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Junior partner Canada

Transatlantic trade relations under Germany's EU presidency

We know that the friendly ties between Europe and the United States and Canada are unique and without alternative. There is no lack of shared challenge. I believe they are more likely to increase than decrease. But we know together as partners we are strong.¹

During the course of Germany's EU council presidency in 2007, Canada was mentioned often in official speeches, government documents, and petitions. Nonetheless, EU-Canadian economic integration was not a serious priority for Germany—or for that matter the European Union. The EU-Canada economic partnership project remained vague in design and scope; there was no mention of free trade or a transatlantic marketplace. Instead, Chancellor Angela Merkel concentrated on an EU-US-centred transatlantic

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¹ Speech by Federal Chancellor Angela Merkel at the American Academy celebrations marking the 60th anniversary of the Marshall plan, 19 November 2007, www.bundesregierung.de.

marketplace. This article outlines and explains the dominance of the United States in Merkel's transatlantic market place initiative. The first part analyses official documents and speeches from Germany's EU council presidency to show how and when Canada appears on Merkel's transatlantic agenda. The second part of the article explains Canada's role in transatlantic economic relations by evaluating commercial ties, interests, and strategies. The article concludes that the fate of the EU-Canada economic partnership project depends very much on high-level support on both sides of the Atlantic, as well as the development of a clear vision. Otherwise the initiative is destined to fail, as have many of its predecessors.

GERMANY'S EU PRESIDENCY: A PUSH FOR DEEPER TRANSATLANTIC INTEGRATION?
EU-US ECONOMIC INTEGRATION AND THE TRANSATLANTIC MARKETPLACE

On 1 January 2007, Germany took over the six-month rotating presidency of the European Union. During its tenure, Germany proved to be a strong strategic leader with regard to transatlantic economic integration. The initiative for a transatlantic marketplace came directly from the chancellery and was driven at the highest political level from fall 2006. In contrast to other trade issues on the presidency's agenda, the chancellery was in charge of Merkel's transatlantic initiative, with the groundwork being carried out by the federal ministry of economics and technology (BMW) and the federal foreign ministry, via their respective country desks.

The chancellor announced her idea to create a transatlantic free trade area in September 2006, reacting to the lack of progress in the WTO Doha round of negotiations and rising global competition due to the economic emergence of China and India. At first Merkel's initiative, which was at the time still vague, caused reactions in Berlin and Brussels that ranged from the reserved to the outright critical. It was not clear what she had in mind, a free trade area along the lines of previous proposals or deeper internal market integration. The idea of using a European-US free trade area as a bulwark against the leading emerging economies was particularly strongly criticized. Bernd Pfaffenbach, state secretary in the BMW, described the initiative as the "deathblow" of the Doha round. EU Commissioner Peter Mandelson warned that the rest of the world would react with dismay if the two largest economic powers agreed to exclusive trade preferences.²

² Peter Mandelson, "EU-Handelskommissar lehnt Freihandelszone ab," *Manager-Magazin*, 3 October 2006.

Above all, the idea of a transatlantic FTA met with resistance because it is no longer deemed appropriate, given that free trade agreements have hardly any effect on non-tariff barriers (FTAs, by definition, focus on the elimination of tariffs). Average customs duties in transatlantic trade, with the exception of some areas with high import tariffs, such as trade in agriculture and textiles, are now extremely low—less than four percent. The problem lies with non-tariff barriers, which continue to represent a serious impediment to market access. These barriers are to be found in standards set for industrial goods—in testing, licensing, and accounting—as well as in customs systems and in the area of government procurement. According to the OECD, liberalizing transatlantic trade could therefore result in considerable growth of up to three percent of GDP for both trade partners. However, such a plan is not easily implemented, as is illustrated by initiatives to form a transatlantic FTA in the 1990s. These efforts all failed, due to lack of interest on the part of the US and resistance by EU members like France. Similarly, harmonizing or mutually recognizing regulatory systems has been called for again and again. However this required complex legal and regulatory changes on both sides of the Atlantic that are not possible without commitment at the highest political level. This is why such initiatives often got bogged down at the working-group level.

Accordingly, the German government reformulated its initiative in more concise terms during the course of its presidency. Speaking to the European parliament's trade committee, Joachim Wuermeling, state secretary in the BMWi, said in January 2007 that "What we are striving for...are improvements in non-tariff barriers. Closer economic cooperation would, for example, be more than worthwhile in regard to the protection of intellectual property, energy, and the environment, as well as financial markets, regulations and standards."³ At the world economic forum in Davos, the chancellor called for a transatlantic economic area, which "isn't intended to be contrary to, but rather to supplement and support, the multilateral approach."⁴ The media campaign behind Merkel's initiative reached its climax in the form of a conference organized by the Christian Democratic Union (CDU) and the

3 Joachim Wuermeling, "Trade policy under Germany's council presidency," first meeting of the INTA (trade) committee of the European parliament, 23 January 2007.

