

Assessing the Costs and Benefits of a Closer EU-Canada Economic Partnership

**A Joint Study by the European Commission and the
Government of Canada**

INTRODUCTION AND EXECUTIVE SUMMARY

Introduction and Purpose of the Study

The well-being and prosperity of the European Union (EU) and Canada depend on healthy international trade and investment relationships and on the ability of Europeans and Canadians to succeed in all areas of global commerce. The EU and Canada – among the most prosperous economies in the world – are heavily dependent on international trade. The EU is the world's largest exporter of goods and services, while one in five Canadian jobs is estimated to be linked to trade. Their openness to the global economy is a key factor underlying this prosperity, as international trade policy now strongly contributes to growth and creation of jobs at home. This openness can be measured in many ways, including trade in goods, trade in services, the movement of capital and labour and technology flows.

International trade, foreign investment and the movement of labour internationally have grown tremendously over the past decades. This growth has been facilitated by many factors including reductions in formal barriers to trade and investment, the opening up of many countries to the global economy and their accession to the World Trade Organisation (WTO), a steep decline in transportation costs, and technological innovations that have reduced the costs associated with communicating and managing at long distances. Like many other economies, those of both the EU and Canada have experienced significant increases in regional and global integration.

While the global marketplace is becoming increasingly integrated, points of friction remain that inhibit the free flow of goods, services, capital and labour. The surge in international activities and the spread and intensification of global supply chains across borders has made cooperation among governments in a wide range of areas more important than ever. To achieve competitiveness on a global scale, consideration must be given – in addition to reducing tariff and non-tariff barriers on the movements of goods and services – to the movement of capital and labour across international borders and enhanced cooperation in a wide range of economic-related areas. While traditional trade and investment liberalisation is key to enhancing prosperity, further gains could be made by enhancing cooperation in additional areas such as science and technology, energy and the environment.

In today's international marketplace, businesses must be able to develop and tap into global supply chains to maintain or enhance competitiveness. Although much focus has been placed on cost savings associated with the deployment of global sourcing strategies, there are other significant benefits as well. With the movement of relatively lower value-added production to low-cost jurisdictions, companies are better able to focus on core competencies to create higher value goods and services, and enhance competitiveness and prosperity. In the case of the EU and Canada, these core competencies are in large part characterised as high value-added and innovative activities.

To reinforce the ability of EU and Canadian companies to leverage their core competencies, the environment within which they operate must be as productive as possible. The enhanced productivity and competitiveness that directly flows from trade and investment liberalisation would, therefore, allow EU and Canadian firms to better compete in the global marketplace.

The EU-Canada bilateral economic relationship is robust and wide-ranging. It has existed in one form or another for many decades and remains strong both in terms of bilateral trade and of investment. The EU and Canada remain important trade and investment partners. In recent years, the relative importance of the EU in Canada's trade has increased. The value of Canadian trade with the EU has grown, although Canada's relative position in EU trade has decreased slightly. Nevertheless, when compared with the EU's trading relationships with countries such as India and South Korea, the EU-Canada relationship appears under-traded. An important facet of the overall economic relationship, and indicative of its true depth, are the two-way investment levels. The EU is Canada's second largest investment partner after the United States, and Canada ranks as the EU's fourth largest (after the United States, Switzerland and Japan).

Nevertheless, as good as it is, the EU-Canada economic relationship is capable of further improvement. Barriers remain in certain areas which mean that it is prevented from reaching its full potential. To this end, key private sector representatives in both the EU and Canada see considerable potential for further enhancing this relationship.

It was in this context that EU and Canadian Leaders made the decision at the 2007 EU-Canada Summit to jointly undertake a study to examine and assess the costs and benefits of a closer economic partnership.

The Joint Study

At their annual Summit in Berlin on 4 June 2007, Leaders agreed to cooperate on a study “to examine and assess the costs and benefits of a closer economic partnership.” They further committed to review the joint study at the 2008 EU-Canada Summit in Montreal on 17 October 2008 with a view to “pursuing balanced and closer future EU-Canada economic integration.” In 2007, Leaders also agreed to intensify work on regulatory cooperation and to open negotiations toward a comprehensive Air Services Agreement. In addition, they welcomed the agreement reached on a bilateral European Community-Canada Air Safety Agreement, and confirmed that it should be signed as soon as possible.

