

Christian Deblock &  
Michèle Rioux

# From economic dialogue to CETA

*Canada's trade relations with the European Union*

Canada's diplomacy since the enactment of the North American free trade agreement (NAFTA) has been marked by a double movement, strengthening relations with the United States and loosening ties with Europe. Unlike the United States, however, Canada is now showing great interest in securing a trade agreement with Europe.<sup>1</sup> In 2009, following 10 years of negotiations, Canada reached a free trade agreement with the European Free Trade Association. For its part, the EU, which had initially shown little interest in an agreement with Canada, agreed to begin negotiations, which began their sixth round in January 2011. It is now expected that this agreement, called the comprehensive economic and trade agreement, or CETA, could be finalized and signed in 2011.

*Christian Deblock is director of the Centre d'études sur l'intégration et la mondialisation (CEIM) and professor of political economy at l'Université du Québec à Montréal (UQAM). Michèle Rioux is professor of political economy at UQAM and CEIM's director of research.*

1 In 2006, "Québec's international policy: Working in concert" highlighted the province's special relationship with Europe. Since then, Québec has played an important role in the launching of negotiations and has multiplied its efforts—which included a 2005 plea by Premier Jean Charest—to persuade the Canadian government and the EU to implement a far-reaching trade agreement.

Canada has many good reasons to look for a strengthened trade partnership with the EU. Business communities support it, and Canada has always considered Europe a partner to counterbalance US influence and reduce its dependence on its powerful southern neighbour. The recent economic crisis that emerged in the United States, and its impact on Canada and the rest of the world, is a further inducement to revive ties with Europe. Yet the two most important reasons for the Canadian initiative are found in the weakening of NAFTA and the difficulty Canada has in finding its place in a world in which free trade agreements are proliferating, particularly in Asia. These phenomena force Canada to rethink its strategy in developing a competitive economy, its privileged relationship with the United States, and the international economic policy it should adopt to avoid being marginalized in a rapidly changing global economy.

The multilateral route traditionally favoured by Canada is currently blocked, as are such regional projects as the free trade area of the Americas or Asia-Pacific economic cooperation. With NAFTA showing signs of weakness, Canada is looking for new bilateral partners but it is struggling to find worthy interlocutors. Asia is far away, and despite increasing trade flows with China, a trade agreement with the latter seems out of reach. It is in this context that Canada is attempting to revive economic and political ties with Europe.

While a Canada-EU comprehensive trade agreement seems within reach, this recurrent transatlantic theme is reminiscent of someone (read Canada) frantically pushing on the replay button in a desperate attempt to trigger some new dynamics, without ever succeeding. Although Canada enjoys good relations with the EU, it does not constitute a priority for Europe, which is a global economic player much like the United States. One can wonder whether the interest and political will are strong enough for the EU and, if so, what negotiating clout Canada could display to reach a favourable agreement in this asymmetric situation. One can also wonder if this new “Europeanization” policy is genuine or if Canada’s efforts to revitalize its relationship with the EU have more to do with the fact that it is looking to find an alternative to a stalling NAFTA model and reduce its dependence on the United States. Political and structural differences may ultimately prove insurmountable, as Canada has embraced the NAFTA regulatory model and a CETA could therefore trigger a clash between two irreconcilable approaches to economic regulation. These are this article’s main arguments, which we divide into three parts: an overview of the stalling NAFTA model;

a discussion of the options available to Canada; and the economic, political, and strategic issues involved in a CETA with Europe.

#### A STALLING NAFTA

Since the mid 1980s, there has been political consensus in Canada on three points: the relationship between trade openness and competitiveness, the link between a thriving national economy and the international competitiveness of firms, and the prioritization of bilateral relations with the United States. Disagreements exist, however, on the way to link domestic economic policy with foreign trade policy, especially to ensure the growth of productivity, as well as to the place, within Canadian trade policy, of countries other than the US.<sup>2</sup> For Canada, free trade with the US was the preferred strategy to increase the competitiveness of its firms and improve national productivity, efficiency, and innovation. While it brought some benefits, it now seems that NAFTA has reached its limits.

Despite its good economic performance, Canada has not reached American income and productivity levels. Productivity growth has even declined compared to pre-NAFTA levels. Productivity increased on average four percent per year in Canada between 1947 and 1973, compared to 3.2 percent in the United States. In contrast, productivity rose 1.6 percent between 1975 and 2000 in Canada, compared to 1.7 percent in the United States, and one percent between 2000 and 2007 in Canada against 2.6 percent in the United States.<sup>3</sup> Canada also suffers from weak productive investment and low innovation, two problems NAFTA has failed to correct. In 2000, investment

2 Andrew Sharpe suggests that Canada's future depends on productivity growth and the ability to adjust to a changing economic environment. He advocates three main policies: the dissemination of best technologies, the elimination of sales taxes on equipment, and the promotion of labour mobility. See Sharpe, "Three policies to improve productivity growth in Canada," Centre for the Study of Living Standards research report no. 2007-05, Ottawa, December 2007.

