to that in effect in the EU, or for that matter in the United States or Japan. While strong patent protection would spur innovation and employment in some Canadian industries, patent “thickets” in some other areas could in some cases prevent the benefits of innovations from spreading (Brander 2010).

The CETA should bring the effective period of market exclusivity for patented products up to a high international standard, but it should also preserve the ability of governments to adapt their IP regimes in light of future circumstances and evidence of their impact. They should also phase in additional protection so as not to confer an immediate benefit on existing products but instead stimulate innovation. The agreement should also clarify the ability of public authorities to intervene in the market for patented products, or for patents themselves, through available competition policy tools, in the pursuit of legitimate public policy goals. These include the goal of ensuring that the patent regime promotes rather than hinders the spread of useful innovation. Finally, Canada and the EU could use the occasion of their discussions on patents to strengthen mutually beneficial cross-Atlantic research ties.

### *Geographical Indications*

The EU has an aggressive approach to conferring exclusive use of a geographical name on makers of products that have historically originated in a particular region, to the point that products made elsewhere from comparable ingredients and using comparable methods – often undistinguishable from the original – are not allowed to use the protected indication at all in their brand name. In cases where there is truly something unique about the product’s geographical origin that informs consumers about the quality of the product, such as “Evian” or “Valpolicella” (or, in some cases, “Canadian”) or if, conversely, an indication is used

fraudulently to mislead consumers about the quality or origin of a product, then Canada should support the protection of geographical indications through its trademark system. In some cases, Canada might confer on the name of a product linked to a particular European area, but which is already used in good faith in Canada in a generic sense or in translation, additional protection through the exclusive use of an “original” label. But there is no reason for Canada to support exclusive European use of geographic indications for names that refer to processes rather than to a quality or history conferred by geographical origin proper.<sup>11</sup>

### *Public-Sector Procurement*

A key goal of mutually opening up government procurement markets is to help governments provide good value to their constituents in the provision of public services, through the purchases of goods and services produced competitively in the private sector. Up until recently, however, Canadian provincial and municipal practices were largely exempt from international agreements opening up procurement practices to more international competition.

The 2010 Canada-US agreement on government procurement (Canada 2010) initiated an opening of doors to sub-federal entities in both countries, establishing a precedent for a more ambitious procurement agreement with the EU covering sub-federal entities. The European Community-Switzerland agreement (European Union 2002), which covers contracts awarded by Swiss sub-federal entities (including districts, municipalities and companies owned by the public sector) above a certain monetary threshold and extends the type of procurement covered beyond the parties’ obligations under the WTO’s General Procurement Agreement, provides another good point of comparison. Naturally, Canada will want

<sup>11</sup> For a review of how the EU approach differs from that of the United States, Canada and others and the issues this raises in trade negotiations, see Hanrahan (2003).

Canadian firms to also have access to sub-federal entities in federal EU member states, to ensure a genuine balance of opportunity to bid on contracts.

An easily and mutually accessible public tendering marketplace should be the goal in both Canada and the EU. Indeed, a logical consequence of reducing public procurement barriers with the EU is that provinces may, in order to secure greater access for Canadians in Europe, have to find renewed enthusiasm for reducing remaining barriers within Canada, for example by pressing on with the wider use of electronic tendering under the aegis of the 1994 Agreement on Internal Trade.<sup>12</sup>

A number of Canadians have expressed concerns that public procurement provisions in a Canada-EU CETA would severely limit the ability of Canadian governments at all levels to specify that public contracts should be awarded to Canadians, or at least stipulate conditions related to local employment, for example. Many also see these provisions, combined with services liberalization provisions and the possibility that the agreement may include NAFTA-like protection for investors, as a “stalking horse” that will force Canadian governments to, in effect, turn public services permanently over to commercial operators.<sup>13</sup>

While it is true that provisions that open up public procurement to greater European competition will by definition mean that some firms and individuals will face more competition in vying for local contracts, a strong CETA should open up equivalent opportunities for Canadians in Europe, at a net benefit for taxpayers on both sides of the Atlantic, and for Canadian firms seeking to grow beyond the confines of the relatively small Canadian market. These growth prospects have been limited by Canada’s lack of offers to

its trading partners regarding its sub-federal procurement markets.