The purpose of this study as described in the 2007 Summit statement is 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. The study would also identify how such a partnership could complement ongoing efforts to enhance bilateral cooperation in areas such as science and technology, energy and the environment.

This broad-based and forward-looking analysis was designed to provide EU and Canadian Leaders with as comprehensive and up-to-date a picture as possible of the potential costs and benefits of closer economic partnership, to allow for informed policy decision-making on future bilateral economic cooperation. In addition to examining potential gains from removing factors affecting the free flow of goods, services and capital, consideration is given to areas such as labour mobility, government procurement, intellectual property rights, telecommunications services and electronic commerce, as well as to the potential benefits of enhanced collaboration in a wide range of related fields from regulatory cooperation to transportation.

Executive Summary

As indicated in the Introduction above, EU and Canadian Leaders agreed at their annual Summit in 2007, to cooperate on a study “to examine and assess the costs and benefits of a closer economic partnership”. The present document constitutes that study. Its form and content have been agreed on jointly between the European Commission and the Government of Canada, which have jointly shared the work involved in drafting both its analytical and descriptive elements.

Serving as a backdrop to the analysis, Part 1 provides an overview of the current state of bilateral economic relations between the EU and Canada. It describes existing bilateral cooperation mechanisms, including between the EU and Canada, between Canada and the EU Member States, and between the Canadian provinces and territories and the Member States, referencing cooperation in multilateral fora. It also outlines the process of economic policy-making in both the EU and Canada, and includes a synopsis of the EU’s and Canada’s economic relationships with third parties.

The analysis of factors affecting EU-Canada trade and investment forms Part 2 of the study, and is the area in which dedicated economic modelling has been undertaken. This quantitative analysis estimates 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. A fundamental assumption of the quantitative analysis is that there will be a successful outcome of the ongoing Doha Round, in which both non-agricultural and agricultural tariffs will be reduced by a substantial margin. (The lack of recent progress in the multilateral Doha talks may create some uncertainty as to the prospect of such an outcome, at least in the short term.) In addition and equally important, qualitative analysis of the factors affecting the flow of goods, services and capital between the EU and Canada supplements the quantitative assessment. Special attention is also paid to the areas of labour mobility, government procurement, intellectual property, telecommunications services and electronic commerce.

The analysis in the study goes beyond the traditional assessments of the impacts of reductions in tariff and non-tariff barriers by also examining, in Part 3, the breadth of existing bilateral cooperation in a wide variety of fields affecting the economic relationship (which range from science and technology, transportation or customs to investment promotion), indicating areas where cooperation could be enhanced. It offers forward-looking analysis that not only indicates areas in which the EU-Canada economic relationship as a whole could be enhanced, but also specific ideas as to how it could be improved.

Part 4 summarises the results of each of the two consultations undertaken in the EU and Canada to gather the views of the European and Canadian private sectors. EU and Canadian respondents provided their thoughts both on the current status of the EU-Canada bilateral trade and investment relationship and on ways in which that relationship could be enhanced.

Finally, the key findings of the study are summarised in Part 5. The study does not provide policy recommendations, which are the prerogative of the policy-makers of the EU and Canada respectively. Nevertheless, it does offer insight into the potential benefits of a closer EU-Canada economic partnership and identifies possible areas where the EU and Canada could continue to enhance their bilateral cooperation.

1. Overview of Bilateral Economic Relations

The bilateral EU-Canada economic relationship described in Part 1 of the study is wide-ranging, long-standing and, for the most part, well-functioning. The relationship as such dates back to 1959, though individual EU Member States' relations with Canada or with individual Canadian provinces, formal or informal, date back many centuries. The EU is Canada's second most important trading partner for goods and services, while Canada is the EU's 11th most important goods trading partner. The investment relationship is even stronger: the EU is Canada's second most important investment partner and Canada the EU's fourth most important investment partner.

