

CANADA'S INTERNAL MARKET - A REPORT CARD

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IT IS IMPORTANT THAT WE REFLECT UPON AND LEARN FROM our now quite considerable experience under the *Agreement on Internal Trade (AIT)*. It is nearly seven years since the *AIT* was signed, and there are still those who argue that there is a crisis in Canadian internal trade relations. The solution they propose is a stricter *AIT* with broader coverage, binding dispute settlement and majority decision-making.

I am concerned that following this misguided advice may provoke a genuine crisis where none now exists. Instead, it is time for a change in approach to internal trade issues and a new, more pragmatic and less legalistic direction for the *AIT*.

There is no credible evidence of a crisis in Canadian internal trade relations. Trade barriers within Canada are relatively small. The policy effort to reduce these trade barriers should be proportionate to the scale of the problem.

Even before the *AIT* came into effect, most serious studies found that the (efficiency) costs of internal trade barriers were fairly small, ranging from 0.05% of GDP to 0.10% of GDP.² Some estimates were even lower.

The one exception, a 1991 Canadian Manufacturers' Association study, suggested that the costs of internal trade barriers were as high as 1% of GDP. Although widely cited, this number is simply not credible. Without going too deeply into the study's serious methodological flaws - basically, it confused some international trade barriers with internal trade barriers and failed to net out the benefits of alleged barriers when calculating the costs.³

I recognize that while the costs to the overall economy may be small, the costs to individuals or individual firms when confronted with a particular barrier may loom large to them. But the best advice to those individuals is to explain their particular problem to officials, politicians, and the public and to insist on practical solutions. Suggesting that there is a general crisis in trade relations within Canada is not convincing and is unlikely to lead to concrete solutions to the specific problems they face.

² See Brian Copeland, "Interprovincial Barriers to Trade: An updated review of the evidence," January 1998.

³ Copeland, *op. cit.*, p.3.

For example, you frequently hear the complaint that it is easier to do business across the Canada-US border than within Canada. Again, anecdotes aside, such claims should be treated with extreme skepticism. McCallum and Helliwell, for example, found that (after controlling for distance and income)⁴ a typical Canadian province traded between 15 to 20 times as much with another province as with a US state of similar size and distance.⁵

This is compelling evidence that (even in the post-FTA/NAFTA era) the Canada-US border remains a significant deterrent to trade and that it is much easier to trade within Canada than internationally.

That there is good empirical support for the view that internal trade barriers are relatively small is not surprising. After all, there are no checkpoints at provincial borders; taxes or tariffs on interprovincial trade are unconstitutional; Canadians have a common currency; and common legal and financial institutions. Canadians are free to move and work anywhere in the country (and these mobility rights are now constitutionally entrenched in the Charter).

Canada is, of course, a federal state. A federal system encourages and values diversity. Much of the controversy about alleged "internal trade barriers" is not about trade. It is really a debate about the role of governments in a federal system, and specifically about how much flexibility governments should have to intervene in private markets.

To quote from a paper by my CCPA colleague Marc Lee,

Focusing the discussion on "trade barriers" diverts attention from the real issue: the presence of laws, regulations and policies at the provincial level that exist to promote economic development; protect consumers, workers and the environment; and to set minimum standards that businesses must abide by. While there may be an additional cost to doing business as a result, these policies exist for a reason. Because provinces have different regional circumstances, economic and social conditions and resource endowments, diverse policy responses must be

⁴ Because you would expect trade to be higher between neighbours and with larger economies.

⁵ McCallum, J. and J.F. Helliwell, "The extraordinary trade-generating powers of the Canadian Economic Union," May 1995. More recent research by Helliwell indicates that this multiple had fallen to 12 times by 1996. For a thoughtful review of this and other evidence that national borders still matter in trade relations see, Helliwell, John F. *Globalization: Myths, Facts, and Consequences*. Benefactors Lecture, CD Howe Institute, 2000.

accommodated. In areas of provincial jurisdiction, provincial governments will make differing policy choices about how best to regulate to achieve important policy goals. This diversity is a legitimate feature of Canadian federalism and democracy.⁶

It is encouraging that Ministers when they approved these major public consultations broadened the focus beyond the *AIT* itself, to assisting governments "in identifying pragmatic and useful ways for improving internal trade."⁶

Indeed, the view that Canada needs an internal "treaty" modeled on international trade treaties is based on a false analogy between relations within Canada and international relations.

The Canadian economic union is not all like the international trade environment. There is a very strong case that we need to create international rules to govern trade between nations. (Canadians can and do disagree, sometimes vehemently, about what these rules should be, but almost everyone agrees that we need rules.) The alternative to international trade rules is lawlessness. But within Canada – far from anarchy – there are strong, long-established, democratically accountable, governing institutions, with well-defined constitutional roles. As previously discussed, citizens and firms have a wide range of legally enforceable rights.

