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Why We Need Freer Trade in Canada

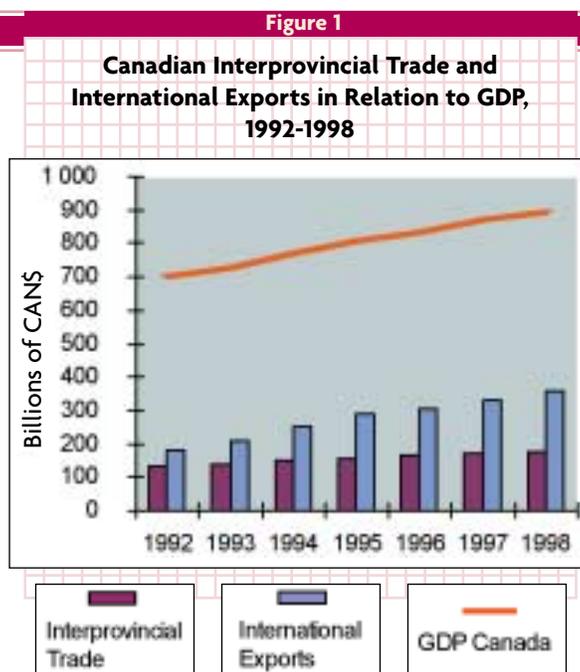
There seems to be a view among Canadian governments that the domestic market and interprovincial trade are not important. Canada as a country doesn't have enforceable trade rules. Provincial governments can and do use their legislative and regulatory powers to protect local interests and limit trade in their markets. We also don't have an effective mechanism to ensure that our domestic market is functioning the very best it can to support and sustain export growth in the future.

There has been a noted shift in the relative importance for Canada of interprovincial and international trade since 1992.

Although interprovincial trade has increased, it has done so at a slower pace than international exports, suggesting that there is less interdependence among provinces¹:

- between 1992 and 1998 interprovincial trade increased at an average 4.7 percent each year;
- during the same period international exports increased by a very strong average of 11.9 percent a year with imports growing at a slightly slower pace at 10.9 percent;

- international exports grew from 26 percent of GDP in 1992 to almost 40 percent in 1998 while interprovincial trade kept pace with GDP at around 20 percent (see **Figure 1**);



- international exports grew faster than domestic exports from 1992 to 1998 in all provinces except New Brunswick.

This strong international trade performance in recent years is good news for Canada's economy but, perversely, the shift in relative importance between international and interprovincial trade may be bad news for Canada as a nation and for export growth in the long run.

¹ The source for all data used in this paper is *Interprovincial Trade and International Trade in Canada, 1992-1998*, Statistics Canada: Catalogue no. 15-546-XIE.

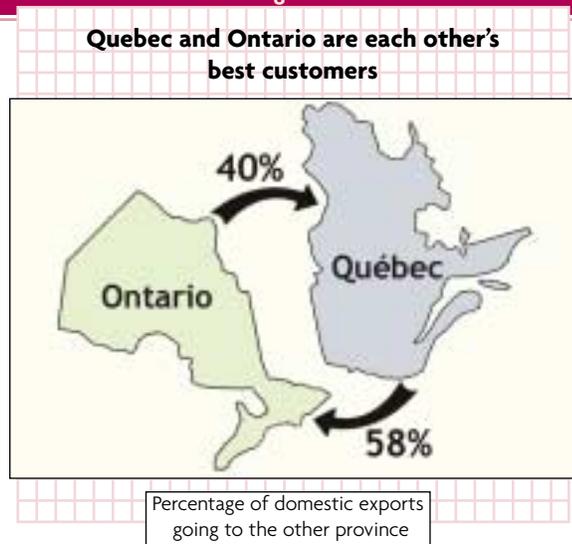


The importance of interprovincial trade

Ontario and Quebec are the major players in interprovincial trade, as would be expected from the two largest and most integrated domestic economies. They remain each other's best customers with 40 percent of Ontario's domestic exports going to Quebec and 58 percent of Quebec's exports going to Ontario (see **Figure 2**).

From 1992 to 1998 Quebec had regular deficits in interprovincial trade with Ontario and Manitoba but surpluses with all other provinces in every year. Ontario is the undisputed trade leader in Canada with interprovincial trade surpluses increasing from \$20 billion in 1992 to \$29 billion in 1998.

Figure 2



Some provinces may now see that their economic destiny lies to the south. Who can blame them? Canada's market is 30 million while there is an increasingly accessible market ten times that size just to the south. But interprovincial trade is not irrelevant to Canada's economy or to its international trade performance and particularly not to Quebec and its trade (see **Figure 3**).

The Agreement on Internal Trade

Quebec's international trade success and that of other provinces is based on the openness and stability of the Canadian market and on more open continental trade provided by NAFTA. If the Canadian market erodes or discourages domestic productivity then our international competitive advantage will diminish.