3 A comparison of OECD countries ranked Canada 16th in 2006. Canada ranked 19th in terms of annual growth in productivity per hour between 1973 and 2006. See Someshwar Rao, Andrew Sharpe, and Jeremy Smith, "An analysis of the labour productivity growth slowdown in Canada since 2000," Centre for the Study of Living Standards, Ottawa, 2005, 3-23. In a recent study, Sharpe linked low productivity to economic liberalization and suggested that the problem was that liberalization was not accompanied by measures in research, innovation, and education. See "The paradox of market-oriented public policies and poor productivity growth in Canada," Centre for the Study of Living Standards research report no. 2010-01, Ottawa, February 2010.

in information and communication technologies accounted for 5.2 percent of private sector GDP in the United States, compared to 3.2 percent in Canada. By 2006, the proportions were, respectively, 3.8 and 2.5 percent.<sup>4</sup> Pierre Fortin had warned that Canada's manufacturing performance was artificial and dangerous: artificial because of the low value of the Canadian dollar and dangerous because services and new technologies are the real new economic drivers of development. Manufacturing is now in trouble, since the Canadian dollar is at near parity with the US dollar and industry faces strong Chinese competition both in Canada and the United States.<sup>5</sup> On the whole, Canada has a trade deficit with other countries, and if we exclude the oil sector it has also a deficit with the United States. Despite efforts to diversify production and embrace the digital era, natural resources continue, more than ever, to play a central role in Canadian international trade, even though the aircraft and service industries made it through the recent global financial crisis better than other sectors.

NAFTA may have awakened the Canadian economy, but it could not solve all problems and fill the vacuum of a national economic strategy. While Canada lacked a more active economic policy, NAFTA did, to some extent, contribute to a dangerous illusion of wealth, thereby further enmeshing Canada in its privileged relationship with the United States. Canada and the United States form the world's largest bilateral free trade zone and geographic proximity is only one of the many factors that contribute to this situation. Intrafirm trade is very developed and its effects on investment flows and the composition of trade are significant.<sup>6</sup> The implications of "integrative trade" are manifold,<sup>7</sup> and, as Michael Hart and Bill Dymond have suggested, the vast network of free trade agreements that worked well in the past is no longer sufficient for North America, which now faces the new challenges inherent in rapid global economic transformations.<sup>8</sup> The

4 Andrew Sharpe and Jean-François Arsenault, "The Canada-US ICT investment gap: An update," Centre for the Study of Living Standards research report no. 2008-1, Ottawa, February 2008.

5 See Ryan Macdonald, "Not Dutch disease, it's China syndrome," *Canadian Economic Observer*, August 2007, 3.1-3.11.

6 It is estimated that one third of Canadian exports consists of imported inputs.

7 See Glen Hodgson, "Integrative trade and the Canadian experience," *EDC Economics*, Ottawa, May 2004.

8 Michael Hart and Bill Dymond, "Trade theory, trade policy, and cross-border integration," in Dan Ciuriak, ed., *Trade Policy Research 2006* (Ottawa: Department of Foreign Affairs and International Trade, 2006), 103-58.

international horizon for both Canadian and US firms has expanded with globalization and the rapid takeoff of emerging countries. The United States continues to capture the bulk of Canadian exports, but shares of other countries, particularly in Europe and Asia-Pacific, are growing quickly. Changes are even more dramatic with regard to imports. The US share of Canadian imports reached 77 percent of total imports in 1998 but dropped to 63 percent by 2009. Investment data show similar trends. The United States dominates Canadian inward and outward foreign direct investments, but there is a pronounced shift in favour of European countries for Canadian outward FDI, with Europe accounting for just under 30 percent of the total stock.

In the US case, trends are similar. Canada's share remains stable while the share of other countries has increased dramatically. As a percentage of GDP, exports to Canada represented about two percent in 1990 and 2008, while the share of other countries increased from five percent in 1990 to seven percent in 2008. As a percentage of GDP, imports from the United States represented 1.6 percent in 1990 and 2.4 percent in 2008, while other countries accounted for seven percent in 1990, 10 percent in 2000, and 12.3 percent in 2008. For Canada, dependence on the US market has declined between 2000 and 2008 and increased vis-à-vis other markets. As a percentage of GDP, exports to the US represented 16.4 percent in 1990, 33.3 percent in 2000, and 21.8 percent in 2008, while other countries accounted for six percent in 1990 and seven percent in 2008. For their part, imports from the United States represented 14.3 percent of GDP in 1990, 24.8 percent in 2000, and 16.5 percent in 2008, while other countries accounted for 6.4 percent in 2000 and 9.5 percent in 2008. The statistics for foreign direct investment stocks are even more revealing. Outward US FDI stocks, as a percentage of GDP going to Canada, increased from 1.3 percent to 1.6 percent, while outward US FDI to other countries rose from 6.8 percent, in 2000, to 20.6 percent, in 2008. Outward Canadian FDI stocks to the United States increased from nine percent to 17 percent of GDP, while outward US FDI to other countries rose from six percent to 17 percent.<sup>9</sup>