In the years since the formal establishment of EU-Canada bilateral trade and economic collaboration through the 1976 Framework Agreement for Commercial and Economic Cooperation, a number of sectoral agreements have been concluded, and others are under

negotiation. The Framework Agreement created a structure for ongoing dialogue, with a Joint Cooperation Committee to review annually the breadth of trade and economic cooperation activities.

As a backdrop to the EU-Canada economic relationship, the study explains how economic policy is developed in both the EU and Canada. Policy-making in the EU and Canada is complex and multi-level, involving EU and Member State competences in the EU, and the federal and provincial/territorial jurisdictions in Canada. It is also useful to place the EU-Canada relationship in the more global context of the EU's and Canada's overall trade policy agendas. As such, Canada's and the EU's economic relationships with third parties are outlined. Where possible, a brief analysis is offered on the impact of certain trade agreements concluded with other partners.

Finally, Part 1 examines the trade and production structures of both the EU and Canada, along with the economic trends from 2002 to 2007. The key economic indicators for Canada and the EU are outlined, including growth rates, per capita gross domestic product (GDP) levels and inflation rates, as are bilateral trade patterns and the respective positions of the EU and Canada in each other's trade partner rankings. From 2002-2007, the relative importance of the EU in Canada's trade has increased. While Canada's relative position in EU goods trade has decreased slightly, the value of Canadian trade with the EU has grown in absolute terms. Nevertheless, the relationship appears to be significantly under-traded, particularly when compared with the EU's trade relationships with countries such as India and South Korea. At the same time, bilateral trade in services, focused primarily on the cross-border supply of business services, reached close to €20 billion in 2007. Two-way investment levels also increased over the reference period in absolute terms and by higher rates than each other's investment in the United States.

2. Analysis of Factors Affecting EU-Canada Trade and Investment

The analysis of factors affecting EU-Canada trade and investment presented in Part 2 of this study shows firstly that most tariffs on goods traded the most between the EU and Canada are low. The eight most important sectors for Canada's exports to the EU comprise 80% of Canada's total goods exports to the EU, and 78.1% of EU goods exports to Canada.¹ Of these important sectors, only processed foods face substantial tariff protection. European exporters face a tariff of more than 30% into Canada, and Canadian exporters face a 17% tariff into Europe. Tariffs on most other top-traded products are below 3%. Tariffs are generally low in the remaining sectors, but there are some tariff peaks: the EU, for example, applies most favoured nation (MFN) tariffs as high as 23% on a number of fish and seafood products, while Canada maintains applied tariffs on footwear as high as 20% and on textiles and apparel as high as 18%.

Notwithstanding the overall low level of tariffs applying to EU-Canada trade, the private sector reported that, in some cases, even low tariffs can serve as barriers to trade and put firms at a competitive disadvantage. Overall, eliminating tariffs will bring significant gains to both the EU

¹ The eight most important sectors for Canadian exports to the EU are: chemicals, transport equipment, metals, minerals, machinery and equipment, electronic equipment, paper products, and processed foods. The eight most important sectors for EU exports to Canada are: machinery and equipment, chemicals, motor vehicles and parts, transport equipment, petroleum, beverages and tobacco, processed foods, and metal products.

and Canada. Nevertheless, in certain highly-protected sectors, there are costs involved in the form of reduced output.

The study reviews a sample of non-tariff measures identified by stakeholders as inhibiting trade in both the Canadian and EU policy frameworks, such as different regulatory approaches to common socio-economic goals. The review demonstrates there may be room to improve the design or implementation of regulatory frameworks to achieve legitimate regulatory objectives in a less trade-inhibiting fashion. As such, for the purposes of this study, a notional cost reduction of 2% is adopted to represent the estimated realistic cost savings, supported by anecdotal evidence based on a sample of regulations identified as having trade-inhibiting effects and economic assessments of the trade-deepening effect of regional economic integration agreements. Since significant trade cost savings are unlikely to be realised in commodity trade, the cost reduction is limited to non-commodity processed goods.

