A Trade SIA relating to the Negotiation of a Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada

Trade 10/B3/B06

Draft Inception Report

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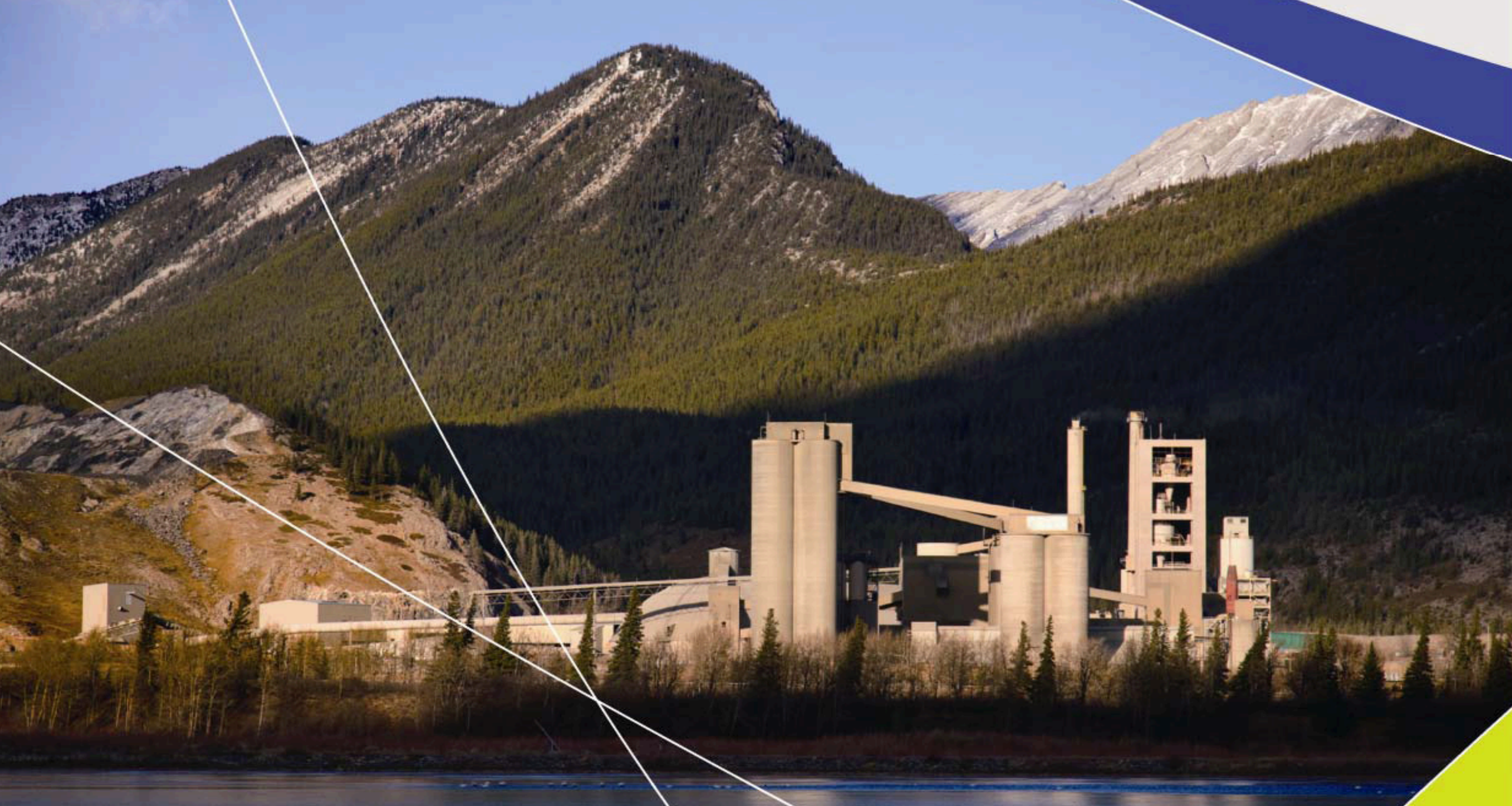

