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TRADE AND INTERNATIONAL POLICY

Uneasy Birth: What Canadians Should Expect from a Canada-EU Trade Deal

by

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- The proposed Canada-EU trade agreement is having a difficult birth. While Canadians wait for the conclusion of the negotiations, it is important to recall the key issues at stake.
- An ambitious trade deal with Europe would improve Canadians firms' access and ability to compete in the EU market, which is 10 times the size of Canada's. It would enhance and diversify Canada's opportunities for trade and, hence, for expanding Canadians' incomes. But many fear that Canada would make excessive "concessions" in relation to these benefits, in particular regarding Canadian governments' room to maneuver on key policy issues.
- After reviewing the likely key components of any deal, which include market access, regulatory issues, intellectual property rights, public-sector procurement, and investment issues, the author concludes that fears of potentially negative effects are greatly exaggerated. If anything, the danger is that the agreement would not open markets enough.

The completion of a comprehensive economic and trade agreement (CETA) between Canada and the European Union (EU), under negotiation since 2009, reportedly has been close at hand for some months now. If and when a deal is reached, Canadians will be able to pore over the detailed text as they debate whether it is in Canada's interest to ratify it. Many of the key issues that would

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engage Canadians in this debate have already been publicly joined. As the final decision to sign an agreement nears, it is timely to recall what is at stake.

An ambitious CETA would improve Canadian firms' access and ability to compete in the EU market, which is 10 times the size of Canada's. It would enhance and diversify Canada's opportunities for trade and, hence, for expanding Canadians' incomes. By enabling consumers, taxpayers, and businesses to get better value for money, an ambitious CETA would also improve Canada's ability to attract or retain talent and investments. But many fear that Canada would make excessive "concessions" in relation to these benefits, in particular regarding Canadian governments' policy space to maneuver.

This E-Brief describes the trade context of Canada's desire to conclude a CETA, and reviews likely key components of any deal that Canadians would want to evaluate. These include: market access, regulatory issues, intellectual property rights, public-sector procurement, and investment issues. It concludes that fears of potentially negative effects are greatly exaggerated. Unless the CETA offers much less than advertised in terms of new opportunities for Canadian producers in the EU market, it will be worth supporting.

A CETA and the New World of Global Trade

Canadian workers and investors live in a world increasingly characterized by "trade in tasks" within complex international production networks.¹ Trade in tasks expands Canadians' opportunities to specialize in activities within an industry, a production network, or a global firm that best suit their talents or resources. Such specialization is far more suited to sustaining high incomes for Canadians than are vertical, "value-added" strategies involving uneconomical natural-resources transformation at home.

Trade in tasks relies on the cross-border exchange of services such as product assembly or design, software development, managerial, logistics, engineering, technical, financial, and cultural services. By its nature, it also involves trade in intellectual property (IP) and products that embody IP, skilled personnel working with consumers or partners in multiple countries, and the international transfer of information. It also highlights the importance of different forms of investments that enable such access to cross-border facilities, partners, or markets.

Trade in tasks between Canada and the EU is characterized by the relative importance of services trade, foreign investment, and foreign affiliate sales between the two economies (see Table 1). Some 375,000 Canadian jobs now rely on trade in goods and services with the EU.² The CETA seeks to create a platform that expands on these existing opportunities.

Expanded Market Access

The CETA's proposed elimination of EU customs duties (or tariffs) affecting Canadian goods, ranging from fish to wood products, automobiles, plastics and machinery, would give Canadian producers of those goods preferential access to the EU market. Some Canadian farmers would still face limits on the quantity of their products allowed to enter the EU duty free, but the CETA likely would loosen these quotas. Only products meeting "rules of origin"

1 For a description of the importance of trade in tasks in the EU-US context, see Lanz, Miroudot, and Nordås (2012).

2 Calculations based on OECD trade in value-added data and output per employee data by industry are available from the author upon request.

