Unlocking CETA's potential
Why Europe will be a growth driver for Canada
THE BIG 3

**CAD 2.0 BILLION**
is the additional annual revenue the Canadian automotive sector could generate upon the signing of CETA.

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**CAD 1.5 TRILLION**
is what will need to be spent on European infrastructure until 2018 and is accessible to Canadian engineering companies and pension funds.

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**74%**
of Canadian energy and mineral production is exported to the US. CETA will expand Canadian mining and energy companies' client base and diversify Europe's supplier base.

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CETA will strengthen relations between Canada and Europe

The Comprehensive Economic and Trade Agreement (CETA) quietly arrived as a signed trade pact between Canada and the European Union nearly two years ago. In addition to removing Canadian and European tariffs on almost 100% of non-agricultural goods and 94% of all agricultural goods, CETA is expected to provide easier access to historically protected markets such as public services. Furthermore, its adoption should facilitate human and financial capital flows.

The silence with which this treaty has been greeted on both sides of the Atlantic is deafening. In Europe, the business community and public sector have barely acknowledged its arrival. Even those closely associated with trade deals are more focused on the complex TTIP negotiations and have forgotten to celebrate, let alone promote the CETA triumph.

The signing of the treaty is expected to generate positive economic benefits on both sides of the Atlantic. According to a joint study developed by the European Union and Canada, CETA could add nearly CAD 30 bn of GDP (about CAD 12 bn for Canada) and create nearly 80,000 jobs for both parties. While free trade agreements pose their own challenges and estimates on the overall economic benefits of CETA may diverge, it is generally agreed that the signing of such treaties reinforces the commercial ties between all signatories.

The NAFTA experience offers a good illustration of the reinforcement of such commercial relations. Since 1994, the Mexican, American and Canadian economies have grown 10% faster than the rest of the OECD countries. In addition, commercial exchanges between Canada, Mexico and the United States reinforced themselves to such an extent that in 2013, the United States exchanged as much with other NAFTA members as with the BRICs, Japan and South Korea combined. While such comparisons have their limits as the economic context and geographical scope of NAFTA and CETA are different, it is important to recognize that 20 years after its signing, NAFTA has had an overall positive impact for all nations involved.

It is by recognizing the benefits of such agreements that the governments on both sides of the Atlantic decided to ratify the CETA agreement. Indeed, international trade, export development and foreign direct investment are a necessity for the growth of two mature economies like Canada and Europe. Europe faces a sustained economic slowdown and thus, a weak interior demand. The prolonged drop in oil and natural resources prices is forcing Canada to develop additional growth levers. Beyond these cyclical effects, demographic decline, scarce local expertise, limited domestic markets and the necessity to diversify trade are structural challenges facing many Canadian provinces and European countries.

While there remain clarification points to be addressed, CETA appears to be an important development lever for both the Canadian and European economies. For the European Union, CETA represents the opportunity to strengthen its economic ties with a stable and reliable partner with one of the world’s largest energy and natural resource reserves. For Canadian companies, preferential access to one of the world’s largest economies and its market of over 500 million consumers is a clear competitive advantage. Moreover, trade
relationships between Canada and Europe have not yet reached their full potential. In fact, even though the trade relationships between Canada and Europe are substantial, the level of exchange in goods and services remains 14% lower than the normalized equivalent United States-European trading levels.

All Canadian sectors will in one way or another benefit from the ratification of this free trade agreement, however the relative structure of the two economies will allow three sectors to disproportionately flourish:

1. The automotive sector predominantly in Canada
2. The infrastructure sector, especially European public and private infrastructure developers along with Canadian engineering firms and institutional infrastructure investors
3. The natural resources sector, primarily for European buyers and Canadian producers

CETA A NEW ENGINE FOR THE CANADIAN AUTOMOTIVE INDUSTRY?
The Canadian automotive sector is structured to support a larger industry and market base than is present in Canada. Since the establishment of the Canada-United States Automotive Products Agreement in 1965, Canadian parts and assembly plants have benefited from free trade access to the entire North American market. As such, the Canadian automotive industry has traditionally been focused around the assembly and supply of parts for GM, Ford, Chrysler, Toyota and Honda cars produced for the Canadian and American markets. Canada primarily produces cars in the standard segment (93% of the total), but is increasing efforts in developing its premium vehicles segment with Toyota (Lexus), Ford (Lincoln) and GM (Cadillac, Buick) in their respective Canadian plants. Out of the 2.3 million cars produced in 2015, only 295,000 (13% of the total production) were purchased by Canadians, with the larger part being exported to the United States.