PROJECT WEBSITE AND FEEDBACK

Feedback and comments on the Inception Report and on the project in general can be sent to the study team by visiting **www.eucanada-sia.org**

Information regarding the project and access to project documents is also available at **www.eucanada-sia.org**

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LIST OF ABBREVIATIONS

CEC	Commission for Environmental Cooperation
CES	Constant Elasticity of Substitution
CETA	Comprehensive Economic and Trade Agreement
CGE	Computable General Equilibrium
CUSFTA	Canada-US Free Trade Agreement
CWB	Canadian Wheat Board
DG	Directorate General
ECTI	EU-Canada Trade Initiative
EEC	European Economic Community
EFTA	European Free Trade Association
FBT	Food, beverage and tobacco
FDI	Foreign direct investment
GATS	General Agreement on Trade in Services
GHG	Greenhouse Gas Emissions
GI	Geographical indications
GTAP	Global Trade Analysis Project
HS	Harmonised system
IEA	International Energy Agency
IMF	International Monetary Fund
IPR	Intellectual property rights
JCC	Joint Cooperation Committee
LDC	Least developed country
MFN	Most favoured nation
MS	Member State
NAFTA	North American Free Trade Agreement
NC	Net cost
NEC	Not elsewhere classified
NTB	Non-tariff barrier

OCT	Overseas countries and territories
OECD	Organisation for Economic Co-operation and Development
PA	Preferential agreement
ROO	Rules of Origin
RVC	Regional value content
SCM	Steering Committee Meeting
SIA	Sustainability Impact Assessment
SITC	Standard International Trade Classification
SME	Small and medium-sized enterprise
SOP	Standard operating procedure
SPS	Sanitary and phytosanitary
TIEA	Trade and Investment Enhancement Agreement
TOR	Terms of reference
TRIPS	Trade Related Aspects of Intellectual Property Rights
TSIA	Trade Sustainability Impact Assessment
TV	Transaction value
VAT	Value-added tax
VNM	Value of non-member materials
WTO	World Trade Organization

EXECUTIVE SUMMARY

The Inception Report provides a contextual overview of key sustainability issues to consider and methodologies to be employed in conducting the Trade Sustainability Impact Assessment (SIA) of the EU-Canada Comprehensive Economic and Trade Agreement (CETA). The Inception Report follows a review of literature covering prior studies on the economic, social and environmental context within countries relevant to the CETA, including studies employing quantitative and/or qualitative analysis; dialogue with study team experts on related topics; and information provided to the team by members of the Project Steering Committee.[1] The Inception Report is designed to outline analytical tools and research methodologies, and provide preliminary research and analysis on overall sustainability issues as well as those important to the sectoral/sub-sectoral and cross-cutting levels to be considered in the SIA.

The Inception Report is divided into a number of sections. Section 1, the Introduction, provides a brief overview of the EU-Canada CETA and the SIA process. Section 2, Methodology, begins by summarising the components of the major deliverables due throughout the study. The section then discusses the quantitative assessment to be employed in the study using a Computable General Equilibrium Model (CGE), Energy-Environment-Economy Model at the Global level (E3MG) model, and three gravity models. The section then provides an overview of the qualitative approach to the study, discussing the use and application of select indicators. Lastly, the section highlights the consultation tools that will be used in the study to solicit stakeholder feedback that will be integrated into the study. Section 3, Context, first discusses the trade and economic relationships between Canada and the EU. The section then reviews a number of overall sustainability themes per the three pillars of sustainability: economic, social and environmental. The next sub-section then describes how the Interim Report will organise an impact analysis at three levels: the macro, sector/sub-sector, and cross-cutting levels. It provides key contextual information therein, particularly for sectors provisionally selected as deserving close analysis, i.e. agriculture and processed agricultural products, fisheries, (certain) services, and (certain) industrial products. Section 4, the Annex, provides a number of important explanations and charts to supplement the body of this report.

In moving forward, the Inception Report establishes a strong foundation for the research, analysis and methodology for the SIA. It provides a necessary stepping stone for the next study deliverable, the Interim Report. The Inception Report importantly serves as a basis for discussion among the Contracting Authority (the EC), Contractor and stakeholders to guide the next phases of the SIA process.

