CATPRN
Canadian Agricultural Trade Policy And Competitiveness Research Network

EVERYTHING IS ON THE TABLE: AGRICULTURE IN THE CANADA-EU TRADE AGREEMENT

CATPRN Trade Policy Brief 2011-03
March 2011

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Trade Policy Briefs are short summaries of studies funded by the CATPRN. As such, the briefs omit many of the details and most of the references contained in the longer reports. This brief is based on CATPRN Commissioned Paper 2010-03 and work conducted following publication of that report. Funding for this project was provided by the Canadian Agricultural Trade Policy and Competitiveness Research Network which is funded by Agriculture and Agri-Food Canada. The views expressed in this brief are those of the authors and should not be attributed to the funding agencies.

Introduction

In October 2008, Prime Minister Harper of Canada and President Nicholas Sarkozy of France confirmed during the Canada-EU Summit that Canada and the EU would start to explore the possibility of a FTA. A few months later (May 2009) the launch of the negotiations for a Comprehensive Economic and Trade Agreement (CETA) was announced. The concept of a FTA between Canada and the EU is not new but for many years the EU has rejected any initiative put forward by Canada to significantly deepen economic relations; leaving Canada as one of only eight countries without any form of preferential trade agreement with the EU. For example, the negotiations on a Trade and Investment Enhancement Agreement were looking very promising, but in 2006 the two parties jointly decided to *pause* the negotiations and no results have been forthcoming. This is troubling because, in 1976, Canada was the first industrialized non-European country that concluded a bilateral Framework Agreement for Commercial and Economic Cooperation with the EU. However, little has resulted from this cooperation agreement.

In October 2008, Canada and the EU released a joint study *Assessing the Costs and Benefits of a Closer EU-Canada Economic Partnership* which outlines the economic benefits that could arise from closer economic integration, namely that GDP in EU would increase by 0.08 percent and in Canada by 0.77 percent. This study is the source of the $12 billion estimated benefit to Canada that is often mentioned in news reports. Canada and the EU have agreed that the major areas for negotiation are: trade in goods and services, investment, government procurement, regulatory cooperation, intellectual property, temporary entry of business persons, competition policy, labour and environment. The attempt to create closer economic cooperation between Canada and the EU has been given a boost by three factors: 1) the glacial pace of the Doha Development Agenda at the WTO; 2) a fundamental shift in economic power towards Asia; and 3) Canada's status as an important energy producer with a stable democratic government. For Canada, a bilateral agreement with the EU would give it better access to 500 million consumers and help it to attract additional investment, technology and skilled workers from Europe. Some of the predictable sensitive issues that will challenge the CETA negotiations are agriculture, ship building, alcoholic beverages, trade remedies, health and safety standards, environmental regulations, intellectual property and government procurement. The market access negotiations in agriculture will also have to deal with a bewildering set of non-tariff barriers including packaging, labeling, certification (technical barriers to trade (TBT)) and health and safety standards (sanitary and phytosanitary standards (SPS)).

Canada and EU Trade and Investment

The economic relationship between Canada and the EU is characterized by strong two-way trade and investment. The EU represents Canada's second-largest trading partner, after the US, with exports to the EU valued at $52.2 billion and imports from the EU of $62.4 billion in 2008. However, Canada is only the EU's eleventh largest trading partner. The EU is the second largest source of foreign direct investment (FDI) in Canada ($133.1 billion in 2008) and Canada is the fourth largest source of FDI in the EU (21.4 percent of Canadian FDI abroad in 2007).

There is a considerable overlap in the product groups that the two parties trade with each other. The largest percentage of trade between the two countries is machinery and transport equipment. More than 60 percent of EU imports from Canada are manufactured products such as machinery, transport equipment and chemicals. Canada's main imports are transport equipment, crude materials and manufactured goods. Canada runs trade deficits with the EU in most industries, including agricultural products.

