TALKING ECONOMICS SERIES
"Canada-European Union Free Trade Agreement: the need for trade diversity"

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Note: there was no PPT presentation. These are the notes prepared by the speaker.

When I was invited some time ago to speak to you today about free trade with Europe, I little thought that I would also be asked to say something first about protectionism.

Anyone familiar with economic recessions and depressions of the past knows they have been invariably accompanied by loud pleas from corporations and labour unions alike for protection against imported goods and services. The current recession, it is now obvious, is no exception. However, all of you are fully aware of the iniquities of protectionism, so I can be brief about it and save my breath for Canada-Europe free trade.

The two subjects come together, however, when a Canada-Europe free trade agreement is seen as an affirmation of open markets and a powerful signal of Canada's continuing commitment to liberalized trade, in other words, a rejection of protectionism. Despite a recent statement by the G20 countries, including the United States, "of the crucial importance of rejecting protectionism", various national legislatures are now calling for additional tariff and non-tariff barriers, however contrary they may be to the rules of the WTO. That such barriers always make matters worse does not deter their advocates.

In brief, the challenge has now sharply increased to all who recognize that additional liberalization of trade and investment continues to offer lower prices and more choice for the consumer. Increased international competition is not a threat, but rather a needed spur to improved domestic productivity and innovation. Recovery will only be hastened by international collaboration, but unfortunately, the global financial crisis has arrived in the wake of the indefinite suspension last year of the Doha Round of the World Trade Organization. Canada is among many nations which now look to regional or event bilateral agreements as the second best route towards eventual global trade liberalization, a route that can provide a needed boost to the Canadian economy without adding a cent to what has now regrettably become again a significant current account deficit.

When Canada two decades ago eschewed the exclusive pursuit of the multilateral route to trade liberalization by seeking agreements, first with the United States and later with Mexico, popular misgivings about the political integration implicit in continentalism were eventually tempered by the realized economic benefits. Today, fortunately, a non-controversial opening for Canada has emerged which is as close to a win-win opportunity for all as any trade and investment agreement can be: I speak of the pending liberalized trade and investment with the European Union, an idea that has been off and on since the Second World War, but is now decidedly on.

Ottawa was convinced that transatlantic trade liberalization was the most immediate way- when matched by the Marshall Plan – out of the economic and social mess left by the War. In early 1948, as an alternative to what Mackenzie King feared was a politically dangerous move toward continentalism, Ottawa proposed that transatlantic ties be embedded in the draft North Atlantic Treaty., thereby making it more than merely a military response to the mounting threat of the Soviet Union. This bold Canadian proposal was never implemented. In light of the eagerness in Washington and in European capitals to get on with military collaboration, the complicating "Canadian article" was much diluted and incorporated in the draft treaty only when it had been reduced to the empty formulation that "[member states] will encourage economic cooperation between any and all of them."

Article 2 – the economic article - of the North Atlantic Treaty was a dead letter from the beginning. It has remained so for 60 years. Yet NATO would have been a more coherent, although necessarily a more complex, organization, if transatlantic economic as well as military cooperation had been sought from the beginning. Intra-European economic cooperation, including the dismantling of trade barriers within Europe, as distinct from transatlantic cooperation, received priority, fostered by the Marshall Plan. Eventually, the result was the near miracle of the European Union, but also a failure to strengthen transatlantic ties, except for the largely inconsequential creation of the OECD and the much more promising multilateral General Agreement on Tariffs and Trade (GATT).

Although playing its military part in NATO, Canada continued to yearn for more in the way of transatlantic ties. In 1958, Canada was the first country outside Europe to appoint an envoy to the then fledgling European Economic Community. In 1967, Lester Pearson, reflecting a growing concern about Canada's increasing dependency on a single market – the United States – called for more intensive efforts to develop transatlantic trade and investment. "It is not a very comforting thought…when you have sixty percent or so of your trade with one country: you are in a position of considerable economic dependency." The GATT had succeeded in reducing trade barriers across the non-communist world, but Canada's dependence on a single market had only increased. Four years later, in a quest for trade diversification, Pierre Trudeau identified a "third option" in Canada's international economic relations: while continuing to pursue trade interests multilaterally in the GATT and bilaterally with the United States, it should pursue policies that would enhance Canadian self-reliance and diversify our trade. Accordingly, in 1976, Canada became the first non-European nation to conclude a "contractual link" with the European Economic Community, but unfortunately little resulted. Exhortatory declarations followed in 1990 and 1996.