These trends can be explained by NAFTA's early springboard effect, which has now faded away. Firms have begun to look elsewhere, not only because NAFTA itself is wearing out but also as a result of the restructuring of the global economy and its impact on North America. While NAFTA has

9 Statistics are from Statistics Canada, UNCTAD, and the US bureau of economic analysis.

undeniably played an important role in shaping the economic landscape of North America, nowadays, like Canada, even Mexico is somewhat losing its power of attraction. Let us recall that NAFTA emerged in a context of competition among triad members—the US, Europe, and Japan. Today the game has changed and new actors have emerged, the most important of which is China. Mexico's share of US trade and investments flows is increasing faster than Canada's. The stock of inward FDI has multiplied by only 3.2 in Canada between 1990 and 2008, by 5.8 in the United States, and by 13 in Mexico.<sup>10</sup> The data of employment abroad by US subsidiaries is impressive: the number of jobs for all subsidiaries rose between 1997 and 2007 from 791,000 to 1,152,100 in Mexico and from 937,500 to 1,115,200 in Canada, while during the same period, the number of jobs created in China rose from 178,000 to 792,900, and in India from 73,700 to 334,800.<sup>11</sup>

Canada's economic performance is still rather good thanks to its exports of energy and raw materials, which allow it to continue enjoying a trade surplus with the United States. Nevertheless, Canada's position is not very attractive. With a strong Canadian dollar and poor productivity levels, manufacturing exports face fierce competition in US markets. For similar reasons, Asian imports into Canada have exploded. Canada has lost its special status as the United States turns to other partners, especially China. Canada needs to revive its economy and reconsider its international economic policy if it wants to adapt to the new global economic trends, just as Canadian enterprises are trying to do. This brings us to the central question: which direction should Canada take? Should it seek to strengthen the institutional architecture of its bilateral relationship with the United States? Or should it become more aggressive in other markets, entering into both "proactive" and "defensive" free trade agreements?<sup>12</sup> Canada has not yet developed a clear idea of the way forward, even after the elaboration of a new global trade

10 "World investment report 2009," statistical annex, UNCTAD, Geneva.

11 Statistics from the US bureau of economic analysis.

12 This distinction is defined by the Canadian house of commons' standing committee on international trade: defensive agreements are signed to gain equal footing in world markets, with countries with which the United States and others already have an agreement or with which they intend to conclude one; proactive agreements are signed with countries with which the United States does not have a free trade agreement.

strategy in 2009.<sup>13</sup> In any case, the bilateral approach seems unavoidable since, in the current international context, other international trajectories face significant obstacles. This is what will appear clearly in the next part of this article.

#### THE INESCAPABLE PROBLEM OF BILATERALISM: CHOOSING A PARTNER

The first option for Canada is to reinvest in NAFTA and its bilateral relationship with the United States. There are many arguments in favour of negotiating a “NAFTA plus,” even if a changing world economy requires a more diversified outlook. Danielle Goldfarb and Michael Hart have both argued in favour of strengthening the bilateral relationship with the United States, which they see as sustainable, stable, secure, and generating many fewer unforeseeable trends than would be the case with diversified trade relations.<sup>14</sup> To quote Goldfarb, “[t]he inescapable reality is that Canada’s trade is and will be concentrated in the US market for the foreseeable future. The top priority of policymakers must be mitigating risks within the Canada-US economic relationship.”<sup>15</sup> Economic geography often has more impact than wishful thinking on the part of politicians. In the late 1970s, the Canadian economy was indeed more dependent on the United States than when the “third option” was introduced to diversify Canada’s trade relations. Today, nobody doubts that the bilateral relationship with the United States will continue to focus attention in coming years and that, with increased competition, many efforts need to be deployed to improve trade corridors and enhance the competitiveness of Canadian industries in North America.

Proposed methods to build on NAFTA and deepen Canada’s economic integration with the United States are varied. Some suggest a customs union, others the creation of a bilateral commission to harmonize

13 “Seizing global advantage: A global commerce strategy for securing Canada’s growth and prosperity,” Department of Foreign Affairs and International Trade, Ottawa, March 2009.

