Toward a Balanced and Inclusive Canada-EU Digital Trade Agreement: Policy Recommendations for Data Governance and Innovation

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Executive Summary

Canada and the European Union are exploring a Digital Trade Agreement (DTA) to modernize trade rules and strengthen cooperation in the digital economy. A Canada-EU DTA would complement the Canada-EU Comprehensive Economic and Trade Agreement (CETA). This policy brief outlines key challenges and strategic recommendations to ensure the agreement promotes innovation, protects privacy, and supports inclusive digital trade.

Key Challenges

- **Regulatory Tension**: Canada must balance the free flow of data with strong privacy protections and national regulatory autonomy.
- **GDPR Adequacy**: Maintaining Canada's adequacy status under the EU's General Data Protection Regulation (GDPR) is critical for seamless transatlantic data flows.
- **Transparency and Accountability**: Trade rules must enable oversight of algorithms and digital platforms without undermining innovation.
- **Fragmentation**: The proliferation of digital trade agreements has created a "digital noodle bowl" of overlapping rules, increasing compliance costs and legal uncertainty.

Strategic Recommendations

1. **Enable Trusted Data Flows**: Prohibit unjustified data localization. Promote interoperable transfer mechanisms and standards.
2. **Strengthen Consumer Protection and Cybersecurity**: Align standards for online rights, dispute resolution and cybersecurity. Foster cooperation on misinformation and platform accountability.
3. **Protect Innovation and IP**: Avoid forced source code disclosure except for legitimate public interest purposes.
4. **Promote Inclusive Digital Trade**: Expand support for SMEs, Indigenous communities and underserved regions through digital infrastructure investment and targeted training programs.
5. **Foster Regulatory Dialogue**: Establish joint Canada-EU mechanisms for resolving digital trade barriers and coordinating on emerging technologies.

Introduction

The digital transformation of the global economy has accelerated over the past two decades, reshaping how goods and services are produced, exchanged, and consumed. Digital trade, defined as digitally enabled transactions in trade in goods and services, has become a cornerstone of modern commerce. It encompasses everything from cloud computing and artificial intelligence to e-commerce platforms and cross-border data flows. The COVID-19 pandemic further underscored the importance of digital trade, as lockdowns and remote work drove unprecedented reliance on digital infrastructure and services.

Despite its potential, Canada remains a relatively marginal player in international digital trade (Leblond 2022a). Its performance lags its economic capacity and is overly concentrated on the U.S. market. Canadian small and medium-sized enterprises (SMEs), in particular, face challenges in adopting advanced digital technologies and engaging in cross-border digital commerce. This underperformance is not due to a lack of ambition or capability, but rather to structural impediments—ranging from inadequate digital infrastructure and fragmented data governance to restrictive international trade rules.

At the heart of digital trade lies a fundamental tension: the need to facilitate the free flow of data across borders while ensuring robust protections for privacy, security, and national regulatory autonomy. Trade agreements increasingly seek to address this tension, embedding provisions that prohibit data localization and promote interoperability. However, these agreements often fall short of resolving the deeper governance challenges. As Patrick Leblond and Susan Aaronson (2019) argue, Canada faces a "data trilemma": it cannot simultaneously achieve free data flows, strong national data protection laws, and high trust in the digital environment. One of these objectives must give way. For Canada, the best way to address this dilemma is to create a single data (or digital trade) area with other like-minded partners where there are strong common data protection laws and standards.

The Canada-EU Digital Trade Agreement should form the basis of such single digital trade area, with other countries joining in the future to reduce the proliferation of digital trade/partnership agreements, which are creating a "digital noodle bowl" – i.e., a complex and overlapping web of rules and standards that complicates compliance, undermines trust and, ultimately, hurts businesses by increasing transaction costs (Leblond 2022b).

In this context, the proposed Canada-European Union Digital Trade Agreement (DTA) offers a strategic opportunity to chart a new course. The EU's emphasis on privacy as a fundamental human right and its robust General Data Protection Regulation (GDPR) regime provide a high-trust model for data governance. Canada needs to move toward greater alignment with the EU if the Canada-EU DTA is to be successful. A

well-designed DTA could serve as a blueprint for reconciling economic openness with regulatory integrity, fostering a single data area among other like-minded partners (Leblond 2024).

Key Issues for a Canada-EU Digital Trade Agreement

The negotiation of a Canada-EU DTA must address several interrelated challenges that define the current digital trade landscape. These issues are not merely technical. They reflect deeper tensions between economic openness, regulatory sovereignty and public trust. Drawing on Canada's experience with CPTPP, CUSMA, DEPA and WTO negotiations on digital trade, the following key issues must be considered:

1. Cross-Border Data Flows and Regulatory Autonomy

Cross-border data flows are the lifeblood of digital trade, enabling cloud computing, AI development and global e-commerce. Trade agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Canada-United States-Mexico Agreement (CUSMA) and the Digital Economy Partnership Agreement (DEPA) between Chile, New Zealand and Singapore have attempted to address these challenges by embedding provisions that promote cross-border data flows and prohibit unjustified data localization.