All such initiatives- and they were uniformly Canadian, not European – were fuelled in part by a recognition that western Europe was integrating, having learned that an economic architecture can provide the girders for a larger political purpose and wider global influence. Much later than Western Europe, North American economic collaboration- beyond the GATT- eventually took a different form, limited to free trade among three member states who certainly did not seek in NAFTA the political integration that has always been a European goal.

Paradoxically, the risk of regionalism on both sides of the Atlantic, however different, has at one and the same time both simplified and complicated transatlantic thinking. On the one hand, Europe and North America were pioneers in pursuing deeper global economic cooperation. In principle, their regional structures, although differing widely, could have provided logical building blocks for an ambitious economic bridge across the Atlantic. On the other hand, the creation of the European Union and NAFTA tended to make both regions more inwardly focused, exaggerating rather than reducing transatlantic differences.

As transatlantic trade and investment flows nevertheless increased, underlying structural or "systemic" differences between Europe and North America emerged. Disputes that were once confined largely to agricultural and industrial trade have more recently encompassed issues as diverse as competition law, taxation, technology policy, government procurement, environmental protection, investment restrictions, health and safety standards, intellectual property, and personal privacy. Unlike the sources of traditional trade disputes, these issues are neither primarily economic nor international in nature. Instead, they involve domestic policies and priorities, reflecting the way that separate legal, regulatory, and even cultural systems have evolved on both sides of the Atlantic. Policymakers in these specific areas operate under mandates very different from those governing trade negotiators: the former respond to different problems, the latter respond to different constituencies – their priorities do not involve trade or investment liberalization; indeed, their constituencies may resist such initiatives, as indeed we are seeing today.

Against the background of transatlantic differences, the EU Commission in Brussels carved out access to various markets through regional free trade agreements (all duly endorsed by the GATT). Indeed, the proliferation of such EU free trade agreements has become so global that the term regional is almost superfluous.

For its part, for more than three decades, Washington viewed open world trade as both in its national interest and as a cornerstone of the post-war international order, initially to rebuild prosperity and stability in Europe and Asia, and subsequently to secure democracy against communist expansions. However, with the fall of the Berlin Wall, this rationale for multilateralism weakened. The free trade coalition in the United States eroded in the face of concerns that Japan and Europe and, more recently, China and India, were free-riding on the openness of US markets. A parallel concern about declining US competitiveness led to a less pronounced US commitment to multilateralism exclusively. Although Washington supported the successful completion of the Uruguay Round of the GATT in 1994, US trade policy since then has focused increasingly on bilateral and regional initiatives. Many of these initiatives were influenced by a desire to respond to commercial competition from Europe and to counter the EU's growing power as a regional trade bloc. Indeed, the Canada-US free trade agreement and the subsequent NAFTA were driven at least in part by concerns about trade diversion arising from EU expansion, as well as by its foot-dragging in the GATT.

More recently, as China and India have emerged as major trading partners, Brussels and Washington have each sought additional free trade agreements with other countries, mainly developing. This expanding web of bilateral and regional free trade agreements can benefit the partners involved (why else would they join?). But, from a wider perspective, the proliferation of free trade agreements also reflects a worrying fragmentation of the global trading system and a concern that preferential blocs can beget greater geopolitical rivalry and instability. The transatlantic powers created the multilateral trading system in the immediate post-war era precisely to avoid a return to a world of divisive trading blocs. In something of the same way, the recent weakening of support for multilateralism is at least partly a reflection of the breakdown of transatlantic consensus. It illustrates why transatlantic economic discord matters, not just because of the economic costs, but because it can have repercussions that extend well beyond its effects on bilateral trade, spilling over into other aspects of the relationship and generating wider geopolitical instability.

However, multilateral trade liberalization did, as I have noted, achieve a victory in the successful conclusion in 1994 of the long-standing and hard-fought Uruguay Round of the GATT. Its most remarkable achievement was the creation of a true World Trade Organization (WTO), an idea which the United States had opposed as early as 1948. Residual industrial tariffs were reduced or even eliminated, progress, however modest, was made in agricultural trade, and a start was made on the new trade issues of a decidedly domestic character. But that victory was short lived. Instead of allowing member states to digest the heartening results of the Uruguay Round – a major adaptation for many – another round was launched too soon.