Agricultural products represent a major import/export sector for Canada (6% of exports, 2.5% of imports). A slight drop in agricultural exports to the EU in 2005 was followed by a continuous increase reaching $2.3 billion in 2008. Canadian agricultural exports to the EU are mainly bulk commodities like grain and oilseeds. Canada's agricultural imports from the EU reached $3.7 billion in 2008. The main agricultural imports from the EU are processed foods and alcoholic beverages. The EU has been a significant net agricultural exporter to Canada for many years.

Barriers to Agricultural Trade

Canada and the EU have a long history of supporting their agricultural sectors with government programs and policies and of protecting the sector from imports through tariffs and non-tariff barriers. Less clear is the role that standards and a variety of sanitary, phyto-sanitary and technical regulations play in providing protection to the sector.

In terms of tariffs, although both the EU and Canada have low *most-favoured-nation* (MFN) average tariffs on industrial goods (3.7 percent for Canada and 3.9 percent for the EU), food and agricultural products still face high tariffs. Overall, Canadian tariffs on imports from the EU have decreased on a trade weighted basis, but access to Canadian supply managed products such as dairy, eggs, turkey and chicken is highly restricted. Although EU tariffs on agricultural products were lowered during the Uruguay Round they are still high. In fact, agriculture is the only major product group that has tariffs in excess of 35 percent (54 percent for dairy products). The smaller fish, shrimp and sea food sector (where Canada is a significant exporter) is also heavily restricted by high tariffs and TRQs.

According to the OECD (2010) support and protection for the agricultural sector in Canada and the EU is near the OECD average of 21 percent of the value of farm output; 17 percent in Canada and 23 percent in the EU. However, the level of spending in the EU (US$120.8 billion) dwarfs Canada's (US$7.8 billion). Despite recent reforms a large percentage of the producer support is based on the level of output – it is *coupled* to annual production and/or prices.

Regulations have long been recognized for their potential to inhibit, restrict or eliminate trade in agriculture and food products in response to protectionist motivated lobbying of politicians. Traditionally, the lobbying for this form of protection has come from producers in import markets seeking relief from foreign competitors. In more recent times, the set of individuals and groups seeking regulatory trade barriers, in the EU, has expanded to include consumers and environmentalists. Thus, the task of those negotiating trade agreements is to put in place systems that can accommodate legitimate regulatory barriers while restricting the use of such barriers for nefarious purposes – but this is not an easy task.

Differing product standards between countries can also act as barriers to trade. For example, the EU requires that to be accepted as organic products in its markets, exporters must have a national standard for organic products and that standard must be acceptable to the EU – it does not mean that the standard must be harmonized with the EU standard. Until recently, Canada had no national organic standard and faced exclusion from the EU market. Canada did develop a national organic standard – but at a considerable cost. As trade in agrifood products is comprised of a rising proportion of processed foods, standards become increasingly important in the governance of trade.

Realistic Expectations for Agriculture

In accessing the gains, in agriculture, from trade liberalization with the EU there are two potential drivers: 1) gains from less competition in third country markets; and 2) gains from increased bilateral trade resulting from lower tariffs and from removing regulatory barriers to trade.

Both the EU and Canada have sectors with significant barriers to market access that negatively impact the exports of the other party in the bilateral discussions. Barriers to market access are not homogeneous with regard to the motivation for their imposition. Some tariff impediments faced by Canadian products attempting to enter the EU market are required to maintain the integrity of the remaining EU export subsidies – export subsidies raise producer prices in the importing country above world market prices and, thus, to prevent consumers from taking advantage of lower world prices, barriers to market access are required. Thus, lowering barriers to market access in these situations will first require that the question of export subsidies be effectively dealt with multilaterally at the WTO. There are, however, some areas where increased market access might be achieved even in the case of export-subsidy motivated tariffs. For example, the EU import tariff on beef is in the 50 percent range. One product that is negatively impacted by this tariff is Canadian bison meat. This is because the EU has no separate tariff line for bison – bison, presumably due to its genetic *closeness* to beef, is classified as beef for EU tariff purposes. This very large tariff has hindered the development of the market for Canadian bison in the EU. Canada could seek agreement that the EU would create a new tariff line for bison meat. After all, there is no export subsidy regime for bison in the EU; in fact there is no bison industry. With no protectionist *vested interests* in the EU, this may be an area where Canada might obtain concessions relatively easily. While the bison industry is not large, it is one that Canadian governments have been trying to foster as part of their diversification efforts in western Canada. A significant opening of the EU market could give a considerable boost to the industry. There may be other niche market products that are caught in inappropriate tariff or regulatory regimes that are, as yet, not of sufficient importance to garner any official action from EU bureaucrats. Creating a *fast track* mechanism to handle tariff anomalies, regulatory vacuums and bureaucratic inertia within the Canada-EU agreement might yield considerable benefits for future industries – where vested interests do not (yet) exist in the EU.