14 Danielle Goldfarb, “Too many eggs in one basket? Evaluating Canada’s need to diversify trade,” commentary no. 236, C.D. Howe Institute, Toronto, July 2006; Danielle Goldfarb, “US bilateral free trade accords: Why Canada should be cautious about going the same route,” commentary no. 215, C.D. Howe Institute, Toronto, August 2005; Michael Hart, *From Pride to Influence: Towards a New Canadian Foreign Policy* (Vancouver, UBC Press, 2008).

15 Goldfarb, “Too many eggs,” 2.

regulations, norms, and standards.<sup>16</sup> The North American security and prosperity partnership, signed in 2005 by Canada, the US, and Mexico, and initiatives such as the implementation of a North American competitiveness council were all part of this dynamic of reforms. It is no doubt possible to structure cooperation efforts more effectively in matters of regulation, but it is hard to get very far at the political level and doubtful whether this bottom-up approach can bring significant economic benefits. Indeed, aside from the fact that these initiatives touch upon the sovereignty of states, an extremely sensitive issue in the US, there is insufficient economic pressure in Canada, the US, and Mexico to engage in bolder forms of integration. NAFTA could never be compared to the EU as a model of integration, as its members prefer intergovernmentalism to the creation of a single market and supranational institutions. NAFTA has introduced a North American governance framework for investment, intellectual property rights, and many other regulatory areas that, in the end, favours the American regulatory system. Canada is now very much integrated within the North American economy and its good economic performance over the last 20 years is related, in part, to NAFTA.<sup>17</sup> North American economic relations are stable and despite some tensions, such as the softwood lumber disputes, conflict is not very significant. Yet NAFTA is stalling and showing signs of weakening. NAFTA plus would not help Canada face the challenges of the new geo-economic order and improve its international competitiveness. The benefits of North American integration for Canada are less evident than they were in the late 1990s.

Bilateral free trade agreements confer exclusive rights to a trading partner and being the first has its advantages. Although the Canada-US free trade agreement was perceived as a great victory for Canada, it soon became apparent that the United States had greater ambitions, namely to transform the multilateral trading system. In this context, it did not take long for other

16 See Danielle Goldfarb, "The road to a Canada-US customs union: Step-by-step or in a single bound," commentary no. 184, C.D. Howe Institute, Toronto, June 2003; Edward D. Chambers and Peter H. Smith, eds., *NAFTA in the New Millennium* (Edmonton: University of Alberta Press, 2002); Gordon Mace and Louis Bélanger, *The Americas in Transition: The Contours of Regionalism* (Boulder: Lynne Rienner, 1999); Gordon Mace, "Quelles institutions pour l'ALENA?" in Christian Deblock and Dorval Brunelle, eds., *L'ALENA: Le libre-échange en défaut* (Montréal: Fides, 2004), 133-54.

17 See the special issue of *Policy Options* 28, no. 9 (October 2007), especially the article by Craig Wright and Derek Holt, "Canada's free trade lessons for the world," 14-22.

countries, notably Mexico and Chile, to ask for similar trade concessions. Canada had no choice but to side with the US on the regional front in order to maintain and, where possible, enhance its trade benefits, thus avoiding a hub-and-spokes scenario. Another goal of regionalism was to open up the Canadian economy beyond the scope of NAFTA. Whether it was the free trade area of the Americas, launched in Miami in 1994, or in Asia with APEC, Canada sought to play an important political role, to stand apart from the US, and to appear to other countries as a fully independent partner.<sup>18</sup> This opening-up strategy ultimately failed in both regions, as the hope of creating large areas of free trade faded.<sup>19</sup>

Another option was to enlarge NAFTA, an idea that circulated during the preparatory phase of the summit of Miami but was later abandoned. At the same summit, it was proposed that Chile be integrated within NAFTA. Congress blocked the project and Canada alone went on to sign a bilateral agreement with Chile in December 1996. Subsequently, Mexico, in April 1998, and the United States, in June 2003, took up negotiations with Chile, but these agreements remain separate from NAFTA. In the meantime, obstacles encountered in the course of hemispheric negotiations and at the World Trade Organization (WTO) led the United States to opt for a parallel track, described by former US Trade Representative Robert B. Zoellick as “competitive liberalization.” In this context, Canada’s strategy became focused on following and, where possible, preceding the United States. Canada engaged in extensive discussions, but with no grand overall plan to orchestrate this movement towards bilateralism. In other words, it was a movement in all directions. The upshot is that Canada’s performance in terms of bilateralism has been poor when compared with the United States, Chile, and Mexico, which are not only better implanted within the Americas but are also more effectively engaged in places where things move quickly, namely in Asia.

Canada also considered strengthening its relationship with Mexico within NAFTA.<sup>20</sup> Certainly, cooperation and economic ties between the two

18 Paul Gecelovsky, “Un gran familia: le Canada et la ZLEA,” *Études internationales* 33, no. 4 (December 2002): 745-62.

19 For an analysis of the failure of the free trade area of the Americas, see Christian Deblock, “Il était une fois dans les Amériques...Le projet envolé de zone de libre-échange,” *Europa y America Latina* 2 (September 2007): 105-32.