That the Doha Round was launched prematurely is now incontrovertible. The new WTO had no time to consolidate or to adapt to the membership of China. There were no pressing trade and investment issues calling for immediate resolution. In fact, the round was hurriedly launched by the United States in an ill-considered effort to display global unity in the wake of the divisive terrorist attacks of 9/11. Further, the problems of the round were compounded by the initiative being named the "Doha Development Round", as distinct from a traditional round based upon the fundamental principles of "most favoured nation". Without waiting for the negotiation of the new round – if such there were ever to be – many developing countries questioned the timing of the initiative by redoubling their efforts to conclude amongst themselves a range of bilateral and multilateral agreements.

They were not alone in their wariness to put all their trade liberalization eggs in the now uncertain multilateral basket. The United States, the European Union, Australia, Canada and Japan – staunch multilateralists of the past – all sought or concluded bilateral agreements with a range of developing countries, although noticeably not Europe and North America with each other.

Scepticism about the multilateral Doha Development Round had spread widely, long before it ground to a halt last year. Theoretically, the round could be revived sometime, but the immediate prospect is that the move toward bilateral and regional agreements will accelerate, and the multilateral forum will need to be content to be their monitor and the resort for the settlement of trade disputes (a lesser but certainly not necessarily ignominious role for the beleaguered WTO, if carried out rigorously).

The Doha Development Round came to a halt ostensibly over the opposition of India and China to any agreement that did not permit them to introduce special measures to protect their farmers in the event of a "surge" in imported foodstuffs. But that specific issue masked a complex host of other unresolved and never lapidary issues. More important, it confirmed the arrival on the world stage (for which the WTO was woefully unprepared) of China and India as decisive players in the new world order.

With the creation of the WTO - the first new international institution of the Post-Cold War era - the multilateral trading system was transformed from a club of the industrialized west to a truly global institution. With the implosion of the Soviet bloc and the policy shift, however uneven, in the developing world toward open markets and trade, the active membership of the multilateral trading system has rapidly mounted. The new WTO has 150 plus members, three-quarters of which are developing countries or economies in transition. The range of its policy interests has expanded in tandem with the expansion of its membership. That spectrum ranges from least-developed countries experiencing great difficulties just living up to their Uruguay Round commitments, to advanced economies pushing for "WTO-plus" - for new rules-making in complex policy areas such as trade in services, investment rules, global mergers and acquisitions, intellectual property protection, and the growing interface between international business and environmental law - an approach seen as an answer to those who contend that no ship must move faster than the convoy. Additionally, China's accession to the WTO marked a profound shift, fundamentally altering the country balance and adding a new dimension of complexity to the management of an already delicate, technology-driven multilateral system. Some now wonder whether a system as universal and as intricate as the WTO can move forward in anything but incremental steps. Grand negotiating rounds may have become a thing of the past.

During seven years of debate in the WTO about a Doha Development Round, the substantive policy differences between North and South, developed and developing, did not narrow; indeed, on some issues, positions actually widened. This is not the place to analyse those differences. It is, however, now evident that the WTO system, however central to European and North American thinking, can no longer provide the only policy and legal instruments for managing transatlantic economic relations. The diversity of the WTO is too broad, its rules to shallow, and the pace of its negotiations too slow, all problems that emerged as the Doha Development Round dragged on.

The debate now is not whether the WTO should be the most important instrument for managing international economic relations, including transatlantic, but whether it should be the only instrument. Not surprisingly, some have taken the troubles that beset the Doha Development Round as a reason to pursue routes additional to the WTO to liberalize trade and investment. In their view, one size does not fit all. The WTO membership is now so diverse that it can no longer be squeezed into the same box of global trade rules, especially when the remaining major obstacles to liberalized trade are mainly domestic regulation, rather than old-style tariffs at borders.