4 "Opening address by Federal Chancellor Angela Merkel at the world economic forum in Davos," 24 January 2007, www.weforum.org.

Christian Social Union (CSU), entitled “Globalization and transatlantic partnership,” in Berlin on 19 March 2007. At this point it was clear what Merkel had in mind: a comprehensive agreement that, in addition to removing tariff barriers, would include technical standards, the integration of financial and capital markets, and questions of competition law, investment, environment, and energy policy, among other areas. This idea was strongly supported by the German business community, which, more vocally than ever before, called for a breakthrough in reciprocal market deregulation.

Indisputably, the council presidency’s scope for exerting influence in trade policymaking is limited both legally and institutionally. The European Commission is in charge of EU trade policy: it has the right to launch initiatives and is responsible for enforcing decisions. It implements the common trade policy with the support of a special committee, the so-called 133 committee, which is composed of the representatives of the 27 member states and the European Commission. However, as chair of the 133 committee, the council presidency determines the agenda for meetings and therefore can set new priorities or give old projects new impulses. It can also launch new initiatives in the council of ministers. This is exactly what Germany did. With the close cooperation of the commission president, the council of ministers, and Germany’s permanent representative to the EU, as well as strong backup from the Transatlantic Business Dialogue, Merkel succeeded in overcoming initial resistance at the European level. Mandelson revised his harsh criticism and declared that the existing EU-US economic initiative could be the basis for further, long-term economic integration. Merkel also received the backing of the European parliament that broadly supported a new transatlantic economic partnership in its resolution on transatlantic relations on 25 April 2007 “with a road map for achieving a barrier-free transatlantic market, to strengthen the position of both partners in global competition and enable them to better use the potential of their economies.”⁵

Right from the beginning of Germany’s presidency, Merkel’s team lobbied extensively in Washington for her transatlantic marketplace initiative. In early January 2007, Merkel presented her idea to President George W. Bush. In the following months, Jens Weidmann, the chancellor’s economic adviser, travelled to Washington on a number of occasions to gain support for the

⁵ European parliament, “Resolution on transatlantic relations of 25 April 2007,” www.europarl.europa.eu.

project. Washington reacted hesitantly at first. With regard to regulatory cooperation, US officials cautioned that individual US states possess extensive regulatory powers and that numerous regulatory agencies are not subject to federal oversight. The fact that the EU and US signed the framework for advancing transatlantic economic integration at the EU-US summit on 30 April 2007, nonetheless, can be attributed mainly to the personal commitment of the German chancellor. Germany's political and economic weight, its close commercial ties with the US, and Merkel's good personal relationship with Bush were doubtless beneficial.

In the context of eliminating non-tariff barriers, the two sides agreed on so-called lighthouse or flagship projects, including mutual recognition of financial market regulations, enhanced protection of intellectual property rights (particularly in third markets), development of common standards regarding secure trade, enhanced cooperation in innovation and technology, and the establishment of a regular dialogue on investment barriers. Furthermore, the EU and US signed a first-stage air transport agreement. The accord, which replaces existing bilateral agreements between individual EU member states and the US, will allow all US and EU airlines to fly between any city in the EU and any city in the United States. Some progress was also made with regard to reconciling the differences between the US's generally accepted accounting principles and international financial reporting standards. In July 2007, the US Securities and Exchange Commission (SEC) issued a rule proposal to allow foreign companies to file with the SEC financial statements prepared in accordance with IFRS. In November 2007, the SEC voted unanimously in favour of this proposal.

One of the key outcomes of the EU-US summit in April was the establishment of a permanent high-level transatlantic economic council to steer and evaluate the cooperation on regulation. This council is currently chaired by Daniel M. Price, assistant to the US president for international economic affairs (formerly Al Hubbard, National Economic Council chairman) and European Commission Vice-President Günter Verheugen. Through the creation of the economic council, the bilateral relationship has gained a new dimension and is more binding in character than in the past. The council held its first meeting in Washington, on 9 November 2007, at which an investment dialogue was launched. It also established a road map for reaching mutual recognition of US and EU trade partnership programs to enhance security in trade by 2009. While it will only become clear in the ensuing months how serious both sides are about the framework for advancing

transatlantic economic integration, as the agreement is not legally binding, the outcomes of the EU-US summit are nonetheless more tangible than those of the EU-Canada summit.

