CENTRE FOR EUROPEAN POLICY STUDIES
CEPS Thinking ahead for Europe since 1983

The mega new-generation deal with Canada

CEPS Commentary/30 October 2008

Selen Sarisoy Guerin

The EU-Canada summit that was held in Montreal on the 17th of October might be remembered as the date both sides decided to negotiate an 'enhanced economic partnership' agreement. Contrary to some expectations (mainly from the Canadian side) that official negotiations would start in Montreal, there was only a subdued announcement that the next step would be to draw up the negotiating mandates.

The discussions on a proposed 'enhanced economic partnership' agreement (it is officially decided that this trade, services and investment liberalisation deal is not going to be named a free trade agreement) were revived during the German presidency of the EU in 2007 when both parties agreed to carry out a joint study[1] on the cost and benefits of such an agreement. The study was finally released just before the summit indicating significant gains for both parties.

Just what kind of a deal is this EU-Canada enhanced economic partnership? In short, it will be one of a kind. The EU has not negotiated deep economic integration agreements with any developed country before, other than its three EFTA neighbours. Canada's track record is somewhat different than the EU's: it has just concluded FTAs with each of the EFTA countries in January 2008, which are expected to come into force after ratification in 2009. However, this partnership agreement between the EU and Canada is to go 'deeper' than NAFTA or any other preferential agreement either party has ever signed.

How deep should this agreement be? The rule of thumb is that the deeper the agreement, the more both sides stand to gain. As the EU's other new-generation FTAs, such as with South Korea, India and ASEAN, started with an ambitious menu of tariff and non-tariff liberalisation as well as liberalisation in trade in services and investment, including beyond-the-border issues such as IPRs, government procurement and geographic indications, an EU-Canada deal should be expected to encompass no less. Although both the EU and Canada have low MFN average tariffs on industrial goods (3.7% for Canada and 3.9% for the EU), the gains from simple elimination of tariffs should not be underestimated. If one can draw an analogy from the impact of the Canada-US FTA signed in 1989 and NAFTA signed in 1994 on Canada-US trade, the gains that can be expected from an EU-Canada deal should be at least of a similar magnitude.[2] Although averages are low, there are many tariff peaks on several tariff lines. To the extent that such tariff lines are used as inputs to produce an end product, tariff liberalisation should not only increase trade in the intermediate goods but also create an additional windfall effect on trade in the end product.

---

1 *Assessing the costs and benefits of a closer EU-Canada economic partnership*, joint study by the European Commission and the Government of Canada, 2008 (http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_141032.pdf).

2 Selen Sarisoy Guerin and Chris Napoli, *Canada and the European Union: Prospects for a Free Trade Agreement*, CEPS Working Document No. 298, July 2008.

Selen Sarisoy Guerin is a Research Fellow and Head of the Trade Policy Unit at the Centre for European Policy Studies in Brussels.

Highlights from the joint study on costs and benefits of an enhanced economic partnership

The joint study that has recently been published by the European Commission and the Government of Canada quantifies some of the potential gains from a trade and investment liberalization. The following are some select results from this study. The baseline scenario includes full tariff liberalization on industrial and agricultural goods, a reduction of non-tariff barriers and cross-border services liberalization.

- Not surprisingly, the sizable portion of income gains for both the EU and Canada comes from services trade liberalization.
- The joint study indicates that largest portion on sectoral output gains will come from tariff liberalisation.
- In terms of sectoral trade impacts, for the EU the leading sectors will be processed food, chemicals, machinery and equipment and transportation services. The EU business services, motor vehicles and parts, insurance and consumer services will also make strong gains.
- For Canada, processed foods, primary agriculture, metals, transportation services, transport equipment and machinery equipment sectors will be able to increase their exports to the EU significantly.
- Finally, metals, transport and electronic equipment sectors in Canada, and processed food, leather, beverages and tobacco and chemicals in the EU make the most significant gains in terms of output by becoming more competitive, not only in their respective export markets but also in their domestic markets against imports.