[1] The Project Steering Committee is composed of the members of the study team and select members of the European Commission, predominately from the Director General for Trade (DG Trade).

I. INTRODUCTION

1.1. EU-Canada Comprehensive Economic and Trade Agreement

1.1.1 Overview of negotiations

With the negotiations on a Comprehensive Economic and Trade Agreement (CETA), the EU-Canada trade and economic relationship has now moved beyond the Trade and Investment Enhancement Agreement (TIEA) toward an agreement with a much broader and more ambitious scope. To recall, the TIEA, on which negotiations began in 2004 but were suspended in 2006, followed several other previous EU-Canada economic cooperation frameworks, for example the 1998 EU-Canada Trade Initiative.

Within the CETA, negotiations are expected on a number of areas including trade in goods and services, investment, government procurement, competition policy, intellectual property and trade and sustainable development. Negotiations on trade of goods are expected to include trade in industrial, agricultural and fishery products while also including tariff and non-tariff measures, trade defence instruments, technical barriers to trade (TBT), sanitary and phytosanitary (SPS) measures, customs/trade facilitation and rules of origin. Within trade in services, negotiations will include cross-border delivery (modes 1 and 2), the temporary presence of natural persons for business purposes (mode 4), and regulatory principles. Investment issues are expected to address establishment (mode 3) for services and non-services sectors, capital movements and payments.

The launch of CETA negotiations was officially announced on 6 May 2009 at the Canada-EU Summit in Prague. The first full round of negotiations was held in Ottawa in October 2009 with many of the Canadian provinces in attendance. As of publication of this report, the most recent round of negotiations was held in July 2010.

1.1.2 Previous high profile studies on the CETA

2008 Joint Study

On 16 October 2008, Canada and the EU publicly released a Joint Study on the costs and benefits of a CETA. The study's primary purpose was to 'examine the existing barriers, especially non-tariff, to the flow of goods, services and capital, and to estimate the potential costs and benefits of removing such barriers'. Using a CGE model to estimate the potential economic effects of the full removal of tariffs on bilateral trade in goods, a partial reduction of the cost of non-tariff barriers on trade in goods, and a partial liberalisation of bilateral trade in services, the study estimates that the EU-Canada trade relationship could be significantly enhanced through a closer economic partnership. Liberalising trade in goods and services is estimated to bring a potential 20% boost to bilateral trade and GDP gains of up to €8,2 billion for Canada (0.77% of GDP) and €11,6 billion for the EU (0.08%) by 2014. These gains were estimated to be significantly influenced by liberalisation of trade in services with more limited, but still significant, gains from the elimination of tariffs on bilaterally-traded goods.

The study found a CETA with the EU could deliver commercial benefits across many Canadian sectors, including aerospace, chemicals, plastics, wood products, aluminium, fish and seafood, light vehicles and automotive parts, and agricultural products such as wheat, beef and pork; and could also deliver benefits across services sectors such as transportation, engineering and computer services. For the EU, the study found a CETA to significantly increase the value of exports in processed foods, chemicals, machinery and equipment and transportation services. Strong gains are also estimated to occur in business services, motor vehicles and parts, domestic trade, insurance and consumer services. The study also supports enhancing the relationship in areas such as investment, labour mobility, regulatory cooperation, environment, and science and technology.

Joint Report on the EU-Canada Scoping Exercise

Incorporating the positive results from the EU-Canada assessment report, a Joint Scoping Group met to determine the shape of an optimal trade agreement and to assess its feasibility. The Group's findings were released in the March 2009 *Joint Report on the EU-Canada Scoping Exercise* which set out the opportunities for enhanced trade and investment between the two sides while outlining a broad and ambitious negotiating agenda. This agenda included a number of areas, including the aforementioned issues currently intended for the negotiating table.