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

Category	European Union	United States	Rest of World
Share in total Canadian exports (goods + services) (%)	10.1	70.3	19.6
Share in total Canadian imports (goods + services) (%)	10.6	61.5	27.9
Services exports as percent of total exports to region (%)	25.8	11.9	22.6
Percentage of which are exports of commercial services (2011) (%)	14.6	8.1	10.9
Share of Canada's outward FDI stock (%)	24.3	40.7	35.0
Share of inward FDI stock in Canada (%)	29.3	51.5	19.2
Canadian FDI in region as a multiple of Canadian exports to region	3.1	0.8	2.3
FDI from region in Canada as a multiple of total Canadian imports from region	3.0	0.9	0.7
Canada foreign affiliate sales as a multiple of total Canadian exports to the region (2010)	1.4	0.7	1.7

Notes: 2012 data, except where noted. Commercial services exclude tourism and transportation.

Sources: Statistics Canada CANSIM database, tables 376-0101, 376-0061, 376-0141, available online at <http://cansim2.statcan.gc.ca>, accessed July 17, 2013; author's calculations.

identifying them as having sufficient Canadian and/or European content would be eligible for this preferential treatment. If restrictive rules of origin prevent certain products – such as, for example, motor vehicles assembled in Canada but embodying significant US or Mexican content – from entering the EU duty free, Canadians will want instead significant Canadian quotas that guarantees market access for such products.

The CETA likely would also improve opportunities for Canadian providers of services in the EU market, beyond those provided under the General Agreement on Trade in Services (GATS). These opportunities would arise in large part as the two sides grant access and national treatment to each others' services providers in markets where their participation is currently restricted.³

The GATS uses a “positive list” approach specifying the sectors and mode of service delivery for which foreign services providers are to be granted market access and national treatment. The CETA, however, would use the

3 Under national treatment, foreign goods or services should be treated no less favorably than similar domestic goods or services in the domestic marketplace, in similar circumstances. One example would be similar handling fees for European and Canadian wines by provincial liquor monopolies.

more dynamic “negative list” approach, whereby all sectors and modes of delivery are covered, unless explicitly excluded (as may happen with cultural services, for example). This automatic coverage of emerging types of services would be a novel approach for the EU and a “win” for Canada, which, as the smaller partner, might otherwise find it difficult to get the EU to revise a positive list in the future.

Lower tariffs would put downward pressure on the price of some consumer products – notably shoes, clothes, food, and automobiles – and on business inputs that make Canadian businesses more competitive. Depending on the specifics of a final agreement, consumers would also benefit from additional quotas for EU cheese and from a somewhat more competitive environment in services such as telecommunications, banking or insurance. Although savings might be small in each case, together these categories amount to a significant share of Canadian consumers’ spending.

Greater access to EU goods and services providers would not of itself limit Canadian governments’ policy room to maneuver, which, in any event, probably would be preserved explicitly through general exceptions for measures taken for the sake of national security, animal and plant health, and consumer protection. The CETA likely would also recognize the parties’ ability to take measures necessary to protect the stability and integrity of their financial systems.⁴

As well, Canada might reserve the right to establish or maintain measures that contravene general CETA obligations, such as market access or national treatment for EU services providers, in sensitive policy areas in which Canadian governments provide services for a social purpose, such as public education, health, and child care. To the extent Canadian governments allowed commercial contractors to operate public services under their responsibility, the CETA would, save for the exceptions and reservations just mentioned, require Canada to treat EU firms on a par with Canadian firms in the tendering process for such contracts. This added competition would expand governments’ options for providing lower-cost and better-quality services (see Dachis 2010; Brubaker 2011), while in no way threatening the public’s ownership of key infrastructure and other public assets, or governments’ ability to set standards for contractors to meet and to impose penalties or terminate contracts for non-performance. Fears of loss of control over public services are thus no more valid in the context of the CETA than they are in the current Canadian context, where governments contract out many such services.

Regulatory Measures

The CETA likely would also bolster bilateral trade through regulatory cooperation, for example, by the EU’s accepting the result of Canadian conformity assessment tests. Ideally, it would also facilitate the two parties’ mutual acceptance of products, when differences in standards can be tolerated without affecting either party’s regulatory objectives.