EU-CANADIAN ECONOMIC INTEGRATION

Canada found its way into Merkel's transatlantic agenda comparatively late in the run-up to the EU-US summit. At the "globalization and transatlantic partnership" conference in March 2007, Volker Kauder, parliamentary chairman of the CDU/CSU group in the national parliament, emphasized that "Deep and friendly relations with North America are a traditional goal of Christian Democratic Foreign Policy... And it should become clear that we are not only addressing the US with regard to transatlantic cooperation, but also Canada."⁶ Accordingly, the CDU/CSU not only invited Robert M. Kimmitt, deputy secretary of the US treasury, to give a keynote speech on the transatlantic marketplace, but Canadian Senator Hugh Segal, at that time still chairman of the senate foreign affairs committee, participated in the podium discussion. After the EU-US summit, the parliamentary state secretary in the BMWi, Dagmar Wörl, emphasized that "Germany is also of the opinion that a similar agreement should be negotiated between the EU and Canada."⁷

But even after Canada was included in official speeches and documents, the terms of reference essentially remained the targeted EU-US economic framework agreement and the existing EU-US dialogues and agreements. Often, even the statistics cited to underline the potential for economic growth of closer transatlantic integration and regulatory cooperation were those of EU-US trade and investment flows, with no mention of EU-Canada trade and investment figures. That Canada remained an add-on to a primarily US-centred initiative is confirmed by the fact that the EU-Canada summit was prepared to a far lesser degree by the chancellery than the federal foreign office and the BMWi. The public campaign for an EU-Canada economic mar-

6 Volker Kauder, "Die Zeit ist reif für eine transatlantische Wirtschaftspartnerschaft," Konferenz der CDU/CSU-Fraktion im Deutschen Bundestag "Globalisierung und Transatlantische Wirtschaftspartnerschaft," 19 March 2007, www.cdu.de. See also, Angela Merkel, "Die transatlantische Wirtschaftspartnerschaft stärken," www.cdu.de.
7 Dagmar Wörl, "Foreign trade policy and globalization," *Business & Diplomacy* 4 (2007), www.business-and-diplomacy.de.

ketplace was also rather weak—coverage in the German media was almost nonexistent. Not only did the federal government show little enthusiasm for a new agreement with Canada, interest within the German business community remained modest at best. There were only few petitions, including Business Europe’s “Canada and the European Union: A stronger partnership” and the Canadian Council of Chief Executives, which argued for an agreement that would “facilitate the free flow of goods, services, capital and people across the Atlantic.” But while there were countless conferences, round tables, and studies conducted on the EU-US marketplace by academia, think tanks, and business associations, analyses of the potential benefits of closer EU-Canada integration remained rare.

Lastly, the initiative was not met with great enthusiasm by the European Commission. For instance, when asked about an EU-Canada trade agreement, an official from the office of the EU trade commissioner answered, “Oh yes, that. We have no project resembling Canada-EU free trade—that idea came from the Canadian side.”⁸ Other EU officials pointed out that the language of an EU-Canada trade agreement needed to be weak since the EU was still holding out for a successful conclusion of multilateral trade talks, not wishing to jeopardize the Doha round any further. However, this argument is rather unconvincing given the fact that the Doha round did not deter the EU from pursuing a new deal with the US or negotiating trade agreements with selected Asian countries.

The driver behind deepening EU-Canada economic integration was clearly Canada itself, a transatlantic free trade agreement having been a long-standing ambition of Canadians. In the early 1990s, then-Prime Minister Jean Chrétien called strongly for a transatlantic free trade agreement, one of the reasons being the EC’s preoccupation with the single market project, while Canada was busy with NAFTA. These developments created concerns that the two sides were drifting apart, leading to potentially exclusionary blocs. At the end of the 1990s, new US-EU advances and the likely launch of EU-Mexico trade negotiations led Chrétien to renew his calls for a Canada-EU free trade agreement.⁹ In 2007, it was above all Québec Premier Jean

8 Paul Wells, “Canada and Québec unite in EU free trade accord,” *Maclean’s Magazine*, 30 July 2007, www.thecanadianencyclopedia.com.

9 Donald Barry, “Towards a Canada-EU partnership?” in Patrick Crowley, ed., *Crossing the Atlantic: Comparing the European Union and Canada* (Aldershot: Ashgate, 2004), 35-58.