A strong domestic Canadian market depends on government policies, regulation and administrative practices that support and promote openness, accessibility and competition. In a federation this requires co-operation among all governments. This is what the *Agreement on Internal Trade* (AIT) is supposed to provide. It was negotiated by all Canadian governments in 1993-94, ratified by First Ministers in July 1994 and came into effect in July 1995.

The AIT's objective is to reduce and remove barriers to trade in Canada and to establish an open, efficient and stable domestic market. It includes a set of rules that eliminates discrimination based on geography, as well as measures that prevent trade or create barriers to trade that are not necessary to accomplish a "legitimate objective" (e.g. public health and safety, consumer and environmental protection, etc.). It also establishes a Committee of Ministers and a Secretariat and puts in place a dispute settlement process.

However, since the AIT came into force in 1995 it has been invisible. It fails in many respects to accomplish its goals and Canadian governments have not used it to co-ordinate their efforts to make Canada's domestic market work better.

Some Specific Problems

Many barriers remain unidentified and unchallenged because the AIT is complex and inaccessible as well as being almost invisible. No doubt some barriers remain in place through institutional and public policy inertia or because of the perceived self-interest of specific industry or groups. Following are some of the more typical and glaring examples that provide a notion of the kinds of problems that exist.

AGRICULTURE: THE DAIRY TRADE

Agriculture is one of the most regulated and protected sectors in Canada. There are three specific cases of barriers that shelter dairy producers and none is necessary to protect the consumer or public health and safety.

First are measures that prevent the sale of coloured margarine in Quebec. Coloured margarine is an accepted product in its own right and consumers are sophisticated enough to determine their preferences. Furthermore, eliminating colour restrictions in other jurisdictions has not had the devastating impact that the dairy industry in Quebec contends it will have.

The margarine industry asked Ontario at least four years ago to use the AIT to solve this issue with Quebec. At the beginning of August 2002, Ontario finally started the process to resolve the issue through an internal trade panel. Thirty days later this process came to a dead stop. Quebec decided, with complete disregard for its commitment to the AIT, not to select a panelist, presumably because the issue was before the courts. This is, however, for the panel to decide.

The second case concerns Ontario's *Edible Oils Products Act* (EOPA), which prevents the manufacture and sale of imitation dairy products that combine vegetable oil and dairy products. These products are commonplace in the North American market. Why they should be excluded from Ontario is a mystery. The main impact is that Ontario companies have lost an opportunity to use their quality vegetable oil produce to establish a competitive processing industry.

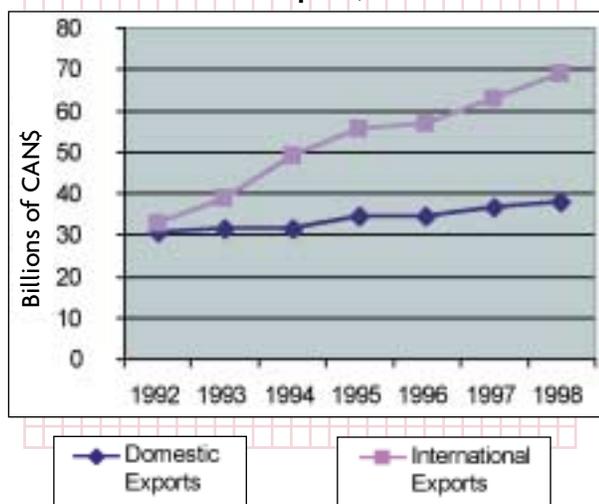


Ontario introduced an omnibus bill to protect food quality and safety in June 2001. Among other things the act repealed the anachronistic EOPA. The new act was passed in November 2001. At the last moment though, the act was amended to keep the EOPA in place until June 2003. Ever since, milk producers have lobbied hard to keep the EOPA, and the trade barrier, in place longer.

Finally, there is the question of fluid milk distribution licensing measures. In the past, most provinces licensed milk processing and distribution for public health reasons. The measures are no longer necessary as national standards and inspection have evolved and technology has improved the safety of fluid milk products. In the West restrictions on the interprovincial movement of fluid milk are gone. But they are still in operation in the East where they have been used to protect local processors, particularly in the Maritime Provinces where the result is an unproductive, non-competitive and vulnerable dairy industry.

Figure 3

Quebec Domestic and International Exports, 1992-1998



Maritime governments continue to resist sensible change even though two internal trade panels, one in PEI and the most recent in New Brunswick, have clearly established that their milk distribution regulating regimes are unfair trade practices. The New Brunswick government even recognizes that its system is protectionist, but says the issue needs further study before it can change it.

LABOUR MOBILITY: ACCOUNTANTS

Mobility remains a problem. Workers in many professions must meet certification and residency requirements and some of these requirements limit mobility and are inconsistent with the AIT. For example, in most Canadian jurisdictions accountants who are properly qualified by one of the three recognized

Canadian professional accounting organizations (Chartered Accountants, Certified General Accountants and Certified Management Accountants) are permitted to do audits and review engagements. But Ontario and PEI exclude non-CAs while Nova Scotia gives preference to CAs as does Quebec.