Given the importance of trade in tasks – for example, Canadians and Europeans making things together for the US market – credible mechanisms in the CETA to facilitate mutual recognition of qualifications for skilled personnel and the temporary entry of business travelers generally would also be an important gauge of success.

4 A means-ends test might be applied to verify that a measure taken for prudential reasons – but that would otherwise contravene the agreement – was linked objectively to the stated prudential goal. Such a test would protect Canadian financial institutions from the EU’s imposition of unnecessary constraints on sound foreign institutions under the guise of prudential policy.

Canadians should be wary, however, of accepting EU norms not suited to Canada. Furthermore, the CETA should also address attempts to block Canadian products whose production methods disturb EU sensitivities even as non-Canadian products with comparable properties enter the EU unimpeded. At the same time, any EU quotas still in place should be raised sufficiently to make it worthwhile for Canadian producers to invest in facilities, such as those producing hormone-free beef, specifically designed to meet EU norms.

In short, Canadians should welcome regulatory cooperation and mutual recognition of standards with the EU where this makes sense, but they will have to guard against the EU's extraterritorial application of its domestic regulations and their continuing use as a trade barrier.

Intellectual Property Rights

Key EU goals in the CETA negotiations have been (i) to restore the effective period of market exclusivity in Canada for patented pharmaceutical products, to compensate for the time it takes to obtain regulatory approval before the product can be distributed in Canada and (ii) a lengthier period of data exclusivity during which firms cannot use tests and other data provided by the patent holders to produce a generic product. These demands, if met, would bring Canadian practices closer to norms in the EU and other comparator economies.

Some analysts (such as Grootendorst and Hollis 2011) predict that higher effective protection for patents in Canada would raise the cost of pharmaceuticals in this country, but independent experts (such as Skinner 2012) contest this prediction. The devil, as always, would be in the details of an agreement. For example, applying added protection only to new patents would delay any such cost pressure. In evaluating the CETA, Canadians also would want to assess whether stronger IP protection is likely to boost research and development (R&D) and the spread of innovation in Canada; the research is mixed on this subject. In any event, Canadian governments would retain the ability to influence pharmaceutical expenditures, including the price Canadians pay for drugs. Indeed, the per capita cost of pharmaceutical prescriptions is lower in the EU than it is in Canada, despite the stronger IP protection there (see Morgan, Daw, and Law 2013).

A CETA likely would not change Canada's treatment of copyright, especially since Canada has passed legislation paving the way for its accession to the so-called WIPO internet treaties (the Copyright Treaty and Performance and Phonograms Treaty), already ratified by countries representing well over 80 percent of the world's economy. Similarly, reasonable EU demands to confer exclusive geographical indication rights on a range of products could be accommodated within Canada's existing trademark system, although in other cases such demands could amount to an anti-competitive practice detrimental to consumers and should be rejected.

Public Procurement and Economic Development

All Canadians probably would agree that procurement by public-sector entities should be of maximum benefit to Canadians, but would such benefit be maximized by shutting non-local firms out of the competition for contracts? Unless the jurisdiction awarding the contract is already a hotbed of open competition for the particular good or service, the answer is "no."

In general, taxpayers would benefit, through better services and lower taxes, from more competitive and transparent public-sector procurement. Some people think that awarding contracts exclusively to local businesses, regardless of price or quality, fosters economic development. Instead, such a practice tends to limit economic growth over time because it reduces the taxpayers' value for money, which, in turn, makes attracting talent more difficult; it sustains firms that are not competitive and therefore have limited growth potential; and it leaves Canada vulnerable to retaliation by much larger trading partners.

Canada should not repeat in the CETA the mistake made in the NAFTA of not opening up more procurement by provinces, municipalities, and their agencies to foreign bidders. More open procurement does not mean that competitive Canadian firms would lose contracts overall – indeed, Canadian firms have proved that they can be successful in the much larger EU procurement market when allowed to compete there.

If past agreements are any guide, the pro-competitive effects of a CETA might be lessened anyway because many types of contracts would still be closed to EU bidders – for example, for services on the “negative list” and subject to other limits on trade in services, those below a certain threshold amounts, and those coming under “set-asides” for certain types of businesses.