The measuring of barriers to the trade in services is far more complicated than for goods. It requires the use of statistical methods to estimate the tariff equivalents of services sector barriers that are necessarily subject to limitations in the available data and underlying assumptions. The study recognises these limitations. The independent consultants who undertook the modelling estimate the barriers to services trade into the EU as representing 18-42% and into Canada as representing 24-52% of additional trade costs. In other words, the barriers to the trade in services are estimated to be significantly higher than those to the trade in goods.

Although it is realistic to expect that tariffs on most goods could be eliminated or significantly reduced, it is not realistic to expect that all factors affecting trade in services can be removed. To assess the extent of service barriers that can potentially be removed through any new EU-Canada trade and investment liberalisation, the study assumes the same expansion in services trade and derived cost savings as has been estimated to have taken place in intra-EU liberalisation. Such an approach provides a good indication of the upper bound of what would be attainable in transatlantic services trade liberalisation.

The study estimates that services trade inside the EU is approximately 35% higher than would otherwise be expected in the absence of the EU's moves towards a single market. This higher intra-EU services trade volume serves as the benchmark for a realistic estimation of the maximum potential for further transatlantic service sector integration. To achieve the same expansion in EU-Canada services trade, it is estimated that the cost of trade in services would have to be reduced by between 2% and 10%. Removing these trade costs constitutes a realistic potential for gains from a liberalisation of bilateral trade in services.

In addition to liberalising trade in goods and services, this study examines the issues of labour mobility, government procurement, intellectual property, telecommunications services and electronic commerce. Qualitative analyses suggest that expanded opportunities for both EU and Canadian companies could result from enhanced collaboration in such areas and from the removal of existing barriers to trade and investment.

The study uses a computable general equilibrium model to estimate the gains from bilateral trade liberalisation between the EU and Canada. Subject to the inherent limits of such models and the

assumptions made, the overall results indicate that liberalisation of trade in goods and services will bring benefits to the EU and to Canada.

The annual real income gain by the year 2014, compared to the baseline scenario,² would be approximately €11.6 billion for the EU (representing 0.08% of EU GDP³), and approximately €8.2 billion for Canada (representing 0.77% of Canadian GDP). Total EU exports to Canada go up by 24.3% or €17 billion by 2014 while Canadian bilateral exports to the EU go up by 20.6% or €8.6 billion by 2014.

Liberalisation of trade in services contributes substantially to the GDP gains (50% of the total gains for the EU, and 45.5% of the gains for Canada); more limited but still significant gains derive from the elimination of tariffs on bilaterally-traded goods (25% of the total for the EU and 33.3% for Canada). The remaining gains are due to a reduction in the trade costs of non-tariff barriers.

These figures relate to the impact of removing readily-quantifiable factors affecting EU-Canada trade. They do not take into account other less-readily-quantifiable areas that provide additional potential for gains. As such, these figures should be interpreted as a lower bound to the potential gains from an EU-Canada agreement.

3. Existing Bilateral and Potential Future Cooperation

To complement the analysis of the factors affecting the flow of goods, services and capital between the EU and Canada, the study also examines a wide range of ongoing cooperation in other related areas. The study identifies several key economic and economic-related areas in which close EU-Canada cooperation exists, be it multilaterally, at the EU-Canada level, between EU Member States and Canada, or between Canadian provinces and territories and EU Member States or sub-national European partners. The areas examined include science and technology, energy, the environment, regulatory cooperation, transportation, customs cooperation and trade facilitation, employment and social affairs, the movement of people, education and training, investment promotion, competition policy, taxation, and fisheries.