The Scoping Group's main findings were that any negotiations of a CETA should address the aforementioned issues and that benefits for both sides would be enhanced by pursuing a maximum degree of liberalisation. As these areas of negotiation mark the primary scope of a CETA between the EU and Canada, its recommendations understandably leave a number of specific issues unresolved. These issues, which will need to be addressed throughout the negotiations, include: more concretely defining the rules of origin; determining the provisions related to emergency action and trade remedies; deciding on the usage and timing of tariff phase-outs; and the design of mechanisms to address specific SPS and TBT issues.

1.2 EU-Canada Sustainability Impact Assessment

European Commission Trade Sustainability Impact Assessments (hereafter also referred as Trade SIAs, TSIAs, or SIAs) assess the potential impacts of proposed trade and economic liberalisation agreements on all pillars of sustainable development in order to optimise policy decision-making/trade negotiations. The EU-Canada SIA will be conducted by DEVELOPMENT Solutions Europe Ltd. (DS) in cooperation with key external experts. The SIA will begin with a baseline assessment of the social, economic and environmental context within the EU, Canada and relevant third countries. It then employs quantitative analyses, performed by a Computable General Equilibrium model, an E3MG macro-econometric model on predicted environmental impacts, and three gravity models for impacts on FDI, portfolio flows and labour mobility. Drawing on these components, and using a series of indicators, an assessment is made on the potential economic, social and environmental impacts of the CETA in Canada, Europe and relevant third countries. Consultation with stakeholders in Europe, Canada and relevant third countries is an important component of this SIA process. The study will conclude with a series of policy recommendations for mitigating flagged negative effects and further enhancing positive effects.

with the Contracting Authority. Revisions to the sectoral selection will be possible pending further discussions with the Contracting Authority and feedback from stakeholders.

Agriculture, processed foods and fisheries

As an area of particular political and economic importance, the agriculture and agri-foods industries have been flagged for in-depth analysis in the SIA. Economically, both the EU and Canada represent large markets for agriculture and agri-food products with the EU serving as the world's largest market for imports (23.1% of global imports in 2007) and exports (20.7% of global exports in 2007) and Canada being the 4th largest exporter and 5th largest importer.[69]

Canada regularly produces a trade surplus in agriculture and processed foods, with exports being $4,976.84 million greater than imports in 2007.[70] Due to its proximity as well as the increased integration ushered in by NAFTA, Canada's trade in agri-foods occurs primarily between its North American neighbours, with exports to the US quadrupling between 1990 and 2006 and those to Mexico increasing nine fold.[71]

In terms of bilateral trade, exports to Canada from the EU of agricultural and processed food products accounted for 8.3% of all EU exports to Canada in 2007, while imports from Canada in such products were 6.9% of all Canadian imports.[72] Despite being a major supplier of food that is highly engaged in international trade, Canada operates a trade deficit with the EU in agriculture and processed food. In 2007, the EU exported $2.59 billion in agricultural and agri-food products while importing $1.95 billion.[73]

The fisheries sector is an important sector particularly in terms of Canadian exports to the EU, although the EU could potentially benefit from some reductions of relevant Canadian NTBs.

Agriculture

In 2007, agriculture – as measured by crop and animal production – contributed 1.61% of Canada's GDP ($18.7 billion).[74] Although Canada has only 0.5% of the global population, it produces 1.5% of the world's food, while consuming only 0.6%. Canada is a major global producer of cereals (particularly wheat), oilseeds (canola) and beef. In 2007, red meats, grains, oilseeds and dairy accounted for approximately two-thirds of total farm market receipts.[75]

EU imports of Canadian agricultural and processed foods are largely concentrated in primary agricultural products with cereals (wheat, in particular), oil seeds & oleaginous fruits (particularly canola) and edible vegetables, roots & tubers cumulatively representing 67.7% of the $2,316.67 million in agricultural

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[69] Eurostat, Statistics Canada
[70] UN Comtrade
[71] Statistics Canada
[72] Eurostat
[73] UN Comtrade. As classified by SITC codes in chapter 0 and 1.
[74] Statistics Canada
[75] Statistics Canada

products imported from Canada in 2007. In terms of cereals, Canada is a major importer from the EU, and serves as its fifth largest external source.[76]

As shown in the 2008 Joint Study, tariff quotas and high over-quota duties in the EU exist on wheat, oats, beef and pork, while high applied tariffs are present on fruits and vegetables.[77] Further, Canada maintains tariff quotas, with high over-quota duties on imports of dairy, poultry, egg, beef, wheat, barley and margarine products. The impact of trade liberalisation in agriculture arising from the CETA is likely to lead to increased exports from Canada of primary agricultural products such as cereals, beef, oilseeds, and soya. While benefiting Canadian producers, there may also be a negative impact on EU producers, who may lose domestic market share as a result of increased competition from Canadian wheat farmers.