With a CETA likely to affirm governments’ ability to give subsidies to locate production, expand facilities, train workers, and carry out R&D on their territories, it is hard to see how an agreement would limit the economic development policies governments might wish to undertake so much as to be worth sacrificing the interests of taxpayers and Canadian workers in firms vying for contracts in Europe.

Treatment of Investments and Investors

The CETA is likely to include a chapter addressing the treatment Canadian investors in the EU can expect, and vice versa. This chapter would be tailored to fit the agreement’s services provisions, since foreign investment is one of the key modes of providing services in foreign markets. So, for example, reservations that Canada takes in certain key policy areas for services trade would also apply to EU investors and investments.

Standard promises in international investment agreements, such as “fair and equitable treatment” for investors and limits on arbitrary expropriation – including “indirect expropriation” – without compensation would apply across the board once an investment is made in Canada (after any screening required under the *Investment Canada Act*) or in the EU. The CETA is expected to include a dispute settlement mechanism under which investors from either side can seek international arbitration of a dispute. The dispute would have to involve claims for monetary losses or damages, and could only go to arbitration in the event of failure of consultations and negotiations to resolve the dispute.

Some have argued that, since the rule of law prevails in both Canada and the EU, there is no need for such a mechanism. However, there have been almost 60 cases over the years of firms in one EU country having initiated investor-state disputes against governments of other EU countries (UNCTAD 2013). This suggests that such a mechanism in the CETA would be valuable to Canadian firms. Concerns that Canada could be penalized at every turn by arbitration panels for policy disputes are out of proportion with the experience with such a mechanism.

Certainly, issues of consistency in arbitral decisions would remain, as well as cases when panels’ interpretations clearly exceed what governments had intended. But experience has shown governments respond. When a NAFTA panel threatened to expand the interpretation “fair and equitable treatment” beyond what had long been customary under international law or when it became apparent that what constituted “indirect expropriation” could be too loosely defined, governments subsequently ensured that their ability to regulate in good faith and in the public interest, even if doing so costs business to a foreign investor, would not be affected.⁵ In practice, the amounts Canada has been forced to pay so far to investors under the much-decried NAFTA Chapter 11 investor-

5 See, for example, the “Notes of Interpretation of Certain Chapter 11 Provisions” (NAFTA Free Trade Commission 2001) and the new model US investment treaty (United States Trade Representative 2012).

state dispute settlement process have been minuscule. They total \$7 million in 20 years, with another \$141 million paid in settlements between the parties in two cases where Canadian governments had discriminated against or expropriated the investor (Cassels Brock & Blackwell 2012, 17).

Given the heavy reliance of the Canada-EU relationship on two-way investments and the proliferation of investment agreements allowing for the possibility of investor-state arbitration, not including such a mechanism in the CETA would put Canadian firms at a competitive disadvantage. Canada and the EU nevertheless could append an interpretive agreement on investor-state dispute settlement to the CETA, to delineate its acceptable use.

Conclusion

In reflecting on whether or not to endorse the CETA, Canadians should weigh the economic opportunities it presents against claims that it would limit unduly Canadian governments' ability to shape economic policy. As a commercial agreement, the CETA likely would mean that, in many sectors of the economy, EU firms would be able to vie for commercial opportunities on par with Canadian firms – and vice versa for Canadian firms in the EU market. This would be positive for many Canadian industries, and for Canadians as consumers and taxpayers.

Greater access by Canadian and EU firms to each other's markets would not come at the expense of public authorities' control of regulations and policies that shape their economies or that affect their citizens' well-being – including health, environmental, or prudential financial regulation, public services standards, or a panoply of economic development policies. Although one must reserve judgment until an agreement is made public, many of the anticipatory criticisms do not relate well to Canada's actual experience with open trade.

If anything, the danger is that a CETA would not open markets enough. Rules of origin, quotas, discriminatory regulations, lists of excluded sectors, and even overzealous patent regimes can all reduce the benefits Canadians could expect from an open trade relationship. But a CETA that substantially enhances access to the large European market for Canadian goods and services would deserve Canadians' endorsement.

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