20 Christian Deblock and Afef Benessaïeh, “Relaciones economicas entre Mexico y Canada desde el TLCAN: Una perspectiva canadiense,” *Comercio Exterior*, January 2002, 53-75.

countries have been strengthened, but they remain primarily bilateral and polarized around the United States. Canada would have been well advised to respond positively to Mexico's request to strengthen the institutional architecture of NAFTA, especially since the United States has increased its own trade relations with Mexico. The Canada-Mexico relationship, however, remains weak because of a general lack of interest on the part of Canadian businesses and because of the inconsistency of Ottawa's policy toward Mexico.

Since the Conservatives came to power in Ottawa, Canada has revamped its trade diplomacy in the Americas where quick gains are possible, but also in other regions, targeting China, India, Brazil, Japan, Korea, the ASEAN countries, the Gulf Cooperation Council and, of course, the European Union. The rapid emergence of newly industrialized countries, especially China, is reshaping and transforming the global economy's architecture, especially in terms of the geography of international trade. What is most striking is not the reemergence of China as a great power, but the speed of change in power relations. Corporate networks and value chains have evolved in Asia, making China a great platform for export to western markets. But China also has other ambitions, seeking to upgrade and diversify its production and to shape global economic governance. Eager to display a mix of power and "peaceful development," it has multiplied trade agreements, including with the ASEAN countries.<sup>21</sup> Canada is not immune to these changes. Since 2003, Canada's imports from China have increased fivefold while its exports to China have tripled. But while Canada's relationship with China is still in its infancy and Canadian companies have lagged far behind their western competitors in all Asian markets, the same cannot be said of its relationship with Europe. The relationship with the EU is much older, but economic integration across the Atlantic remains fairly superficial. This shallow integration is not for want of trying, on Canada's part, to transform this state of affairs. From another perspective, Canadian companies are now well implanted in Europe, and the increase in exchanges of commercial services is promising. Nonetheless, as we shall now specify, Canada suffers from two problems: it has a hard time standing apart from the US and it does not figure among Europe's priorities.

21 Christian Deblock, Éric Boulanger, and Christian Constantin, "Le régionalisme en Asie: Un chantier, trois concepts," *Mondes en développement* 26, no. 144 (2008): 91-114.

## A TRANSATLANTIC RELATIONSHIP IN THE SHADOW OF THE UNITED STATES

The EU is the second-largest market in Canada. Trade with the EU-27 represented, in 2009, 8.5 percent of Canada's total exports of goods, and 12.4 percent of its imports. Trade has slightly increased since the turn of the decade but remains in deficit for Canada. Trends are similar for commercial services. Investments are most important: Canada is the third-largest investor in Europe and the EU is the second in Canada. As a percentage of the total, the EU represents approximately one quarter of all Canadian foreign direct investment.

This confirms two things: the first is that market penetration in Europe relies on foreign direct investment, i.e., with production on site; and the second is that even if it generates trade, foreign direct investment is primarily motivated by the search for market opportunities.<sup>22</sup> European investors can only have limited interest in a Canadian market that grows in the shadow of the US super-market and, conversely, the interest of Canadian investors in Europe is also limited in scope.<sup>23</sup>

If the EU is Canada's second-largest trading partner, Canada is only the EU's tenth trading partner, representing a meagre two percent of EU merchandise trade, a proportion that has been on the decline since the beginning of the decade, for both imports and exports. By comparison, the US and EU are each other's main trading partner, with the US representing 23 percent of EU exports and 13 percent of its imports, a proportion, however, that is also on the decline. Investment data are even more revealing and important, considering that the transatlantic economic relationship is shaped more by foreign direct investment than by trade. In the case of Canada, let us recall that a little over a quarter of Canadian direct investments abroad are made in Europe and just over a quarter of foreign direct investments in Canada emanate from the EU. For the United States, more than half of outward foreign direct investment is directed towards Europe, while over 70 percent of US inward foreign direct investment comes from Europe. This not only confirms how deeply US firms are now implanted in Europe, but

22 A study by Statistics Canada shows that, unlike American firms, European firms established in Canada export little to their country of origin. Sales of Canadian subsidiaries in Europe are four times higher than exports to Europe. See Craig Byrd, "Foreign control of Canada's merchandise exports, 2002," Statistics Canada, Ottawa, October 2005.

23 Studies show the lack of interest of European investors for Canada. See Dan Lemaire and Wenguo Cai, "Lost over the Atlantic? The Canada-EU trade and investment relationship," Conference Board of Canada, Ottawa, June 2006.

also that trade relations between the United States and Europe are casting a shadow over the relations Canada seeks to establish and maintain with the other side of the Atlantic.