Other areas that stand to benefit from increased liberalisation would be in Canadian red meat (beef), fruits and vegetables, and oilseed (canola) sectors. Since 1990, the contribution from red meats and fruits and vegetables has been increasing while producers of grain and oilseed and red meat are particularly export oriented, earning 40%, 70% and 56% of their earnings from export markets, respectively.[78] It should be noted that while Canadian producers of beef would stand to likely realise gains from increased liberalisation in the CETA, the size of the impact is contingent on the EU's concessions regarding its treatment of Canadian beef including its restrictions on hormone treated beef.

Processed foods

Processed food in Canada accounted for 1.47% ($16,779.28 million) of GDP in 2007 while the beverages and tobacco products sector accounted for an additional 0.41% ($4,667.15 million).[79] In terms of the food, beverage and tobacco (FBT) processing industry, major Canadian sectors include meat, dairy product and beverage processing.

Within the FBT industry, seafood (discussed in the section on fisheries), grain & oilseeds, sugar & confectionery, fruit, vegetable preserving & speciality food, and meat are particularly export oriented.[80] Imports of FBT account for approximately one-fourth of the domestic market, with seafood, sugar & confectionary, grain & oilseed and fruit, and vegetable preserving & specialty food being the largest imports.

Canada is a leading market for EU exports of olive oil and cheese, as the fifth largest recipient of both. It is also the fourth largest importer of EU wine.[81] Exports of beverages, spirits & vinegar (SITC 22), in particular, have represented over 40% of the value of all trade in this sector for the past decade.[82] According to trade data at the HS code 2-digit level, EU exports to Canada are predominantly in

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[76] UN Comtrade
[77] *Assessing the costs and benefits of a closer EU-Canada economic partnersh*ip (2008).
[78] Statistics Canada
[79] Statistics Canada
[80] Agriculture and Agri-foods Canada
[81] Eurostat
[82] Eurostat

beverages, spirits and vinegar, with this sector representing 49.2% of the value of all EU exports in agriculture and agri-food in 2007.[83] Other important export sectors for the EU are in preparations of grains, pasta, cocoa and cocoa preparations, dairy products, eggs & honey and animal/vegetable fats & oils.

Using a greater level of disaggregation, it is revealed that the following products, listed in the table below, are important in Canada-EU bilateral trade. It is noteworthy, that the major export products for Canada are in primary agriculture while those for the EU are in processed agriculture.

Product	**HS Code**	**Imports into Canada from the EU 2007 (in mio.$)**	**Exports from Canada into the EU 2007 (in mio.$)**
Coffee	0901	$23.88	-
Black tea	0902.30/40	$64.43	-
Olive oils	1509	$124.70	-
Chocolate/cocoa food preparations	1806.10/20/31/32/90	$163.55	-
Pasta	1902.11/19/20/30	$37.45	-
Sweet biscuits	190531	$62.09	-
Beer	220300	$244.49	-
Grape wines	2204.10/21/29	$796.49	-
Whiskies	220840	$94.77	-
Liqueurs and cordials	220870	$119.54	-
Cheese	0406	$138.58	-
Peas, beans and lentils	0713.10/20/31/32/39/40/50	-	$200.16
Wheat	1001.10/90	-	$507.01
Canary seed	100830	-	$27.07
Soya beans	120100	-	$220.40
Linseed	120400	-	$163.71
Mustard seeds	120750	-	$37.08
Canola oils	1514	-	$43.99
Maple sugar and syrup	170220	-	$30.33
Dog or cat food for retail sale	230910	-	$25.55