From a broader public interest perspective, and from the point of view of healthy federalism, there are very significant downsides to overreacting to alleged internal trade barriers by creating legalistic straightjackets modelled on international trade treaties.

- It distorts the policy debate. What should be discussions about regulation – for example the appropriate level of consumer or environmental protection, professional standards, the use of the precautionary principle, regional economic development policies, value-added natural resource processing – get couched as trade debates, which they are not.
- The *AIT* may become a tool for the federal government to implement its international trade treaty obligations in areas of provincial and local government jurisdiction.

⁶ Marc Lee, "In Search of a Problem: The Future of the *Agreement on Internal Trade* and Canadian Federalism," Canadian Centre for Policy Alternatives, September 2000.

⁶ Internal Trade Secretariat, "Report on the Regional Consultations and Next Steps," April 2001, p.1.

- Even though the current *AIT* is not itself legally enforceable, it could inadvertently set standards which are legally enforceable under the NAFTA or other international trade agreements. (For example, a foreign investor or government might argue that the federal government must take all necessary measures, including the enforcement of the *AIT*, to ensure compliance by provincial or local governments with the NAFTA.⁷) The provisions in the *AIT* which anticipate such a situation are likely ineffective.⁸
- The *AIT* copies some of the worst features of international trade agreements by privileging commercial interests over other legitimate interests such as environmental protection. (The first *AIT* panel decision, on MMT, badly undermined the precautionary principle, and cleared the way for Canada's disastrous and humiliating settlement of Ethyl's NAFTA investor-state case.)
- The *AIT*'s negotiating processes are secretive and untransparent. It is disgraceful that, after several years of negotiation, the nearly completed draft energy chapter is still not a public document. Will the public finally see this chapter only after it is approved by Ministers and already a *fait accompli*?
- In the case of the energy chapter, certain provinces are now trying to deny poorer provinces the right to use the very same sorts of local benefits and regional economic development policies that these richer provinces relied upon to promote their own economic development.
- The *AIT* imposes inappropriate and administratively costly "one-size-fits-all" tendering rules on public purchasers. These compulsory re-tendering rules are particularly inappropriate in sectors like health and social services where they disrupt continuity of care and quality of service.⁹

What then is to be done about the *AIT*?

The experience to date shows that the continued focus on rule-making, negotiating legalistic text, and formal dispute settlement is fruitless and even counterproductive. It contributes to suspicion and conflict, rather than flexible thinking, problem-solving, and cooperation.

The enormous bureaucratic effort it takes to negotiate and agree to generally applicable rules is disproportionate to the scale of the problem.

While a few internal trade disputes are intractable, most can be

⁷ Cf. NAFTA Article 105.

⁸ Cf. *AIT* Article 1809.

⁹ The procurement of health and social services is currently excluded from the *AIT* procurement chapter (Annex 502.1B). This vital exemption, which is at risk, must be maintained.

resolved, or managed, through diplomacy, peer pressure, and publicity. A diplomatic approach is more likely to consider both the costs and the benefits of a specific measure and to craft a compromise that balances all interests.

The *AIT* must remain a political agreement and a consensus-building process. I urge you to resist the persistent calls for more rigid rule-making, binding enforcement, and ending consensus decision-making.

The machinery of international trade dispute settlement has no place within the Canadian federation, where we already have a common judicial system, extensive federal-provincial and interprovincial consultative bodies, and a long, and generally successful, experience of resolving or, when necessary, managing inevitable differences.

Stop for a moment and consider where the calls for binding enforcement and majority decision-making would lead – to bickering, animosity and, ironically, to the erecting of new retaliatory trade barriers.

Fortunately, the kinds of retaliatory measures used to enforce international trade treaties, punitive tariffs, would be illegal and unconstitutional within Canada.

And how could other jurisdictions compel an unwilling government to agree, when it is within its constitutional authority to refuse? In a contest between the *AIT* and the Canadian constitution there can be little doubt which would prevail.

In short, these tough-talking prescriptions are misguided and unworkable.

There are positive roles for the Committee on Internal Trade, for regular discussion of irritants among Internal Trade Representatives and other sectoral officials, and for the Internal Trade Secretariat as a contact point, clearing house and facilitator of creative solutions to inevitable differences.

But, if heeded, the siren calls for legally binding enforcement and to end consensus decision-making will draw the *AIT* on to the rocks. They would lead to a misallocation of government and bureaucratic resources in an overreaction to what are relatively small and manageable issues. They are a formula for further gridlock and drift.

Instead to strengthen the Canadian union, Canadians need a new pragmatic, problem-solving approach, a balanced assessment of the specific costs and benefits of alleged barriers, much greater transparency, and more examples of positive cooperation and upward harmonization.