However, trade agreements that mandate unrestricted data flows can constrain national regulatory autonomy. Canada's commitments under CPTPP and CUSMA, for example, limit in principle its ability to impose data localization requirements or require consent for data transfers, measures that may be necessary to protect privacy or national security (Leblond 2019).

While these agreements include exceptions for "legitimate public policy objectives", the scope and enforceability of these exceptions remain uncertain. Dispute settlement panels could interpret these provisions narrowly, potentially undermining Canada's ability to regulate data in the public interest, or broadly, potentially allowing all sorts of regulatory impediments to cross-border data flows. On the one hand, it raises concerns about the long-term flexibility of Canada's digital policy regime and its ability to adapt to emerging risks and technologies. On the other, it raises concerns about digital trade provisions' ability to maintain the free flow of data in the long run.

2. Privacy Protection and GDPR Adequacy

The European Union's General Data Protection Regulation (GDPR) offers a high-trust model for data governance, treating privacy as a fundamental human right. Canada's current adequacy status under the GDPR enables Canadian firms to receive personal data from the EU without additional safeguards. However, this status (given at the

discretion of the EU) has an uncertain future, because the federal government has repeatedly failed to modernize its privacy protection legal framework. Losing GDPR adequacy would significantly hinder Canada-EU digital trade, forcing Canadian firms to adopt costly compliance mechanisms or risk losing access to EU markets. This can have a particularly adverse impact for SMEs.

A Canada-EU DTA must therefore reinforce Canada's commitment to high-standard privacy protection and ensure regulatory interoperability with the GDPR, ensuring that Canadian and European businesses can continue to operate seamlessly across borders while upholding shared values of privacy, transparency and accountability.

3. Algorithmic Accountability and Source Code Transparency

Modern digital services increasingly rely on algorithms and AI systems to make decisions that affect consumers, workers and businesses. Ensuring accountability in these systems can sometimes require access to source code and algorithmic logic, particularly in cases of discrimination, fraud or harm to individuals, businesses or governments.

Trade agreements such as CPTPP and CUSMA prohibit mandatory disclosure of source code, except under narrow exceptions. While these provisions protect intellectual property, they may also hinder regulatory oversight and public interest investigations. A Canada-EU DTA should strike a balance between protecting innovation and enabling transparency, especially in critical sectors such as health, finance and transportation. Moreover, by embedding balanced provisions in the Canada-EU DTA (i.e., protecting intellectual property while allowing oversight in narrowly defined public interest cases), Canada and the EU can provide firms with regulatory certainty to promote Canada-EU trade.

That said, this will be particularly challenging for Canada since it is placed between the EU, which is the first jurisdiction to regulation AI with the AI Act, and the U.S., which has returned to a non-interventionist/free-market approach under the second Trump administration.

4. Cybersecurity and Consumer Protection

Cybersecurity is essential to maintaining trust in digital trade. Consumers and businesses must be confident that their data and transactions are secure. The Canada-EU DTA should promote cooperation on cybersecurity standards, incident response and risk-based regulation. It should also offer the opportunity for firms in each jurisdiction that offer cybersecurity hardware and/or software to face a common certification process so that they offer they products and services seamlessly in both Canadian and EU markets.

Similarly, consumer protection in digital markets such as dispute resolution, spam regulation and online rights should be aligned across jurisdictions to help facilitate greater Canada-EU trade.

5. Fragmentation and the "Digital Noodle Bowl"

The proliferation of digital trade agreements around the world has created a fragmented regulatory landscape, the so-called "digital noodle bowl" (Leblond 2022b). Businesses, especially SMEs, face high compliance costs and legal uncertainty as they navigate overlapping and sometimes conflicting rules on data flows, privacy, cybersecurity, and digital standards. This complexity undermines the scalability of digital business models and disproportionately affects smaller firms with limited legal and technical capacity.

In this fragmented landscape, Canada and the EU have an opportunity to lead. By negotiating a forward-looking DTA, they can help shape global norms for digital trade and data governance. Such an agreement should go beyond existing precedents, embedding principles of trust, inclusion and innovation to allow data and digital trade to flow freely between the two partners under shared standards and oversight. A Canada-EU DTA should aim to simplify and harmonize digital trade rules, reduce regulatory ambiguity and promote interoperability across jurisdictions. As such, a Canada-EU DTA could form the basis for a plurilateral single digital trade area among like-minded countries.