NAFTA changed the landscape of the Canadian automotive industry by shifting the terms of trade for labour intensive assembly activities to lower wage environments. Nearly 1 in 3 jobs were abolished from 2004 to 2014 with employment falling from 148,000 employees to 108,000. The most recent financial crisis further disrupted the industry with Canada’s contribution to the total North American automobile output decreasing from 17% in 2010 to 13% in 2015. As a result, Canadian players along the automotive value chain are searching to support their facilities in North America by diversifying into overseas markets. Despite this constant decline in size, the Canadian automotive sector remains the second largest exporting sector for Canada (11% of total exports) just behind oil & gas extraction.

Some concerns have been expressed surrounding the potential negative impacts of CETA on the Canadian automotive industry. However, these impacts should be minimal since Canadian production is primarily focused on the standard segment while European imports are mostly in the premium segment: 82% of all Canadian vehicle imports from Europe are in the premium segment, with Audi, BMW and Mercedes-Benz, accounting for approximately 69% of all premium European imports. Most of these premium car manufacturers have existing assembly lines in either the United States or Mexico which already provides them with tariff-free access to the Canadian market. Therefore, it is not expected that the signing of CETA will negatively impact the number of cars produced in Canada. Although concerns remain with the opening of the Canadian automotive market, the main risks are a result of the broader global trend of shifting manufacturing capabilities towards lower cost regions than with CETA.

CETA should be viewed as an opportunity to increase car production in Canada. However, the current structure of the Canadian automotive industry will make it difficult for automakers to meet the rule of 55% Canadian content required to qualify for tariff-free exports to Europe. To level the playing field, CETA contains a provision under which 100,000 Canadian vehicles will qualify for tariff-free access to Europe at a lower threshold of 20% Canadian content. The 55% local content rule could be the ideal opportunity to strengthen the Canadian automotive industry. As the average car currently produced in Canada and exported to Europe is estimated to be worth CAD 22,000 with...
actual exports of approximately 5,000 cars, selling approximately 95,000 additional cars in Europe could represent a potential increase slightly above **CAD 2 billion** for the Canadian automotive industry. In addition, North American automakers could seek to further optimize their manufacturing footprint and transfer a share of the American-made cars exported to Europe into Canada in order to benefit from the lower CETA tariffs which represent around 11% of the landed cost of a car in Europe.

However, Canada’s advantage in tariffs with Europe alone will not be sufficient to reposition the country as a globally leading car manufacturer. The signing of CETA could provide the necessary springboard to define an integrated national automotive strategy. Such a plan could capitalize on Canada’s strengths: its highly skilled labor force, its access to natural resources such as lithium, aluminum and steel, and its expertise in advanced technologies. Development priorities could for example include support mechanisms to integrate tier 2s and tier 3s within the European automotive value chain, consolidating electric car production expertise in Canada, and pooling cross-industry resources between the ITC and automotive sector to better answer the needs of the connected and autonomous car market.

The Canadian automotive sector has more to gain from CETA than to lose. However, to make this happen, the industry and governments need to reflect on how to proactively reposition the industry in the transatlantic value chain based on the implications CETA will bring to the existing market.
Unlocking CETA’s potential

REINFORCING CANADIAN PRESENCE IN THE EUROPEAN INFRASTRUCTURE SECTOR
Following the 2008 financial crisis and the sovereign debt crisis, most European governments implemented austerity packages. This directly impacted public spending, mostly in Portugal, Greece, Spain and Cyprus where public infrastructure budgets decreased well below their pre-crisis levels.

Infrastructure such as roads, utilities, public transportation and telecommunication networks are key drivers of Europe’s competitiveness. Maintaining Europe’s economic advantages will require investments beyond sustaining the capital in place.

Moreover, a recent World Economic Forum ranking revealed that there are two key infrastructure depreciation trends challenging Europe. Firstly, the European Union as a whole is not keeping pace with faster growing competitive economies in Asia. Secondly, within the European Union there is a growing divide between infrastructure investments and infrastructure quality found in the financially stronger nations and those in stressed nations of Greece, Italy, and Spain among others.