What, in these circumstances, should Canada, in trade policy terms, do now? It should begin by phasing out its own protectionist agricultural policy, as Australia and New Zealand have so successfully done. “Supply management” in the dairy and poultry industries has prevented Canada from playing a leading or creative role in multilateral trade negotiations. Agriculture should not be - cannot be - exploited as a pretext for arresting progress in other major trade disciplines in a fast-globalizing world. Canada will make progress only if it is ready to subject its own policies and practices to closer scrutiny and adjust them where necessary in the interests of improved trade relations. That requires both an unusually self-critical approach and the courage to drive through often controversial changes in the face of resistant domestic constituencies.

More fundamentally still, Canada has redoubled its efforts to conclude bilateral and even regional free trade and investment agreements as the second-best way of achieving additional trade liberalization, partly in the conviction that they are stepping stones to an eventual multilateral agreement - which rightly remains the goal of all liberally minded trading countries.

Beyond Mexico and the United States, Canada has concluded free trade agreements with Chile, Costa Rica, and Israel, completed negotiations with Iceland, Norway, Switzerland, Columbia, Panama, and Peru, and engaged in talks with South Korea, Singapore, and several other receptive countries. But the biggest prize abides: the European Union, the world’s largest market. However, for reasons best known to the EU Commission and never fully explained to Ottawa, the European Union has for 15 years or more rejected Canadian overtures for a free trade agreement while welcoming those of developing countries, leaving Canada today as one of only eight countries without some form of preferential agreement with the EU.

The EU itself, in a July 2008, letter from French president Sarkozy and European Commission president Barroso to Prime Minister Harper, stated that a free trade agreement between the EU and Canada would give rise to demands by other OECD members - notably Japan, but also Australia, New Zealand, and potentially the United States. Such potential demands make it necessary that the EU finally address the issue of agreements with OECD countries. Negotiations with Canada would help to clarify the real questions. A second factor in making for an EU decision to proceed is reflected in the fact that Brussels is no longer putting forward the Doha Development Round as a reason that a Canada-EU deal should not be discussed. With the indefinite suspension of the Round, North America and Europe have a clear mutual interest in increasing their leverage vis-à-vis Asia, in light of fundamental power shifts in the global economy. Yet they have failed signally to find common cause with Asia. Worse, they now risk being left outside the grand free trade arrangements that are being designed among themselves by China, India, the ASEAN group, and other Asian and now African countries.

Asia would find it impossible to ignore a transatlantic free trade agreement, which would fundamentally transform the international economic dynamic. It would place, perhaps for the last time, ineluctable pressure on China, India, and others to negotiate seriously with a transatlantic bloc for fear of losing their competitive access to a newly integrated - and massive - North Atlantic economy. This same logic applied even when a Doha deal still looked possible. The logic is even more compelling in a world where the multilateral option is languishing. A transatlantic agreement could be the lever needed to move world trade forward.

A third consideration in Brussels may arise from the recognition that if a full NAFTA-EU agreement is not an early prospect, Europe could use a Canada-EU agreement as a reason for arguing that the United States should follow its two NAFTA partners in engaging in broad transatlantic negotiations. Certainly, US companies would be prompt to recognize the fact that their Canadian and Mexican competitors had gained preferential access to the world's largest market. Washington would face strong pressure from its business community to strike a similar transatlantic agreement, as happened in response to the free trade agreements between Chile and its two NAFTA partners, Canada and Mexico.

A further argument for transatlantic liberalization of trade and investment should now be self-evident to both Canada and Europe. Transatlantic problems there certainly are, as the recent abortive effort to conclude the negotiation of an ill-conceived Canada-EU Trade and Investment Enhancement Agreement - the TIEA - demonstrated, but the European Union is Canada's second-largest commercial partner; Canada is among Europe's ten largest partners, with two-way trade totalling $109.4 billion in 2007. Investment has grown rapidly - the European Union is the second-largest foreign investor in Canada; Canada is the fourth-largest investor in the European Union. Sales in each other's market by wholly owned affiliates are now four times the value of exports, with sales by Canadian affiliates within Europe growing especially rapidly.

A declaration in support of an EU-Canada trade and investment agreement, signed shortly before the June 2007 Berlin meeting of Prime Minister Harper and Chancellor Merkel of Germany (then also the president of the EU) called for "balanced and closer future EU-Canada economic integration" and launched a joint EU-Canada study of the benefits and challenges. The Berlin declaration was matched by a statement of corporations in Europe and Canada urging that "[i]t is more important now than ever to push forward achieving a barrier-free Canada-EU market. This is a first step towards realizing the goal of a transatlantic marketplace and will strengthen transatlantic leadership in global trade negotiations."