For example, the result of excluding provincial procurement from the NAFTA has been that Canadian firms were affected by the domestic purchasing requirements of the *American Reinvestment and Recovery Act* of 2009, and it took special negotiations with the United States leading to the above-mentioned agreement to partially reverse that mistake. In any event, the CETA provisions on procurement will only apply to contracts above certain thresholds, and the likelihood is that there will continue to be some exemptions for small business and regional development – though in those areas the agreement should at a minimum require more transparency and reporting on how legitimate public policy objectives, such as regional development, are actually achieved by exemptions.

Fears that the CETA will prevent governments from regulating or even operating public services are likely not well founded. One should look at comparable experiences before concluding that governments will lose control over public services or their right to regulate – there is no record of that having been the experience of Switzerland and the EU, for example. The right of governments to regulate in a non-discriminatory way without having to compensate for incidental loss of profits is well established in international law, including in a NAFTA context (OECD 2004).

The likelihood is that the thrust of an agreement will be that if the Canadian private sector is allowed to bid on contracts over a certain amount tendered by the public sector, government agencies, or government-owned corporations, European entities should be allowed to bid on equal terms, and that Canadians will be offered equivalent opportunities to bid on European

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12 The current state of progress on reducing internal Canadian barriers to public procurement and labour mobility in Canada under the AIT can be found in the sectoral chapter reports in the AIT annual reports. The annual reports can be found at: [http://www.ait-aci.ca/index\\_en/reports.htm](http://www.ait-aci.ca/index_en/reports.htm).

13 See, for example, Sinclair (2011).



contracts. Both the added competition to provide services and the new opportunities in the immense European market will benefit Canadians.

### *Services*

A competitive service sector is of vital importance in supporting high value-added jobs within global value chains.<sup>14</sup> Canada and the EU should make progress on this issue by going beyond exiting WTO commitments in lowering barriers to investment in each others' territories for service providers and allowing them greater access to public procurement, to the extent this can be done without limiting government's ability to enforce regulations and to attain legitimate public policy objectives. Canada and the EU have agreed to use a "negative list" approach to negotiating services liberalization (i.e., all sectors will be covered except those listed), as opposed to a "positive list" (listing the type of services that the parties commit to liberalize). The negative list should take longer to put together – in particular as this is a novel approach for the EU – but will be more effective in that it will encompass an ever-increasing share of services over time.

### *Movement of Business, Skilled and Professional People*

Canada and the EU are seeking to expand the ability of their citizens and businesses to conduct transactions with each other that require the movement of personnel. In particular, the agreement should assist in the intra-company movement of skilled workers – the purpose is to encourage mutually beneficial temporary movement of citizens, not modify policies affecting permanent migration.

An agreement should not lower the standards required of professionals and skilled people operating in any jurisdiction, but there needs to

be increased transparency and accessibility regarding examinations, testing or apprenticeship procedures required to meet standards in an EU or Canadian jurisdiction. On this question, the federal government should insist on the provinces and territories completing the mutual recognition of skilled trade qualifications and professional designations, as agreed in the 1994 Agreement on Internal Trade (AIT), and work with the provinces to expand the list of those covered by this agreement. Going further, a dynamic process to encourage the mutual recognition of qualifications, along the model of the Québec-France Understanding on the Mutual recognition of professional qualifications (Quebec 2008), should be encouraged between key Canadian and EU jurisdictions.

### **Conclusion**

In summary, an ambitious Canada-EU CETA would provide a number of benefits to Canada. It would allow Canadian businesses and individuals to significantly expand the size of the potential market for their goods, services and skills, in particular outside of the resource sectors. It would allow public entities, through more competition for public contracts, to find new ways to reduce costs without reducing services. By requiring provinces to work together with the federal government to address public markets, labour mobility, and other issues over which the provinces have significant jurisdictions, the CETA could help spur a more productive Canadian economic union.

In a number of areas – agriculture, intellectual property, public procurement and services, the CETA also holds the potential for Canada to introduce changes that will make it a more attractive trade partner globally, and play a more constructive role in the post-Doha world, which will likely be characterized by the continued mushrooming of multilateral trade agreements

<sup>14</sup> This reality is increasingly recognized worldwide. See, for example, Swedish National Board of Trade (2010).

such as the TPP. Even more concretely, since the EU and the United States do not have a similar agreement, a CETA could help spur investments in Canada by European firms seeking improved access to the US market via Canada.

These advantages will only emerge, however, if the agreement is a meaningful one. With a bevy of recent or future regional or bilateral agreements

resulting in a deepening of relationships among Canada's trading partners, Canada's talks with Europe assume a highly strategic importance. Canada will need to find the will to expand its horizons to conclude this deal – otherwise, these horizons risk being increasingly confined to home.

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