Policy Recommendations

Canada and the EU should pursue the following set of strategic and forward-looking policy recommendations.

1. Enable Trusted Cross-Border Data Flows

A Canada-EU DTA should include provisions that facilitate the free flow of data between their jurisdictions while embedding robust safeguards to protect privacy and national security. For instance, this means prohibiting unjustified data localization requirements, which can increase costs for businesses and limit access to global markets. It also means upholding strong encryption standards and due process for government access to data, ensuring that surveillance and law enforcement activities do not undermine trust in the digital environment.

2. Strengthen Consumer Protection and Cybersecurity

A Canada-EU DTA should include provisions that align consumer protection and cybersecurity standards across jurisdictions. These include:

- **Establishing common rules for online consumer rights**, including transparency in digital transactions, dispute resolution mechanisms and protections against deceptive practices.
- **Fostering cooperation on cybersecurity**, including joint incident response protocols, information sharing, and capacity building. Cybersecurity should be addressed through a risk-based approach that balances innovation with resilience.
- **Mitigating misinformation and disinformation**, particularly on digital platforms, through coordinated regulatory and policy responses. This includes transparency in algorithmic content moderation and platform accountability.

These measures will help build trust in digital markets and ensure that consumers are protected regardless of where they transact.

3. Protect Innovation and Intellectual Property

Innovation is central to digital trade, but it must be protected in ways that do not stifle competition or regulatory oversight. For example, a Canada-EU DTA should:

- **Avoid forced disclosure of source code and algorithms**, except in cases where public interest justifies access (e.g., discrimination, fraud, harm). Such exceptions should be made clear at the outset and offer legal oversight in case of abuse.
- **Consider looser regulations for text and data mining** to enable AI development and research in academic and non-commercial contexts. These exceptions should nevertheless be compatible with copyright regimes and international standards. In commercial situations, however, text and data mining should be carefully regulated to protect consumers, individuals' privacy, market competition and intellectual property rights.

4. Promote Inclusive Digital Trade

A Canada-EU DTA must be inclusive, enabling participation from all regions, sectors and communities. Promoting inclusive digital trade is a powerful tool for expanding markets and customer bases. In doing so, firms of all sizes must be able to tap into new opportunities while strengthening the resilience and diversity of the Canada-EU digital economy.

Therefore, Canada and the EU should cooperate to:

- **Include targeted support for SMEs engaging in international digital trade**. This includes training on cross-border e-commerce, digital marketing and compliance with digital-market regulations.

- **Ensure accessibility for Indigenous Peoples, youth and marginalized communities**, including through investments in rural broadband infrastructure and culturally appropriate digital literacy programs.
- **Support digital entrepreneurship and innovation**, particularly in underserved regions, by providing access to risk capital, mentorship and international market intelligence.

5. Foster Regulatory Dialogue and Transparency

Finally, Canada and the EU should promote ongoing regulatory cooperation and stakeholder engagement through the DTA. This includes:

- **Establishing joint Canada-EU committees and contact points** to resolve digital trade barriers, share best practices, develop high-quality standards and coordinate policy developments. These committees and contact points should meet regularly (e.g., quarterly), report on their work, including producing an annual report explaining the work that has been done and the results obtained.
- **Encouraging transparency in digital policy changes**, including public consultations, impact assessments and regular reporting.
- **Collaborating on emerging technologies**, such as digital identity systems, fintech, and AI governance, to ensure that innovation is guided by shared values and standards.

These mechanisms will help ensure that the DTA remains adaptive, inclusive, and responsive to future challenges.

Conclusion

The negotiation of a Canada-European Union DTA presents a timely and strategic opportunity to shape the future of digital trade and data governance. As digital technologies continue to transform global commerce, Canada and the EU must position themselves as leaders in crafting rules that balance openness, innovation, and trust.

This policy brief has outlined the core challenges facing Canada-EU digital trade. It has also proposed a set of actionable policy recommendations to address these challenges, ranging from enabling trusted data flows and promoting digital inclusion to strengthening consumer protection and fostering regulatory cooperation.

At the heart of these proposals is a recognition that digital trade is not just about economic efficiency, it is about values. Privacy, transparency, accountability, and inclusion must be embedded in the architecture of any future Canada-EU DTA. Canada and the EU share a commitment to these principles, and a well-designed DTA can serve

as a model for other jurisdictions seeking to reconcile economic integration with democratic governance.

The Canada-EU DTA is not just a trade negotiation; it is a governance project. It is an opportunity to define the rules of the road for the digital economy and to ensure that those rules reflect the values and interests of Canadians and Europeans alike.

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