[83] Statistics Canada

As highlighted in the 2008 study, of heavily traded goods, processed foods face the most substantial tariff protection in bilateral EU-Canada trade.[84] As such, and based on the above, it appears that increased liberalisation in the bilateral trade of processed foods could stand to significantly benefit both EU and Canadian producers of processed foods. This would include greater overall gains in the EU due to the greater existing exports in such products as cheese, pasta, olive oil, coffee and chocolate and cocoa preparations. Sizeable gains may also be realised by the EU in the alcoholic beverages sector, which already represents the largest exports of agriculture and processed foods products to Canada. The level of these gains, however, depends on the degree of liberalisation as well as the dismantling of government control of the alcoholic beverages sector in Canada. From the Canadian perspective, producers of processed foods may also realise substantial relative gains from liberalisation as the EU applies tariffs which are contingent on the content of dairy, wheat and sugar ingredients.[85]

State trading in Canada: Alcoholic beverages and wheat

The issue of state trading within Canada is an issue that is likely to play an important role in the CETA's chapter on competition policy and the agreement's impact on the agriculture and processed foods industries in Canada and the EU. Herein, two specific state trading regimes within Canada have come under increased scrutiny: Canada's provincial liquor boards and the Canadian Wheat Board.

Provincial liquor boards in Canada

Within Canada, each province and territory has a body that overseas control, distribution and sale of alcoholic beverages within its jurisdiction. With the exception of Alberta, which is the only Canadian province to have privatised its alcohol distribution system, each of these liquor boards are granted a quasi-monopoly position over the import, supply and distribution of alcoholic beverages. These liquor boards operate under two primary objectives: profit maximisation for revenue generation and limitation of abusive/excessive alcohol consumption.

Operating independently (i.e. not at a federal level), these liquor boards establish 'reference' or 'floor' pricing standards, which set the minimum retail price for each product category. These prices are enforced within the retail and distribution system operated by these liquor boards, with the aim of encouraging profit and collecting tax. Where off-site point of sale is allowed, e.g. in licensed bars, restaurants and hotels, etc., the retailer is required to purchase their products through the liquor board outlet. While operating a controlling share of the retail network, it should be noted that in recent years Canada has increasingly opened the marketplace to competition. In Ontario, for example, the liquor control board controls 50.8% of the marketplace, while the privately run Beer Store network has taken over 28.5% of the market.[86]

The EU has taken issue with the provinces' monopoly control over distribution and retail, arguing that

[84] *Assessing the costs and benefits of a closer EU-Canada economic partnersh*ip (2008).
[85] *Assessing the costs and benefits of a closer EU-Canada economic partnersh*ip (2008).
[86] Liquor Control Board of Ontario. The remaining market share is divided between winery retail stores, other legal outlets and illegal outlets.

liquor boards 'appear discriminatory and substantially hinder the access of European alcoholic beverages to the Canadian market'.[87] Garnering particular contention from the EU has been the complaint of discriminatory listing procedures, pricing and quota systems that favour domestic over imported products. The liquor boards' listing procedures require any supplier of beer, wine or spirits wishing to sell their product(s) in a province to first obtain a listing from the provincial marketing agency. The EU has complained that decisions by the boards pertaining to listing requests lack transparency, while such decisions have seemed to discriminately exclude entry of imported products.[88] Further, it is claimed that the monopoly status of these boards, which for example has made the Liquor Control Board of Ontario the world's largest purchaser of alcoholic beverages, has allowed these provincial liquor boards to leverage their position to inflict further 'onerous commercial conditions on suppliers, once an imported product is listed'.[89] In addition, the EU claims that provincial liquor boards in Ontario, Quebec and British Columbia provide discriminatory pricing mechanisms that favour locally produced wines.[90]

In reference to the quota systems placed on imported products, it is important to note that liquor board purchasing groups have strict sales quotas for all brands listed. Brands not reaching their quota are discounted at the supplier's cost, sold out and denied future access to the retail network. The EU has claimed that this system imposes discriminatory quota systems for imported wines that make it difficult for EU products to meet the quota and therefore maintain the ability to be sold in state-run retail stores.