Charest who pushed to revitalize EU-Canadian economic cooperation. In preparation for the 4 June EU-Canada summit, Charest met the ambassador to the European Union and the Canadian members of the Canada-Europe Round Table to discuss the potentials of closer Canada-EU economic relations. He also lobbied the other provinces for the initiative, winning the—albeit hesitant—support of provinces that traditionally are more focused on the US and Asia, including British Columbia and Alberta. At the Davos world economic forum in January 2007, he discussed his ideas with Michael Glos, German federal minister of economics and technology, and Peter Mandelson. Charest contended that Canada and the EU had many common values, including an interest in a liberal international economic order and the simultaneous maintenance of a strong welfare state. A further selling point was that Canada is a stable long-term supplier of natural resources, especially energy. The initiative gained momentum, especially after the EU-US summit in Berlin. It is not the first time that Canada feared being pushed to the margins of the transatlantic relationship by closer US-EU ties. The negotiations on a declaration on European Community-United States relations in 1990 led to a similar reaction, resulting in the declaration on European Community-Canada relations.

In the past, the Canadian government's efforts to promote bilateral free trade with the EU have met with little success. Trade and economic cooperation between the EU and Canada is based on the 1976 framework agreement for commercial and economic cooperation (the EU's first framework cooperation agreement with an industrialized country), subsequent bilateral political declarations (notably the 1996 Canada-EU joint action plan and the 1998 EU-Canada trade initiative), and several bilateral sectoral agreements, such as the agreement on trade in wines and spirits signed in Niagara Falls on 16 September 2003. Canada has always lacked the political and economic weight of its US and European partners to shape the transatlantic agenda. Even so, the establishment of the joint action plan and the trade initiative, along with growing business interest, created a new dynamic that resulted in the Canada-EU trade and investment enhancement agreement founded at the Ottawa summit in 2004. The enhancement agreement—an answer to stagnant Canadian-EU economic exchange—was to result in closer cooperation between EU and Canadian regulators on subjects ranging from the mutual recognition of professional qualifications to financial services and government procurement. However, after a first round in 2005-06, negotiations were suspended (at the request of the EU), pending the outcome of the

Doha round. Regardless of Doha, however, negotiations had hit a dead end. Not only were the subjects extremely difficult ones, they were also being negotiated separately, which, in comparison to broadly based negotiations, precludes tradeoffs. Since government procurement was the first on the list—a particularly difficult issue for Canada—slow progress came to nobody's surprise.

The Canadian business community has discovered relatively recently that there are large opportunities to be realized in transatlantic trade. In 2006, the Canadian Chamber of Commerce still listed sustaining and expanding commercial relations with the US as Canada's top priority, followed by the conclusion of the Doha round and increasing trade relations with China, India, and South Korea. Europe and the enhancement agreement negotiations were hardly more than an afterthought.¹⁰ In advance of the EU-Canada summit in Berlin, the Canada-Europe Round Table, a strong advocate of Canada-EU trade and investment relations, organized a campaign leading to the declaration in support of a Canada-EU trade and investment agreement, which was signed by 55 Canadian and European corporate executives.¹¹

Though one would not suspect it from the name "free trade area"—and this did lead to some confusion among German policymakers—Canada does not only aim at reducing tariff barriers. As in the case of the EU-US transatlantic marketplace, Canada has deeper integration in mind, including convergence or mutual recognition of regulations and standards. Such an agreement would move significantly beyond the voluntary framework of the enhancement agreement. Contentious issues, on the other hand, could be excluded: neither the EU nor Canada is yet ready to liberalize trade in agricultural products. Such an agreement would also more easily allow excluding trade in cultural goods and services—two sensitive issues for Canada. At the same time, a free trade area has to fulfil certain requirements (most notably substantially all trade between the members of an FTA needs to be liberalized), and the exclusion of whole sectors would prove difficult and hardly compatible with the WTO.

10 Canadian Chamber of Commerce, "Canada's international trade and investment priorities 2006," www.chamber.ca.

11 Canada-Europe Round Table, "Declaration in support of an EU-Canada trade and investment agreement," www.canada-europe.org.

On 4 June 2007, Angela Merkel and Canadian Prime Minister Stephen Harper discussed a new initiative for transatlantic economic relations at the EU-Canada summit in Berlin, along with other representatives from Canada, Germany, and the EU. The EU and Canada committed themselves to “building on [the] negotiations towards a Canada-EU trade and investment agreement...and further advancing EU-Canada economic integration and facilitating trade and investment flows.”¹² Both sides agreed to “cooperate on a study to examine the costs and benefits of a closer economic partnership.” The study will analyze existing barriers to the flow of goods, services, and capital, and estimate the potential benefits of removing these. The report, which has a broader spectrum of subjects than the enhancement agreement, is expected to be made public in late spring 2008 but was delayed considerably. This study is particularly important since, unlike in the case of EU-US relations, Canada and the EU do not publish regular reports about bilateral market access.