The study points to specific areas or activities through which existing cooperation could be deepened at all levels. This cooperation, in turn, would enhance the overall bilateral economic relationship (be it directly or indirectly), by helping to improve the productivity of the EU and Canadian economies and the competitiveness of EU and Canadian businesses in the global marketplace. This forward-looking analysis demonstrates that there is significant potential to enhance the EU-Canada economic relationship on several levels, in addition to the more traditional trade and investment areas addressed in Part 2. The study also reveals that there are a number of important issues which fall, in whole or in part, under more than one jurisdiction or competence, e.g. provinces/territories in Canada, Member States in the EU. In order to further advance the EU-Canada relationship, this will need to be addressed in the future. The list of potential areas for

² This scenario includes assumed tariff reductions resulting from successful Doha negotiations.

³ Increase in 2014 GDP at 2007 prices.

future cooperation is extensive, albeit by no means exhaustive, with proposals of varying scope – from cooperation between a small number of experts to more wide-ranging initiatives.

For example, several proposals are put forward in the three areas singled out in the 2007 EU-Canada Summit declaration: science and technology, energy and the environment. As the EU and Canada are key sources of new technologies, cooperation in these areas is important to improving innovative capacity and economic competitiveness. The study suggests there is scope for further enhancing science and technology cooperation through collaboration on a common research agenda. It proposes a renewed focus on “flagship cooperation projects” in key strategic areas like energy and the environment, where joint EU-Canada research is valuable in helping address pressing global issues. The study also sees potential for increased EU-Canada collaboration involving the private sector in applied research and development and commercialisation. Furthermore, the EU-Canada 2008 High-Level Dialogues on Energy and the Environment have identified several areas which would benefit from future discussion and cooperation, ranging from world energy relations and security issues, to climate change and biodiversity.

Further examples of potential future cooperation are identified in Part 3. These include, among others, enhanced regulatory cooperation; a comprehensive air services agreement; a supply chain security agreement including container security; an expansion of networks of arrangements on social security matters; the establishment of a degree equivalency system with the possible introduction of a diploma supplement; EU encouragement of increased business links and investment promotion through chambers of commerce in Canada; continued cooperation under the 1999 Competition Cooperation Agreement; continued cooperation under double taxation conventions; and continued close cooperation in the Northwest Atlantic Fisheries Organisation.

4. Private Sector Views

In the context of this study, the EU and Canada separately sought the views of their respective private sectors on the status of the EU-Canada trade and investment relationship and on ways in which the relationship could be enhanced. (European and Canadian respondents together have also publicly expressed their support for an enhanced relationship.)

There was a general consensus among EU respondents that enhanced economic cooperation between Canada and the EU was desirable. Most responses mirrored sector-specific interests. Respondents noted the need to remove tariff peaks and onerous non-tariff barriers to trade, as well as to enhance regulatory cooperation. In addition, EU respondents underlined their interest in increased investment opportunities in Canada. Government procurement by Canadian authorities at all levels was deemed to offer great business opportunities for European exporters and investors. Finally, most EU respondents noted that any form of enhanced EU-Canada economic cooperation should include all levels of government in Canada.

Canadian respondents noted that the bilateral relationship with the EU has not reached its full potential and that there exist significant opportunities to improve trade and investment. Canadian respondents were clear in their support for a comprehensive trade and investment agreement between Canada and the EU, which they believe will strongly aid in increasing economic flows.

They also believe the EU and Canada should work more closely on regulatory cooperation. Like the EU respondents, Canadians saw important potential with improved labour mobility and mutual recognition of professional qualifications. The development of the two-way economic relationship supports the economic values of both parties, enhancing their competitiveness and prosperity, including by increasing transatlantic global value chains.

5. Key Findings

The key findings of the study form Part 5. The summary includes not only the essence of the primarily descriptive parts of the study, such as the status of the EU-Canada bilateral economic relationship in Part 1 and the views of the EU and Canadian private sectors in Part 4, but more particularly the analytical and forward-looking findings resulting from the analysis of the factors affecting the flow of goods, services and capital, notably the economic modelling results, and from the analysis of those economic or economic-related areas in which future cooperation could be broadened or deepened and the overall economic relationship thereby enhanced. As noted above, while the study does not provide policy recommendations, it does offer insight into the potential costs and benefits of a closer EU-Canada economic partnership, together with possible areas where the EU and Canada could continue to enhance their bilateral cooperation.