Published in late 2008, the joint study on the costs and benefits of a closer economic partnership found that a major reduction in barriers would significantly increase the gross domestic product of both Europe and Canada upwards of $40 billion.

Currently the "scoping" of the terms of the negotiations with Canada is near completion. This scoping will provide the basis for the launch of negotiations at the Canada-EU Summit on 6 May in Prague.

Perhaps I should add parenthetically here that in the preliminary discussions leading to the scoping exercise, Canada favoured the simple designation of a "free trade agreement," a designation that has wide public recognition in Canada. The European Union, on the other hand, has been wary of the phrase, preferring for reasons best known to itself a designation such as an "economic enhancement agreement."

In any event, whatever the agreement is called, it should cover such key areas as: the elimination of barriers to investment and services, including tax; the opening of capital and procurement markets; comity in competition and environmental regulation, including avoidance of discriminatory non-tariff barriers to trade; trade facilitation, with a focus on improved efficiency for goods and services crossing borders; and strengthened cooperation on science and technology. Any agreement should also establish a common skilled labour market between the two territories. This latter would include removing onerous restrictions of length of stay for non-resident executives and residency requirements for boards of directors. Further, a provision should allow future markets, such as those for carbon emissions trading, to be incorporated into the eventual agreement.

In the complex area of regulatory cooperation, greater convergence of standards and regulations in both goods and services should be a priority. At a minimum, an agreement on regulations should discourage future divergence and reduce existing regulatory barriers, both federal and provincial. In the rapidly growing area of trade in services, regulatory barriers should be reduced at least to a level corresponding with intra-EU barriers. Regulatory collaboration on certification, packaging and labelling, and health and sanitary and phytosanitary standards should be binding, supported by a dispute settlement mechanism. In this broad area of regulation, Canada will need to keep in mind the parallel "harmonization" in NAFTA to meet US requirements.

Opening services markets will require commitment at both the national and sub-national levels. Similarly, greater transparency and open competition in public procurement will need to carry the support of both the federal and provincial governments. The mutual recognition of professional qualifications will also require federal-provincial cooperation, as will the free movement of skilled workers.

For trade in manufactured goods, remaining tariff and non-tariff barriers should simply be eliminated. For trade in agriculture, however, major non-tariff barriers are so well entrenched on both sides of the Atlantic that the question abides of whether they will be tackled or simply left aside in whole or in part for later WTO negotiations. In any event, trade in goods would benefit from customs cooperation and other trade-facilitation measures, including agreement on supply chain security. Competition policy and regulation would probably take much of the negotiators' time and ingenuity - the former requiring, for example, agreement on the protection of confidential information and, more indirectly, on the mutual recognition of standards.

With the suspension of the Doha Round of the WTO last year, the time has never been more propitious for a transatlantic agreement. Canadians, for their part, increasingly perceive, if only intuitively, that enhanced transatlantic economic relations are the best way to help transform Canada into the most competitive economic space in North America - as the key to attracting additional investment, technology, leading-edge production practices, and skilled workers who can respond to enhanced labour mobility. A bilateral deal with Europe would give Canadian companies a competitive advantage over US and Asian rivals in the burgeoning European market. It would also sharpen Canada's competitive edge vis-à-vis the United States. And it would strengthen Canada's hand in negotiating bilaterally with the United States, as US companies would be concerned about the dilution of their access to the Canadian market. This would be especially so if the agreement were made accessible to other countries that meet its disciplines. And, needless to add, such an agreement would represent a powerful answer by Canada and Europe to protectionism.

Broader and deeper transatlantic relations should be seen as a cornerstone - and a foreshadowing - of relations in the wider global order. The Atlantic community is a set of countries that ultimately must stand together, work together, and continuously reinforce shared global interests, as Canada continues to do within NATO. To the extent that technological changes is altering the foundation of international relations and creating friction, Canada and Europe need to discover together the ties that bind. It is not that deeper transatlantic cooperation is an alternative to broader global cooperation; rather, it is that a strong North Atlantic architecture is central to our mutual ability to defeat protectionism and to manage and advance a larger global agenda.