From the Marshall plan to the 2007 “Framework for advancing transatlantic economic integration,” the United States has tried to establish a transatlantic community rooted in free trade and shared values.<sup>24</sup> During the Cold War, the alliance against communism was strong and Europe was integrated into the multilateral trading system. Following the end of the Cold War, priorities changed. In the context of the widespread liberalization of trade, a Washington-Brussels axis helped strengthen the multilateral trading system and develop a complex institutional architecture of interdependent economic blocs. Many are the historical and economic ties uniting the two sides of the Atlantic in their desire to liberalize trade, but for reasons pertaining both to differences in conceptions of integration and to the problems of agreeing on a specific agenda, a transatlantic free trade agreement has never emerged. Bilateral relations remain friendly, cooperation is close, and summits and high-level meetings are regular but, over the years, Europe has distanced itself from the United States. Atlanticism, indeed, no longer generates the fervour that it once did, and each side now seems resigned to follow its own path.<sup>25</sup>

Canada has always had great difficulty defining its role in the midst of this privileged yet complicated relationship between Europe and the United States, a relationship that has been the “backbone of international relations since the Second World War.”<sup>26</sup> After the war, economic ties with Europe gradually weakened in favour of the US. During the 1970s, the third option

24 “Framework for advancing transatlantic economic integration,” 2007, [www.eurunion.org](http://www.eurunion.org).

25 Ivo H. Daalder, “Are the United States and Europe heading for divorce?” *International Affairs* 77, no. 3 (2001): 553-67. See also Jean-Marie Paugam, “Le dialogue économique transatlantique est-il hors sujet ?” Institut français des relations internationales, policy paper no. 6, Paris, December 2003; Marcel H. van Herpen, “Six dimensions of the growing transatlantic divide: Are the US and Europe definitively driving themselves apart?” in Hall Gardner, ed., *NATO and the European Union: New World, New Europe, New Threats* (Aldershot: Ashgate, 2004); Gregory C. Shaffer and Mark A. Pollack, “The future of transatlantic economic relations: Continuity amid discord,” *Journal of the European Consortium for Political Research*, 2006, 28-62.

26 Jacques Mistral, “Un partenariat économique transatlantique adapté à l’ère de la globalisation,” Centre des études économiques, Institut français des relations internationales, working document no. 16, Paris, October 2007.

gave way to closer ties between Canada and Europe, which led to the signing, in 1976, of a framework agreement on trade and economic cooperation. But its results did not live up to expectations and, consequently, Canada turned to the United States for a “marriage of reason.”<sup>27</sup> In the 1990s, the “transatlantic declaration” and the “new transatlantic agenda” allowed Canada to reconnect with Europe and give new impetus to bilateral trade relations. Canada even became the advocate of a transatlantic free trade agreement, but the project met with opposition from both the United States and Europe.<sup>28</sup> Paradoxically, it was with Mexico that the Europeans signed a trade agreement in 1997. A revival of the economic dialogue was eventually initiated by the United States, leading to a rather soft formula of transatlantic economic partnership. Nevertheless, Canada seized the opportunity in 1998 to agree with the EU on a new initiative, the EU-Canada trade initiative, which was aimed at addressing various obstacles to transatlantic trade and investment.

Canada-EU trade relations are good despite a few remaining disputes. High-level meetings are regular and joint working committees have been established, giving bilateral cooperation a more formal setting. The business communities also have their own transatlantic forums and roundtables. Nevertheless, Canada has never been a top priority for Europe, as it is perceived to follow the US too closely. And Canadian efforts to revive its relations with Europe have often been short-circuited by the US. Admittedly, Canada has never really had a “European” policy, at least none comparable to its “US policy.” While this may yet change as the EU and Canada negotiate CETA, nothing is less certain.

There are good reasons for Canada to be interested in Europe. Europe may lack the economic dynamism of Asia, but its institutions are strong and it is Canada’s second-largest partner in terms of trade and investment. The bilateral trade relationship is satisfactory but still “underdeveloped.”<sup>29</sup> EU rules are off-putting for Canadian firms, and Canadian foreign direct investment is concentrated in a very small number of EU member-states. For their part, European investors prefer the United States; the Canadian market is seen as secondary, if not as a US satellite. These international

27 Sidney Weintraub, *A Marriage of Convenience: Relations between Mexico and the United States* (New York: Oxford University Press, 1990).

28 Robert Wolfe, “Vers l’ALETA ? Le libre-échange et la politique étrangère canadienne,” *Études Internationales* 27, no. 2 (June 1996): 353-80.