There is good news though. In October 2001, an internal trade panel found that Ontario's public accountant licensing system operates as a barrier to mobility for non-CAs. About a year later Ontario announced that it will change its system to license anyone who meets its standards regardless of their professional affiliation. PEI, Nova Scotia and Quebec are also reviewing their systems.

CONSTRUCTION: QUEBEC REGULATORY RESTRICTIONS

Since the mid-seventies, Quebec has restricted who may do construction work, either as individual workers or as a company, in designated regions. This regulatory framework was introduced to resolve conflicts in the construction industry. As a by-product it has limited worker mobility and competition and restricted access to the construction industry for contractors and workers from the neighbouring provinces of New Brunswick and Ontario. Workers and companies from Quebec have open access to these markets but the reverse is not true.

Ontario and Quebec have tried to resolve this issue for years and have failed every time. In 1999 Ontario lost patience. Rather than try to resolve the issue through the AIT, Ontario passed the *Fairness is a Two-Way Street Act* that allows it to register contractors, construction workers and aggregate haulers from Quebec in a way that is similar to Quebec's requirements.

Quebec started the process to resolve the issue through an internal trade panel in March 2002. This complaint also came to an abrupt end. This time Ontario refused to appoint a panelist. The excuse was that a panel was not the right place to resolve this issue. But what is an internal trade panel for if not to resolve domestic trade disputes according to the rules all Canadian governments accept?

PUBLIC SECTOR PROCUREMENT

The AIT establishes an electronically based public sector procurement market. This was one of its major accomplishments. This success is qualified however by a long list of exceptions that governments are having a hard time cutting back. Quebec still excludes Hydro-Québec and Société des alcools while Ontario excludes none of its departments, agencies and crown corporations.

The chapter also excludes large volumes of contracts for services and construction below \$100,000. It is hampered by a toothless, obscure and ineffective bid protest mechanism for provinces that discourages suppliers from complaining if the governments don't obey the rules. Governments are trying to liberalize this chapter but there is no compromise in sight.



FINANCIAL SERVICES REGULATION

The financial sector is excluded from the *Agreement on Internal Trade*. This means the regulation of Canada's capital market is not part of the AIT. This is not necessarily a bad thing but this component of Canada's domestic market needs the urgent attention of Canadian governments².

Gordon Nixon, chairman and CEO of RBC Financial Group, put the problem clearly in a speech to the Canadian Club of Montreal in May 2002: "*In financial services, RBC is subject to the oversight of more than 50 financial services regulators spread across 14 jurisdictions. We should be striving for a lot more regulatory efficiency, as it is ultimately a drag on our competitiveness.*"

Not including regulation of financial institutions by the federal government, there are 13 separate securities regulators and laws, one in each of Canada's provinces and territories. Five regulators are self-funded autonomous agencies; the remainder are structured within, or report to, government line departments. These regulators come together in an informal organization, the Canadian Securities Administrators (CSA), to discuss common issues and to attempt to design consistent solutions through harmonizing, streamlining their regulations and operations and through mutual recognition.

In all there are over 40 financial regulators, including self-regulatory organizations, in Canada. In contrast in Australia there are now two financial sector regulators (as of 1998) and in the United Kingdom one (as of 2001).

It becomes more critical than ever that our governments co-operate to reinforce the Canadian union by removing all remaining internal trade barriers.

Here are the things that Canadian governments have to fix: the inefficiency of Canadian markets in raising investment capital and meeting the other needs of Canadian business; the inability of 13 different regulators to respond quickly and effectively to critical policy issues such as the current perceived crisis in the governance of public companies; the capacity of 13 different regulators to effectively enforce their regulations; the competitiveness of the domestic capital market in fast-moving international capital markets; and the ability of Canada to speak with a clear and unified voice internationally and, in particular, in bilateral dealings with the Securities Exchange Commission (SEC) in the United States. Canadian governments have two alternatives to resolve these issues: either enhance the current system through increased harmonization, mutual recognition and reliance and coordination, or create a single regulator.

Conclusion

There are other internal trade issues that may not be important to the economy in a macro sense but that are, nonetheless, anywhere from bothersome to critical for individuals or businesses.

In an age of increasing globalisation, it becomes more critical than ever that our governments co-operate to reinforce the Canadian union and remove all remaining internal trade barriers. The fact is that while Quebec's, and the rest of Canada's, growth may be in the markets south of the border, our strength is in our domestic market, in its stability, its openness and its predictability.

To sustain our growth we need to be sure that Canadians can move and conduct business in every part of the country and that commerce is seamless and as free as can be. For that we need a functional and effective *Agreement on Internal Trade*.

² A report to the Minister of Finance by Harold MacKay, dated November 15th 2002, describes the problems that faces Canada's financial community, identifies the issues that need to be addressed and recommends how Canadian governments should proceed. It can be found on the Department of Finance web site at www.fin.gc.ca.



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