While these concerns have, in part, been addressed bilaterally through the 1989 EC-Canada Agreement on trade and commerce in alcoholic beverages and the 2004 EU-Canada Wine and Spirits Agreement, the issue remains unresolved due to continued concern from the EC over lack of enforcement/compliance at the provincial level and continued ongoing discriminatory behaviour. As such, resolving these issues either through greater enforcement or a significant reduction in the provincial boards' monopoly status stands to be an important means of ensuring greater access for Europe's alcoholic beverages industries. With these products being the most widely exported processed food products into Canada and exhibiting sizeable demand in Canada, such an outcome by the CETA could produce significant gains for the European industry.

Opponents of the proposed CETA's encroachment on the provincial liquor boards claim dismantling the liquor boards will undermine the government's ability to 'implement policies that reduce the substantial social and economic harm caused by alcohol consumption'.[91] Herein, these opponents cite increases in

[87] Market Access Database. http://madb.europa.eu/madb_barriers/barriers_details.htm?barrier_id=960047&version=6
[88] Market Access Database
[89] Market Access Database
[90] This includes: (1) 'minimum (and maximum) price requirements on certain imported products'; (2) 'the waiver or reduction of various charges to the domestic industry (e.g. freight, direct delivery mark ups, costs of marketing programmes) not available to imported products'; (3) 'Ontario, authorizes the Liquor Control Board of Ontario to apply an additional reduction of 5% on all sales of Ontarian wines to restaurants and bars'; (4) 'British Columbia allows the BC Liquor Board to practise a mark-up discount on the province's wines, which obviously would not benefit imported wines'.
[91] Grieshaber-Otto, Jim. (2010). 'Protecting Ontario's Alcohol and Public Health Policies in Negotiations on the Proposed Canada-EU Treaty'. Alcohol Workgroup: Ontario Public Health Association

drunk driving convictions and sales to minors following privatisation in Alberta.[92] Additional concerns over the potential negative social impact revolve around employee benefits derived through the liquor board owned distribution system's usage of union employees. Specifically, concern has been raised over the impact on Alberta's employees in the alcohol industry who have seen privatisation lead to lower pay and benefits as well as decreased job security.[93]

It is noteworthy that provincial monopolies over liquor distribution found in Canada show similarities within the system operated by the EU Member State of Sweden. Sweden's Systembolaget is itself a government-owned chain of liquor stores that maintains the sole right in retail of alcoholic beverages exceeding 3.5% alcohol content by volume. Similar to Canada, the Systembolaget is maintained as a means of ensuring public health by reducing the abuse and excessive consumption of alcohol. To that end, a recent report by the Swedish National Institute of Public Health found that privatisation of retail alcohol sales in Sweden would raise consumption of alcohol by 14 to 29 %, while significantly raising alcohol-related deaths, assaults and absence from work.[94] Although similar in many regards, differences between Sweden and Canada may exist in Systembolaget's expressed mandate of being brand-neutral and selecting its products based on consumer demand.[95]

Canadian Wheat Board

An additional area of state-trading in Canada that has received particular attention is that of Canadian Wheat Board (CWB). Established in 1935 by the Canadian Parliament as a means of controlling the price of grains, the CWB is a state-trading company that is granted monopoly status as the country's only exporter of wheat and barley. With Canadian farmers, located predominantly in the Western Prairies, being forced to sell their wheat and barley to the CWB, the CWB is the largest wheat and barley marketer in the world.

The CWB continues to receive complaints from the US and EU through claims that its exclusive rights over the export of wheat and barley from Canada make it non-competitive. The EU in particular has expressed negative views towards supply-management practices used by such state-trading enterprises as the CWB, maintaining their provision of an unfair competitive advantage. The role that the CETA has on trade in wheat and barley between Canada and the EU may therefore be influenced by its impact on the CWB.

[92] National Union of Public and General Employees. http://www.nupge.ca/content/3387/canadas-liquor-board-unions-join-fight-save-lcbo
[93] National Union of Public and General Employees.
[94] Swedish National Institute of Public Health. 'If Retail Alcohol Sales in Sweden were Privatized, what would be the Potential Consequences?'
[95] Systembolaget.se