While the 50 percent tariff on beef is sufficient to exclude Canadian beef from the EU market, beef represents a clear example of layered barriers to trade. Even if the high EU tariff on beef could be removed, movements of beef into the EU market would still be prohibited. This is because of the EU ban on imports of beef produced using growth hormones – note it was only a few beef products (largely offal), whose tariff lines were not subject to the high beef tariffs, that were affected by the hormone-based ban. Thus, removing one layer of market access restriction may lead to another binding constraint.

Beef can be produced without the use of hormones in Canada. Thus, it may be possible to profitably supply hormone free beef to the EU. The large EU tariff on beef, however, has prohibited the development of this form of beef production in Canada. The EU does, however, allow limited quantities of beef to be imported without the tariff being applied. This limited access in known as the *Hilton Quota*. The US recently gained an expansion in its Hilton Quota as a result of bilateral negotiations with the EU. As part of the CETA, Canada could negotiate an increase in its allotment of Hilton quota. The increase would have to be of sufficient size to justify the establishment of hormone-free beef production in Canada and the co-requisite of a segregated supply chain for hormone-free beef. If this degree of increase in market access could be secured in the negotiations it would be an important facet of the agreement.

The case of beef produced using hormones is only the *tip of the iceberg* for a significant issue pertaining to market access to the EU. This is the problem the EU has in dealing with consumers, environmentalists and others requesting barriers to market access. The WTO's trade architecture only recognizes the right of governments to respond to producers asking for protection. In recent years, however, consumers, environmentalists and others have been asking – sometimes forcefully demanding – that the EU Commission impose trade barriers on a variety of products. Often, these products can originate in Canada. For example, some consumers in the EU have been advocating an import ban on seal pelts from Canada and have been sufficiently persuasive to have the European Parliament legislate a limit on imports. As discussed above, consumers in the EU were successful in having imports of beef produced using growth hormones banned – and in having the EU Commission accept retaliation rather than complying with a WTO disputes Panel ruling. The latter, while within the EU's rights under the WTO, is an unprecedented action.

The EU will also be looking for market access opportunities in Canada. The opportunities for EU agriculture and food exporters probably lie where Canadian trade barriers are the highest – and where Canadian opposition to trade liberalization is the most vociferous – those areas where supply management is the Canadian domestic policy. Access to poultry markets is unlikely to be a major area of interest for the EU – although there might be some niches where specialty products could benefit from lower barriers to access. Dairy products are where the EU would like to gain better market access – in particular specialty cheeses. The EU has long chafed under high tariffs and other market access restrictions for their differentiated cheeses. Resistance to increasing market access is, however, strident among Canadian dairy producers. They have successfully defended supply management in other bilateral negotiations like the Canada-US Free Trade Agreement (CUSTA) and the North American Free Trade Agreement (NAFTA) as well as during the Uruguay Round and the current Doha Round. This does not mean, however, that some increase in the minimum access commitments for some EU products could not be negotiated. This might require some modest adjustments in the supply managed sectors.

The EU also wants better market access for its wines. The main barrier, however, is the purchasing/sales practices of monopsonistic/monopolistic provincial government liquor boards in some Canadian provinces. Of course, this enters the realm of constitutional division of powers in Canada – although it was stick handled in the CUSTA.

We believe there is the making of a grand bargain in agriculture – don't you push for broad-based market access into the EU and we won't push for broad-based market access in Canada. There does not seem to be compelling pressure from outside the sector in either country to trade off market access in agriculture to obtain something in services or manufacturing – so the grand bargain is likely to stay within agriculture and any gains in market access are likely product specific and relatively limited.