29 Lemaire and Wenguo, “Lost over the Atlantic?”

economic trends cannot be changed with the stroke of a magic wand. Yet Ottawa thinks a CETA can change perceptions within the business world and pull the bilateral relationship out of its underdevelopment. The trade and investment enhancement agreement was launched at the Canada-EU summit in Ottawa in 2002. The aim of this initiative was to move beyond traditional cooperation and deepen the trade, investment, and overall bilateral relationship, but after three rounds of negotiations, discussions were interrupted in May 2006. Later, at the Berlin summit in 2007, both parties ordered a feasibility study while continuing discussions on a sectoral basis. Published in October 2008, the joint study concluded that a trade agreement could generate trade increases of about 25 percent from Canada to Europe for goods and 14 percent for services, and a little over 35 percent and 13 percent for goods and services respectively in the other direction.<sup>30</sup> In 2009, Canada and EU released a joint report on the EU-Canada scoping exercise, laying out a negotiating agenda on trade and investment. Thereafter, they announced negotiations toward a CETA, which was to build on the abandoned enhancement agreement. The basic issues—agriculture, regulation, commercial arbitration, environment, and sanitary and phytosanitary standards, to name but a few—still remain, and Canada seems more flexible now than it was previously. For its part, the EU has taken a major step by agreeing to negotiations on something that, while not called *free trade*, is at least “comprehensive.”

Like Canada and the United States, the EU seems to have given up, at least for the time being, on the WTO Doha round, and has instead embraced bilateralism in certain regions and with key countries. For instance, European trade diplomacy has not given up on an agreement with MERCOSUR. Moreover, European attention continues to drift towards Asia and, to a lesser extent, to the Africa-Caribbean-Pacific and Mediterranean. As the resources of diplomacy are limited, they must be mobilized for negotiations with specific partners and, even though Canada is eager to reach an agreement with the EU, it is uncertain whether Brussels feels the same sense of urgency. Nonetheless, Canada has been successful in convincing the EU to

30 “Assessing the costs and benefits of a closer EU-Canada economic partnership,” [www.international.gc.ca](http://www.international.gc.ca). Other studies published since have shown similar results. See Patrick Leblond and Magdalena Andreea Strachinescu-Olteanu, “Le libre-échange avec l’Europe: quel est l’intérêt pour le Canada?” *Canadian Foreign Policy/La politique étrangère du Canada* 15, no. 1 (2009): 60-76; and Selen Sarisoy Guerin and Chris Napoli, “Canada and the European Union: Prospects for a free trade agreement,” Centre for European Policy Studies, working document no. 298, Brussels, July 2008.

start negotiating. Other factors speak in favour of these negotiations: the proliferation of free trade agreements and the general movement towards bilateralism, Canada's successful negotiations with the European Free Trade Association, and the neutrality of the Obama administration vis-à-vis this initiative. We can therefore feel moderately optimistic about the outcome of these negotiations, although much remains to be done. A leaked draft of the January 2010 CETA draft agreement confirmed that the negotiations are indeed advancing and that "all, if not almost everything" is on the table.<sup>31</sup>

The CETA draft indicated that the agreement would constitute a global landmark with many institutional innovations. Although its benefits could be significant, such an agreement may well trigger more adjustments and costs for the Canadian economy, as Canada's desire for CETA is greater than Europe's. Indeed, there are important issues related to the extent of economic and policy reforms that would be required of Canada, notably in foreign investment rules (telecommunications), intellectual property rights enforcement, agriculture, government procurements, and many regulatory and standards-related issues affecting trade and foreign direct investment.

Europe will probably gain more than Canada. In agriculture, Canada may not see the end of the common agriculture policy and other important obstacles. In contrast, Canada may be forced to give up its supply management practices. Officials claim that Canada could get WTO-plus treatment but that the common agriculture policy might not be on the table. At the moment, nothing is clear. CETA could change the rules of the game for farmers both in Canada and Europe, but the fact remains that Europe may still be better equipped to promote exports and reduce entry of imports. Regarding intellectual property rights, Europe's trade-related intellectual property rights-plus framework could, for effective enforcement, extend intellectual property rights further than ever, while in the US, these rights are actually a subject of debate, with many advocates suggesting that they have already been extended far beyond what was necessary for the protection of innovation and its proper and orderly dissemination. Still, it should be noted that interesting innovations have been made on labour and environmental issues, even though it clearly appears that some provisions are not as strong as others and that differences are more significant than in other chapters.

It is not possible in this short article to analyze the CETA draft in detail, but three important remarks can be made. The first is that a CETA would

31 On 19 April 2010, the Trade Justice Network released a leaked copy of the CETA text, which is available at <http://tradejustice.ca>.

be deeper and broader in scope than NAFTA and on several issues it would make advances on key aspects of global economic governance. With respect to economic regulation, the draft agreement clearly indicates that CETA could set a new standard for other free trade agreements or for the WTO. Firms will certainly benefit from regulatory clarity in agriculture, telecommunications, the service sectors, and a variety of others. Undoubtedly, given that it makes headway on issues of key significance to the private sector, which desires a more secure international legal framework, CETA is important to firms big and small. However, CETA does not mean that clarity and regulatory convergence will be easy, as there are significant divergences in regulatory frameworks and policymaking. Many contentious issues remain on the transatlantic front, which brings us to the second remark.