According to recent estimates, total infrastructure investment needs in the European Union member states are staggering. Current infrastructure requirements encompass a wide variety of domains ranging from transportation to energy or digital infrastructure. European transportation infrastructure alone will require more than EUR 1.5 trillion in investments between now and 2030 to match the projected increase in transportation need. In the energy sector, around EUR 1 trillion must be invested before 2020 to meet Europe’s energy policy objectives and climate goal. In the digital sector, Europe needs to invest EUR 600-700 billion to develop fiber optic networks and next generation high-speed 5G wireless applications and networks, in order to catch up with the United States and China.

More importantly, the majority of these infrastructure investment needs are immediate, with spending estimates until 2018 standing at CAD 1.5 trillion. To put that in perspective, the size of the entire Canadian economy in Q2 2016 was CAD 2.0 trillion at current prices.

Since CETA will provide Canadian engineering and construction companies with access to European public procurement contracts, the current state of European infrastructure provides significant investment opportunities for Canadian firms. As infrastructure financing models have evolved from purely public models to hybrid public/private models, Canadian engineering companies could seek to bundle their unique expertise with Canadian pension funds’ investment capacity. CETA will also substantially broaden Europe’s infrastructure capital and service base at the precise moment it is most needed. Europe has put in place mechanisms to support such projects and increase their attractiveness to international investors with the Juncker Plan. The European Fund for Strategic Investments (EFSI) aims at de-risking infrastructure investment projects through the use of EU funded senior debt tranches for projects presenting a viable business case.

CANADIAN OPPORTUNITY
Increase automobile production by at least 95,000 units
Foster the development of automotive tier 2s and tier 3s and facilitate their integration within the European automotive value chain
Leverage Canadian expertise in the information and communication technology sector with the connected and autonomous car

BENEFITS FOR THE EUROPEAN UNION
Easier access to the Canadian market for premium manufacturers
Potential to acquire Canadian parts manufacturer and support their development to gain access to the US car assembly market

WHAT NEEDS TO HAPPEN?
Automotive manufacturers must understand the impact of CETA on their optimal production footprint and could reallocate a portion of their capacity to Canada
Canadian auto part suppliers must establish relationships with European automakers
Canada should develop an integrated national automotive strategy to ensure the competitiveness of the sector using CETA as a trigger to further develop the industry
2015 CANADIAN AUTOMOTIVE SALES BY ORIGIN AND SEGMENT [thousand units, %]

**CANADA**
- Total: 295
- 3% Premium
- 97% Standard

**PREMIUM**
- Cadillac
- Lincoln
- Lexus
- Buick

**STANDARD**
- Ford
- Chevrolet
- Toyota
- Honda
- GMC
- Chrysler

**EUROPE**
- Total: 125
- 18% Standard
- 82% Premium

**PREMIUM**
- Audi
- Jaguar
- BMW
- Porsche
- Volvo
- Land Rover
- Mercedes-Benz

**STANDARD**
- Volkswagen
- Ford

Source: IHS, Desk Research, Roland Berger
Despite some uncertainty about its final form, the dispute and settlement mechanism included in CETA will also provide the necessary regulatory framework to make cross border opportunities attractive as it will shield Canadian investors from the complexity and fragmentation of Europe’s legal framework. The European infrastructure sector offers interesting investment and revenue generating opportunities for project developers and investors along the Canadian infrastructure value chain. Canadian companies now need to investigate which business model would best fit the requirements of European states, Canadian investors and engineering firms.

**CANADIAN OPPORTUNITY**
Access to major infrastructure projects throughout the next decade for engineering, project management and construction firms

Equitable participation for institutional investors in large scale infrastructure projects in developed countries

**BENEFITS FOR THE EUROPEAN UNION**
Increase in available service base to help design, build and operate essential infrastructure projects

Large source of foreign direct investment through Canadian institutional investors and possibility to diversify

Access to Canadian infrastructure projects

**WHAT NEEDS TO HAPPEN?**
Canadian businesses need to evaluate investment opportunities and establish early partnerships in selected European countries for specific types of infrastructure

European infrastructure project "owners" need to establish investor roadshows specifically targeting Canadian institutional investors

Project developers need to ensure their projects comply with the Juncker plan to gain access to available financing

Source: Eurostat, Roland Berger
CETA PAVES THE ROAD TO EUROPEAN ENERGY SECURITY

Canada is resource rich in minerals, oil and gas. As such, the natural resources sector plays a significant role in Canada, contributing to almost 10% of its economy with two thirds being attributed to the energy sector alone. Canada exported close to CAD 112 billion in natural resources globally in 2015 with 99% of all Canadian oil & gas exports and 23% of all Canadian mineral and metals exports destined to the United States.