Another area where the EU and perhaps Canada will be looking for concessions is represented by Geographical Indications (GIs). GIs are a form of intellectual property. GIs require protection from the state because they apply to goods where value is derived from *credence attributes*. Credence attributes are those that consumers cannot identify even after the product is consumed. Unlike *search attributes* that can be identified by consumers prior to purchase (e.g. the colour of a shirt) and *experience attributes* that can be identified through consumption (e.g. the tenderness of a lamb chop), credence attributes cannot be directly discerned by the consumer (e.g. whether the fortified red wine they just consumed was produced in Porto Portugal).

As agricultural policy has become more oriented toward GIs, the EU has become increasingly interested in garnering additional protection for their GIs in foreign markets. If foreign governments can be convinced to enforce GIs granted in the EU then monopoly rents accruing to the rights holders should increase, thus assisting in raising the incomes of agricultural producers (and/or others) in the EU and contributing to a range of rural policy objectives. There are three contentious international issues pertaining to GIs: 1) a major global split in the mechanism used to protect this particular form of intellectual property; 2) the treatment of some products that have been granted GI status in the EU as *generic* terms in some other countries – meaning that they are considered common terms and not identified with production being undertaken in a particular geographic local (e.g. Feta cheese in Canada); and 3) garnering foreign protection for less well known or new EU GI designations. The EU position on GIs in the negotiations has not been made public. One might, however, gain some insights regarding what GIs they might want Canada to protect from other EU requests pertaining to GIs. At the WTO Cancun Summit in 2003, the EU brought forth a list of GIs for which it sought protection. At that time it was suggested that the EU was likely to demand that list, comprising 40 products, be accepted by WTO members as non-generic, protected terms as part of the *market access* package for the Doha Round (USDA, 2003). If most of the EU GIs for wine and spirits were recognized by Canada in the Canada-EU Wine and Spirits Agreement, the major contentious issue for CETA negotiations is represented by non-wine and spirits (mostly cheeses and cured meat) that EU might sought protection for.

Conclusion

Given the existing set of agricultural policy constraints that exist in both the EU and Canada, only limited liberalization can be expected in the agricultural sector as a result of the CETA. The original premise of the agreement was that agricultural issues would be largely taken care of multilaterally under the Doha Development Agenda. For example, the list of both country's *sensitive products* would have been agreed – thus, for example, Canada's supply managed products would have been removed from the *table* in the Canada-EU negotiations. In a similar fashion, the issue of EU export subsidies would have been resolved. Further, there would have been a new regime for obligations pertaining to domestic support. With the Doha Round not yet (and maybe never) completed, all of these issues, in theory, come under the ambit of the Canada-EU negotiations – *everything is on the table*.

While everything may be *on the table* it is possible to agree to disagree – to opt for something close to the *status quo*. The things that Canada really wants like secure market access when EU officials are faced with resistance from consumers, environmentalists and others with social concerns (e.g. beef produced using hormones, products using genetic modification in their production and animal welfare regimes) are difficult areas for EU negotiators. In Canada, areas where the EU may have interests such market access for speciality cheeses strike at the heart of Canada's supply management policy – which has been a *no go* area for Canadian negotiators for decades. Geographical indications are also likely to entail difficult negotiations.

Thus, despite *everything being on the table* it is difficult to see where significant movement away from the *status quo* in agriculture can be negotiated. Most observers agree that the major areas where gains can be made in CETA are in the services sector and selected areas of manufacturing. It seems unlikely that CETA will be as all encompassing as the NAFTA with only a few agricultural products excluded from full tariff elimination. Still, it sends a bad signal if some trade liberalization is not achieved in agriculture and with a long implementation period no reason not to make progress. The major gains in agriculture are likely to be in niche markets which taken individually are small but in aggregate could provide a boost to Canadian agriculture. Most importantly, a trade agreement with the potential to open a rich market with 500 million consumers to the wide range of products and services exported by Canada cannot afford to be hijacked by challenging negotiations in agriculture.