CETA could quite possibly challenge the NAFTA model. CETA may be incompatible with North American practices and normative frameworks. The regulatory models that have been developed on both sides of the Atlantic may not be reconcilable. North America has favoured an ex-post, private-based, and bottom-up regulatory model of capitalism that contrasts with the ex-ante, politically driven, and top-down EU governance system. These models may not be compatible or interoperable, even if there are trends toward convergence, international comity, and mutual recognition.

This brings us to the third and final remark, which concerns the imbalance between the economic and sociopolitical dimensions of integration. Admittedly, a CETA is more oriented toward market access and the security of corporations rather than towards the organization and surveillance of markets and social security. Canada and Europe could place environmental, public health, and human rights concerns in a more balanced position with the interests of corporations. On both sides of the Atlantic, much could be done to improve the social and political dimensions of economic integration, and this includes improving the negotiating processes that have traditionally consisted of a series of concessions rather than a pooling of common interests and objectives.

#### CONCLUSION

As a producer of primary products, dependent on trade and natural resources, Canada has had to adapt to the changes in the world's economy. It has always sought to diversify its trade and production, but its proximity with the United States has made it difficult for Canada to avoid becoming entangled in an increasingly special relationship with its powerful neighbour. Since NAFTA, Canada has had no choice but to give the highest priority to its

bilateral relationship with the United States. This approach has borne fruit but the weakening of the NAFTA model, on the one hand, and the failures of regionalism in the Americas and with APEC, on the other, now force Canada to rethink its international trade policy.

With multilateralism on hold while bilateral ties with the BRIC countries (Brazil, Russia, India, and China) and Asia develop slowly, Canada finds nowhere else to turn but Europe in its latest attempt to reduce its dependence on the US economy and to look for a new engine for growth, competitiveness, and prosperity. Trade relations are developing and Canadian firms are everyday more active in Europe—commercial services are showing interesting prospects—but the United States is a much bigger economic player than Canada and the prime transatlantic interlocutor for the EU. Moreover, the EU is too busy building Europe and developing its own trade and investment cooperation partnerships to pay real attention to a dialogue with Canada. Finally, the Canadian objective of harmonizing market standards and regulations could prove to be an insurmountable task, given how different the North American and European systems are.

A Canada-EU CETA could represent an important step in the quest for more coherent global economic governance, especially if it becomes a stepping stone to a greater North Atlantic economic zone. CETA could be a first step towards an EU-US free trade agreement and the creation of a truly transatlantic market. Being the first to negotiate allows Canada to play a bridging role between its two most important economic partners. However, for benefits to translate into economic, social, and political gains for Canadian and European societies, the economic dialogue needs to become more than a comprehensive free trade agreement with a purely mercantile outlook. Since NAFTA, Canada should know that negotiating with a global economic player is costly and that freer trade does not magically translate into better economic fundamentals. Market access needs to be regulated and, especially for smaller countries and more vulnerable actors, regulations and policies need to be smarter rather than freer.

The fundamental problem with CETA is that Canada is mostly getting closer to Europe for the wrong reasons—i.e., NAFTA's weakness and trade diversification away from the US. Europe knows that Canada has never truly developed a European policy except to save itself from the stranglehold of the United States. Getting closer to the US to increase its internal competitiveness has never translated into more productivity or more innovation, and a CETA with Europe may prove just as useless, and even dangerous, if Canada does not develop a necessary complement to free trade, i.e., a real economic policy

that stands a chance of improving productivity and innovation levels and contributing to social justice and a better distribution of wealth. Of course, Canada has yet to decide whether its economic future lies on its Atlantic or its Pacific side. Still, whichever way it turns, Canada must begin by improving the interface between its domestic and international economic policies, and it should probably start its work at home. Canada has lived in the comfort of its relationship with the United States to the point of forgetting that the key to its future development resides in productive and human investment, innovation, and knowledge, as well as in information and communication technologies. A Canada-EU CETA will never be a counterweight to US influence on the Canadian economy and politics if Canada does not truly develop a European policy and a *comprehensive* economic development strategy. In the 1970s, Canada tried actively to diversify its trading partners, only to end up signing a bilateral free trade agreement with the United States 10 years later. That proved a point: choosing a trading partner is no replacement for an economic strategy, and this is even more important when a closer relationship involves market access concessions that increase competition, i.e., a freer trade environment. To put it bluntly: what NAFTA could not do, a Canada-EU CETA alone will not achieve.