Source: Assessing the costs and benefits of a closer EU-Canada economic partnership, joint study by the European Commission and the Government of Canada, 2008 (http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_141032.pdf).

No doubt there will be many challenges ahead. The thorny issues will include liberalisation of agriculture trade, access to public procurement, geographic indications and ‘mode 4’ services liberalisation. In terms of agriculture, there are sensitive items on both sides, and sometimes they are the same product such as dairy products: fully closed with prohibitive tariff rates where average MFN rates for Canada reach 249% and 54% for the EU. However, it is not unimaginable that the EU and Canada can liberalise agricultural trade. After all, both have signed other FTAs where agricultural trade was largely included with the exclusion of some sensitive items. Unfortunately agricultural subsidies usually remain untouched. During the Parliamentary level meetings in 2007, the Canadian side raised the EU’s Common Agriculture Policy (CAP) as ‘a serious issue’ to Canadians and the discussion of agriculture trade and subsidies was high on the agenda on both sides of the Atlantic.

Issues on access to public procurement and allowing professionals to work in the host country for a temporary period have long been on the table since the Trade and Investment Enhancement Agreement (2004). At the European Parliament and Canada Inter-Parliamentary Meeting in November in 2007, the EU made clear that the most important obstacle standing in the way of a partnership agreement were the inter-provincial trade barriers in Canada. Both the EU and Canada are signatories to the plurilateral WTO agreement on Government Procurement (GPA). Although both sides agreed to open and transparent tendering and no discrimination against foreign suppliers, the coverage has remained limited due to the principle of reciprocity. The EU has included commitments in both sub-central (i.e. member states) and other entities to all GPA members, but Canada did not include procurement at the provincial level. Hence Canada cannot access member-state procurement in the EU also because of the reciprocity clause. Inter-provincial movement of professional service providers is also restricted in Canada due to provincial differences in licensing and qualification recognition policies. Although the Agreement on Internal Trade (AIT) has been signed by the federal and provincial governments in Canada in 1994, full labour mobility is still not established. However, there is some progress in this area now that the federal and provincial governments have recently committed to full labour mobility within Canada by 1 April 2009. As these issues represent the most challenging technical points at the negotiation table, there seems to be a disproportionately large task falling on the part of the Canadian government to convince its provinces and hence the EU that this deal is worth the trouble.

If and when such an EU-Canada partnership agreement is signed, it will have significant impact on both EU-US and Canada-US relations. Its impact on the US depends on the details of the agreement and on two issues in particular: first is the 'rules of origin' and second the technical standards to trade. As the 'rules of origin' actually determine which goods qualify to benefit from the preferential tariff liberalisation, the level of restrictiveness may depend on the agreement. Hypothetically, at one end of the spectrum the agreement can be totally restrictive to only allow goods that are 100% manufactured in Canada (or the EU) or at the other end, it may accept any goods of 'Canadian origin' with some minimum level of value added. If the agreed 'rules of origin' requires for example a high value-added content, tariff liberalisation on those lines will *de facto* be ineffective where the production chains are vertically integrated with the US, such as the case with the automotive sector. The question regarding convergence on technical standards and conformity assessment between Canada and the EU will also bring the US into the equation. Basically, the gains (or profits) from exporting Canadian goods to the EU should exceed all additional costs of complying with any new standards agreed with the EU, plus the transport costs. As standards evolve over time, the cost of this diversion may increase for the US if the EU is more innovative in new products.

What does this agreement mean for the future of the Doha Round and the WTO? One can argue that this can be the start of a new era of transatlantic relations not just with Canada but also with the US. When a deal is concluded and enters into force, US businesses will feel an erosion of their competitiveness not only in the EU but also in some certain sectors of Canada where they previously enjoyed a privileged relationship due to zero tariffs, regardless of efficiency concerns. One may also speculate that one day the US may also be tempted to enter into a similar trade agreement with the EU. In that case, however, one should worry about the future of WTO, an institution that is arguably in need of reform in any event.