Furthermore, the EU and Canada plan to intensify work on regulatory cooperation, reinforcing their commitment to fully implementing the existing framework for regulatory cooperation and transparency. In this context, they called upon European and Canadian regulatory authorities to step up their efforts to enhance regulatory compatibility and convergence by considering each others’ measures before adopting new approaches. In addition, they pledged themselves to the free and secure movement of people between them and agreed to start negotiating a comprehensive Canada-EU air services agreement: the first round of negotiations took place in late November 2007.

Overall, the EU-Canada economic partnership project remains vague in design and scope, and the tone of the joint declaration was rather hesitant. The BMWi, in its report “Europe’s economy in the age of globalization: Achievements of the 2007 German presidency of the council of the EU in the field of economic policy,” lauded both the EU-US and the EU-Canada summits as successes. But although the summit statements varied considerably in their scope and reach, there was—as in earlier documents on transatlantic economic integration—no clear distinction drawn between the two initiatives. The document lists the lighthouse projects of the framework for advancing transatlantic economic integration and describes the design and

12 Canada News Centre, “2007 EU-Canada summit statement,” 4 June 2007, www.news.gc.ca.

objectives of the transatlantic economic council; the feasibility study for deeper EU-Canada integration was omitted. Canadians should thus not read too much into European use of the word “transatlantic.”

EXPLAINING CANADA IN TRANSATLANTIC RELATIONS

Two obstacles stand in the way of closer EU-Canada relations. The first is the EU’s unwillingness to endanger deeper economic integration with the US, which promises far greater benefits, along with its recent push for bilateral trade agreements with Asian countries. The same holds true for the Canadian side: there are still strong voices favouring further Canadian-US integration over increasing transatlantic ties. The second obstacle is the lack of a clear vision. On both sides of the Atlantic, a consensus has yet to emerge about the objectives and institutional settings of a new EU-Canada economic agreement.

The European view: Limited benefits

To provide an idea about the importance of the US to Germany and the EU, a few numbers will suffice. There is no other region of the world with which Germany and Europe maintain such intensive economic relations as the United States: the US is Germany’s principal trading partner outside the EU. In 2006, German exports to the US grew by 12.6 percent and German imports from the US by as much as 16 percent compared with 2005. The US is the main investment destination for German companies and the largest foreign investor in Germany.¹³ The picture is similar for the EU. The US and the EU have the largest bilateral trade and investment relations worldwide: both sides conduct roughly 20 percent of their respective trade and about 40 percent of their respective foreign direct investment with one another. The US is the EU’s largest trading partner: in 2006 about 23 percent of the EU’s total exports went to the US and 13 percent of its total imports came from the US.¹⁴ In 2006, EU investment in the US accounted for 28 percent of the global amount invested by the EU abroad. The US is also the main foreign investor in the EU, accounting for 48 percent of total inflows.¹⁵

EU-US commercial relations dwarf EU-Canadian trade and investment flows by a wide margin: among the EU’s top trading partners, Canada ranked

13 Auswärtiges Amt, “United States of America,” www.auswaertiges-amt.de.

14 European Commission, “USA statistics,” www.trade.ec.europa.eu.

15 Eurostat, “EU foreign direct investment by the EU,” www.epp.eurostat.ec.europa.eu.

only 10th in 2006 with 1.8 percent of the EU's external trade. Only 1.5 percent of EU imports originated in Canada and 2.3 percent of its exports are directed to Canada. Canada's share of EU-25 trade in services amounted to 2.6 percent in 2006. Canada continues to run a significant trade deficit with the EU that, after a slight decrease after 2002, has been rising again. In 2006, it amounted to almost seven billion Euros.¹⁶ Canada is the second most important destination for EU foreign direct investment: in 2006 roughly 12 percent of the direct investment of the EU went to Canada. But only 4.5 percent of FDI in the EU originated from Canada in the same year.¹⁷ While bilateral trade relations between Germany and Canada have been on an upswing since 2005, Canada only ranks 33rd for imports and 27th for exports in Germany's foreign-trade statistics.¹⁸

From the German and European perspectives, Canada is a relatively small market and not high enough a priority for additional efforts to negotiate a more ambitious economic partnership agreement. An EU-US transatlantic marketplace would be a much bigger prize. Thus, the EU does not want to make concessions to Canada in areas that might later need to be negotiated with the United States. But Merkel's initiative was not only driven by Germany's strong economic interests. There were also significant political motivations behind her agenda: Merkel wanted to improve the US-German relations that had become severely strained under Gerhard Schröder's chancellery, particularly over the question of war in Iraq.