Market diversification is needed, especially for the energy sector which is highly dependant on the United States. The slowdown of the Canadian natural resources sector is weighting on Canada’s overall growth following the recent drop in commodity prices. The signing of CETA will allow the Canadian natural resources sector to diversify its clients base and, at the same time, secure financial investments to access key production equipment at lower costs.

With regards to minerals, CETA should allow for the elimination of remaining customs regulations on raw materials such as aluminium, zinc, uranium and iron ore. In addition, CETA reinforces the competitiveness of Canadian minerals as a secure source of essential raw materials to European industries. For example, Canada’s lithium and cobalt resources could be used to produce electric car batteries, its nickel can be used for airplanes, its titanium dioxide in the coating industry, its uranium in the nuclear and medical industry, and so forth. While strategic raw materials can be secured through the signing of long-term contracts, the ratification of CETA will also provide an opportunity for European end-users to strategically invest in the Canadian natural resources sector to secure production volumes. CETA in turn, provides an opportunity for Canadian companies to attract new sources of capital as the free trade agreement will provide greater predictability of financial flows and easier dispute settlement mechanisms. In addition, the easier mobility of employees should allow employers in the mining and energy sectors to hire key employees outside of their domestic markets more easily and thereby fill key positions. →D

VALUE OF EXPORTS FOR MINERALS, OIL & GAS EXTRACTION [CAD bn, 2015]

Source: Statistics Canada, Roland Berger
In the oil & gas industry, CETA opens the possibility for Canada to further expand its client base and for Europe to diversify its supplier base. Canada’s current trading is quasi exclusive with the United States. The Gulf of Mexico provides substantial refining capacity for Canadian heavy and synthetic crude oil. Western Canadian gas reserves act as a swing capacity in the North American market. Europe, by contrast is heavily reliant on North Sea, Eastern European and Russian oil and gas imports. As of today, close to 30% of all European natural gas is supplied by Russia and it is estimated that by 2020, about half of all European gas supply will have to come from external sources. Some Central European countries, such as Bulgaria, Estonia, Finland, Latvia, Lithuania and Sweden exclusively rely on Russian natural gas. While logistics costs would have to be taken into account, the signing of CETA provides a framework to envision longer term projects that could justify the development of new transatlantic infrastructure such as new oil pipelines to coastal waters, and LNG plants that would enable natural gas to be transported by tanker overseas.

To capture the longer term benefits of CETA, mining and energy companies must start branching out beyond their historical partners and business models. Demand for mineral and fuel products is robust and transatlantic industry value chains could be integrated with each region focusing on their respective strengths. Short-term outcomes are unlikely, but the industry as well as politicians must capitalize on the longer term opportunities for better supply security in addition to investing in commercial opportunities.

**CETA PROVIDES A FRAMEWORK, INDUSTRIES NOW NEED TO ACT**

CETA’s pertinence no longer needs to be demonstrated. Time has come to take advantage of the opportunities offered by CETA and maximize the underlying benefits in Canada and the European Union. Canadian companies have to be prepared for this opportunity and understand European market dynamics, as well as conditions for success (customer expectations, distribution channels access, business model requirements, etc.) to unleash CETA’s full potential.

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**CANADIAN OPPORTUNITY**

- Reduce export market risks by diversifying outside of North America
- Attract new sources of capital
- Access to key production equipment at lower costs
- Access to larger and specialized human capital resources

**BENEFITS FOR THE EUROPEAN UNION**

- Reduce energy dependence on historical partners
- Access to stable sources of strategic raw materials through transatlantic value-chain integration

**WHAT NEEDS TO HAPPEN?**

- Feasibility studies must be conducted to assess market potential and required investment commitment in export infrastructure for goods destined to Europe
- Canadian natural resources companies need to promote their projects towards European investors
ABOUT US

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FURTHER READING

ENGINEERING BREXIT
British industry must fight to "remain"

The so-called Brexit Referendum, this game-changing choice leaves a great deal at stake for the country’s science and engineering related industries. These sectors remain the backbone of the nation’s economy and are a direct employer of 2.6 million workers, many of them highly skilled. Yet amid the economic tribulations of the Eurozone and the migrant crisis in which the EU is presently embroiled, public opinion of the EU has hardened and is now as "anti" as at any time since the 1980s. This publication attempts to cut through the politics and place the focus where it should be—on those industries that have a disproportionate amount to lose from the Brexit.

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