In addition, the Europeans' geographical focus had undergone a decisive change following the departure of the EU's then-trade commissioner Pascal Lamy, who astutely prioritized the multilateral trade talks. Mandelson, taking a different approach, focused more on bilateral free trade deals, particularly with Asian countries. The German presidency vigorously supported complementing multilateral trade negotiations with deep FTAs that include, in addition to the removal of tariff barriers, many so-called "trade plus issues" such as investment, government procurement, competition, and trade facilitation. Since the initiative was kicked off under the Finnish presidency, the goal of the German council presidency was to reach a decision on the negotiation mandate for the commission so as to start talks with prospective FTA

16 European Commission, "Canada statistics," www.trade.ec.europa.eu, 1.

17 Eurostat, "EU foreign direct investment by the EU," www.epp.eurostat.ec.europa.eu.

18 Statistisches Bundesamt, "Außenhandel," www.destatis.de.

partners as quickly as possible. As a result, free trade negotiations were opened with South Korea, India, and the ASEAN countries. Canada, on the other hand, was not included in the list of potential FTA partners.

The Canadian view: A clear vision?

For Canada, trade and investment relations with the US also outrival those with the EU by far. In 2006, the US purchased approximately 79 percent of Canadian merchandise exports; 65 percent of Canadian imports came from its southern neighbour (trade in services is slightly less concentrated). However, exports to the US have been declining steadily (1.9 percent from 2005 to 2006), struggling with the strong appreciation of the Canadian dollar against its neighbour's currency since 2002. In 2006 alone, the Canadian dollar appreciated against the US dollar by 6.8 percent while the appreciation rates against the euro and the pound were six percent and 5.6 percent respectively.¹⁹ Slower export growth can also be explained by a slowdown in demand due to the economic downturn in the United States. Thus, while the goods surplus with the US is still the main source of Canada's overall trade surplus, it has dropped by about 11 percent. Canada's second-largest trading partner is currently the EU. In 2006, nine percent of its merchandise trade took place with the EU (12.4 percent of Canada's imports originated in the EU; six percent of its exports went to the EU).²⁰ Merchandise exports to the EU-25 grew by 16 percent, powered by robust growth in goods exports to the UK, outpacing growth in imports (9.5 percent).²¹ In 2006, Canada exported \$36 billion in services to the US and \$12.4 billion in services to the EU.

Foreign direct investment has become, over the years, the strongest element of the transatlantic relationship: both FDI stocks held by the EU in Canada and Canadian FDI in the EU more than tripled from 1995 to 2006. Nonetheless, the US continues to be the most important destination for Canadian direct investment abroad, making up 43 percent in 2006—even if Canadian direct investment abroad has become increasingly diversified, with the focus on the US down from 51 percent 10 years ago, and 66 percent 20

19 DFAIT, "Canada's state of trade, trade and investment update 2007," www.dfait-maeci.gc.ca

20 European Commission, "Canada statistics."

21 Statistics Canada, "Merchandise trade," www.statcan.ca.

years ago. European countries held 29 percent of Canada's FDI at the end of 2006, up from 28 percent in 2005. Foreign direct investment in Canada, on the other hand, is neither as diversified nor growing as fast. Sixty-one percent of FDI stock in Canada originated in the United States. European countries (the UK, nine percent; France, seven percent; the Netherlands, five percent; and Switzerland, three percent) made up the next four largest investors in Canada.²²

QUEST FOR DIVERSIFICATION

According to OECD data, Canada's exports were the second least-diversified among OECD countries, behind only Mexico. It is precisely this dependence on the US, coupled with slow progress in the Doha round and the rising number of bilateral and regional free trade agreements worldwide (the US alone has concluded 11 bilateral free trade agreements since 2001) that fuelled concerns about Canada's competitiveness. Some commentators are also alarmed about the US taking the lead in shaping global economic governance by concluding bilateral trade deals, setting standards in investor protection, government procurement, and the treatment of cultural goods and services—in part clearly diverging from Canadian values and interests. Lastly, some worry that economic dependence on the US forces Canada to adopt US foreign policy positions.

This is why the Conservative party policy declaration stated in 2005, “[t]o create new employment opportunities, our trade agenda will focus on diversifying both the products we sell abroad and the markets in which we sell these products.”²³ This is not anti-American and does not imply reducing economic relations with its southern neighbour in absolute terms. The objective is rather to simultaneously increase economic relations with the US and other partners to achieve a better balance. One way to counterweight Canada's reliance on the US market has always been to establish stronger trading relations with the rest of the world through multilateral trade liberalization.²⁴ And indeed, Canada is still a strong supporter of the WTO and the Doha round. However, David Emerson, then-minister of international trade,

22 DFAIT, “Canada's state of trade, trade and investment update 2007,” 42-43.

23 “Conservative party policy declaration 2005,” 14, www.conservative.ca.

24 Axel Hülsemeyer, “Canada's relations with the European Union,” in Patrick James, ed., *Handbook of Canadian Foreign Policy* (Lanham: Lexington, 2006), 365-88; Michael Lusztig, “The evolution of liberalization in Canada's trade policy,” in *ibid.*, 83-104.

repeatedly warned that Canada has fallen behind others as the only major trading partner not concluding bilateral trade deals: by 2006, Canada had only signed FTAs with the US and Mexico (1994), Chile (1997), Israel (1997), and Costa Rica (2002). According to the finance ministry's report "Advantage Canada: Building a stronger economy for Canadians," more trade agreements could help the economy to be stronger and more successful within a rapidly changing global economy. The report recommended "pursuing regional and bilateral trade, investment and science and technology agreements, ideally together with our NAFTA partners." During a visit to Brussels and Berlin in September 2007, Emerson stated, "[w]e should be thinking about reaching a new stage within our bilateral agreement [with the EU] even if the Doha round was ended successfully."²⁵

In the Americas, Canada has now concluded negotiations with Peru, and talks with the four Central American countries—El Salvador, Guatemala, Honduras, and Nicaragua—are still pending, as well as negotiations with the Dominican Republic, Colombia, and the Caribbean community (CARICOM). In Asia, Canada is pursuing free trade agreements with South Korea and Singapore. Most recently, Canada has signed a free trade deal with the European free trade association (Iceland, Liechtenstein, Norway and Switzerland), its first in six years. "Canada is back in the game," emphasized David Emerson.²⁶ The agreement was viewed as an important step towards trade and investment intensification with the broader EU market. This view is shared by the business community. Roy MacLaren, the Canadian chairman of the Round Table and former minister for international trade in Chrétien's government, argued that concluding an agreement with EFTA was a way to demonstrate to Brussels, which had repeatedly rebuffed attempts for deeper integration, that a free trade area with Europe was doable.²⁷

In his quest for trade diversification, Emerson found a strong ally in Charest. Of all the provinces, Québec has the most trade with the EU and has long sought to strengthen transatlantic economic and cultural ties. Québec hopes that closer transatlantic cooperation will trigger an influx of invest-

25 David Emerson, cited in Paul Dubois, "Kanada und Deutschland: Verstärkung der wirtschaftlichen und finanziellen Partnerschaft," October 2007, www.dfait-maeci.gc.ca.

26 David Akin, "Free trading Emerson," 7 June 2007, www.politicsblog.ctv.ca.

27 University of British Columbia, institute for European studies, "Interview with Roy MacLaren and Dan Lemaire," in "Canada and Germany as global economic policy actors," January 2008, www.ies.ubc.ca, 1.

ment and expertise to Canada, which would give Canada a stronger voice in trade negotiations with China, India, and other Asian markets, give Canada more leverage dealing with the United States, and help to solve the country's problems with an aging population and a shrinking workforce. Early in 2008, Québec stepped up its efforts again, Jean Charest urging Harper at the Davos forum to get official free trade negotiations underway.²⁸ So far Québec and Ottawa seem to be working hand in hand. The prime minister is willing to let Québec take the lead on a global file, while Québec keeps the rest of Canada in mind, consulting the other provinces. What remains unclear is whether both are striving for the same kind of transatlantic deal, since the terminologies used in the debate differ—from free trade area to economic marketplace to economic partnership agreement.

CAUTIOUS VOICES

While the Canadian Council of Chief Executives, the Canadian chambers of commerce, and the Canadian Exporters and Manufacturers Association have started to show interest in the idea of deeper EU-Canadian integration, support is still in its infancy. Not everybody has joined the calls for deeper EU-Canadian integration. Former Canadian trade negotiator Michael Hart argued that a Canada-EU deal is “silly,” promising only marginal trade gains. He also warned that Canada, by adhering to more stringent EU regulations on matters like product safety, could run into problems with its neighbour.²⁹ Conference Board of Canada chief economist Glen Hodgson cautioned that Canada's trade focus should be on removing internal barriers to inter-provincial trade, while lifting NAFTA to another level.³⁰ William Robson, president of the C.D. Howe Institute, agrees, arguing that regulatory harmonization in goods and services and freer flow of capital and people with the US should be the clear priority on the government's political and negotiation agenda.³¹

28 Canadian Press, “Harper needs to pitch Canada-EU free trade deal, Québec says,” 24 January 2008, www.cbc.ca.

29 Peter O'Neil, “EU cool to free trade deal with Canada,” Canwest News Service, 4 February 2008, www.canada.com; Michael Hart and Bill Dymond, “Waiting for conservative trade policy,” *Policy Options*, October 2006, www.irpp.org; Bill Dymond and Michael Hart, “Trade policy at the crossroads,” *Policy Options*, February 2004.

30 Thomas Watson, “Free trade lofty ambitions,” www.nmatrade.com.

31 William Robson, “Stuck on a spoke: Proliferating bilateral trade deals are a dangerous game for Canada,” C.D. Howe Institute e-brief, 16 August 2007, www.cdhowe.org, 4.

Danielle Goldfarb, also from the C.D. Howe Institute, disputes the necessity of diversifying Canadian exports since vulnerability to US market developments has often been overestimated. Moreover, policy-led diversification (especially to more risky markets) could even increase volatility, making Canada worse off in economic terms.³² Others argue that greater benefits could be realized in expanding commercial ties with China and India, given the low degree of Canadian exposure to these fast-growing markets.

In January 2008, the Council of the Federation called on the federal government to move forward to complete bilateral trade agreements. The premiers agreed that there was a window of opportunity for an agreement in the short term for a new economic partnership with the European Union.³³ While the provinces have thus begun to sign up for the idea of an EU-Canada economic partnership, their support dwindles when it comes to specific issues such as government procurement practices, since this would entail the removal of interprovincial trade and investment barriers. According to MacLaren, the provinces that oppose the removal of interprovincial trade barriers are also only lukewarm to the idea of an EU-Canada agreement. While an April 2007 agreement on trade, investment, and labour mobility between Alberta and British Columbia stepped up pressure on other provinces to double their efforts towards trade liberalization, translating this deal to the national level remains difficult, further complicating negotiations with the EU.

Finally, there has been considerable distraction away from Europe in recent months. The US Democratic presidential candidate, Barack Obama, has repeatedly emphasized his skepticism towards free trade, pledging to renegotiate NAFTA if elected president—with a potential opt-out by the United States. He is catering to an electorate that exhibits an increasing unease with globalization. Such statements should always be taken with a grain of salt: in Canada's 1993 federal election Chrétien promised to back out of the FTA signed with the US in the late 1980s. However, in the light of shifting public opinion towards protectionism and increasing protectionist rhetoric in the US congress, this is nonetheless a worrisome development. Reopening NAFTA would be highly disruptive to US-Canadian trade. Chances are that

32 Danielle Goldfarb, "Too many eggs in one basket? Evaluating Canada's need to diversify trade," C.D. Howe Institute commentary no. 236, July 2006, www.cdhowe.org.

33 "Premiers move to strengthen trade," Council of the Federation, 28 January 2008.

addressing the risk of losing access to the US market will become a top priority for the Harper government during the next months.

A LONG-TERM PROJECT

Whether or not the upcoming EU-Canada summit in Montreal in fall 2008 will result in closer commercial cooperation largely depends on how serious both sides of the Atlantic are about Canada-EU relations. Merkel and French President Nicolas Sarkozy have voiced their support. Given his so-far rather unsuccessful domestic agenda, Sarkozy will want to make a significant achievement in the foreign policy field under French EU council presidency. One such achievement could be signing a new Canada-EU trade agreement at the summit. But the fate of the EU-Canada economic partnership project also greatly depends on the formulation of a clear vision for future cooperation. Given the many different voices within the trade debate in Canada, as well as the various terminologies used by different players to describe a possible EU-Canada trade agreement, European policymakers have been left slightly puzzled about Canada's objectives and priorities. Unquestionably, this does not simplify transatlantic economic negotiations. As the early months of Merkel's transatlantic marketplace initiative have shown, the inconsistent use of different terms for the same initiative or the selection of a name that does not clearly reflect the initiative's objectives can seriously endanger its success. The feasibility study could help correct this.

While promoting further transatlantic economic integration is a reasonable goal, it should be viewed as a long-term project. Regulatory cooperation is never an easy task, given that it is always inherently political due to its distributional effects. Not all parties benefit from the same set of policies. For Canada, in particular, it is difficult to negotiate an EU-Canada trade deal as a federation, since many areas are under the exclusive or shared jurisdiction of the provinces and no agreement affecting provincial responsibilities can succeed unless the provinces are closely involved in its negotiation and implementation. Given the many sensitive issues, the fact that not all provinces or EU member states are on board yet and the EU Commission still shows little enthusiasm about an EU-Canada trade deal, negotiations at the upcoming summit will not be easy. To expect more of the summit than a broad endorsement of the feasibility study and a statement for future negotiations would thus be overly optimistic.