

THE ONTARIO-QUEBEC TRADE AND COOPERATION AGREEMENT

The Quebec and Ontario governments have recently signed a trade and cooperation agreement that will take effect on October 1, 2009. The agreement is intended to facilitate trade between the two provinces, promote labour mobility, strengthen economic cooperation and work toward greater regulatory harmonization. The goal is to create wealth and jobs by improving the competitiveness of the two economies and by combining the strengths of each of them in sectors seen as strategic.



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The strong economic integration of Quebec and Ontario helps raise the productivity of our businesses, enabling them to supply consumers in both provinces with quality products at affordable prices. While this integration is already a reality in many industries, there remain certain regulatory and administrative obstacles to trade. The agreement is intended specifically to eliminate some of these irritants.

There is a tendency to underestimate the economic relationship between Quebec and Ontario. However, Canada's two most populous provinces together represent a market of 18 million inhabitants. Their joint GDP was nearly \$890 billion in 2008,¹ making this the fourth largest economic space in North America, behind California, Texas and New York State. Economic studies tend to focus on comparisons or even competition between Quebec and Ontario, neglecting the close economic links between the two provinces. Each of them is the other's largest trade partner. According to data from 2005, Ontario was the destination of 61% of Quebec's exports to the rest of Canada and the origin of 69% of Quebec's imports from the rest of the country.² In

many respects, the economic structures of the two provinces are complementary. Quebec and Ontario form the core of manufacturing activity in the country, with three-quarters of all production.³

However, there are still too many irritants preventing full economic fluidity between the two provinces. Eliminating them is particularly necessary now that the U.S. market, the primary foreign destination of Canadian exports, has fallen into recession. The situation requires our companies to find new outlets, and one way of doing this is to broaden and liberalize their local economic space.



The cost of trade barriers

Economic literature generally recognizes two outcomes of trade between individuals: a broader selection of goods and services for consumers, and lower prices. When trade barriers⁴ come down, trade and competition between companies increase. A more competitive environment forces companies to offer goods and services that offer higher quality and lower prices. Companies generally achieve this by specializing in market niches. This

1. Statistics Canada, *Gross domestic product, expenditure-based, by province and territory*, <http://www40.statcan.gc.ca/101/cst01/econ15-eng.htm>.

2. Ministère du Développement économique, de l'Innovation et de l'Exportation, *Le calepin – Le commerce extérieur du Québec*, June 2009, p. 38.

3. Ministère du Développement économique, de l'Innovation et de l'Exportation, *Signature d'un accord Québec-Ontario sur le commerce et l'économie*, <http://www.mdeie.gouv.qc.ca/index.php?id=4404>.

4. Trade barriers mostly take the form of customs tariffs, taxes, quotas or other forms of regulation that limit exchanges of goods or services or push up their costs.

dynamic has been observed in North America since the implementation of the North American Free Trade Agreement (NAFTA).⁵

A competitive environment also raises an economy's productivity level. Once trade barriers are removed, companies become more productive and more innovative, not only because they are exposed to greater competition but also because eliminating barriers reduces the cost of doing business. In particular, companies get access to a broader choice of suppliers, to a larger market and to less expensive inputs.⁶ Free trade, whether between countries or provinces, also reduces non-tariff barriers.⁷ This helps avoid a waste of time and resources in doing business in another province or country.

Studies have evaluated the costs of interprovincial barriers in Canada.⁸ They estimate that these costs amount to 0.05% to 1% of the country's annual gross domestic product.⁹ Another cost linked to interprovincial barriers is lower business productivity. A study by the Conference Board of Canada in 2006 concluded that interprovincial trade barriers reduced the productivity of Canadian companies.¹⁰ Two recent studies, by the OECD and the IMF, strongly recommend that Canada eliminate remaining obstacles to interprovincial trade and reduce the number of regulated trades and professions so as to raise the country's productivity.¹¹ The authors of these studies recommend, among other things, that the impression – whether legitimate or not – that Canada is riddled with irritants to interprovincial trade harms foreign investors' perception of the country.

Also, most studies fail to take account of the “indirect” costs of trade obstacles: the proliferation of regulations and different interpretations of each province's laws also undermine the productivity and competitiveness of Canadian companies.

If Canada hopes to prosper and be competitive in a globalized economy in which capital is mobile, it would benefit by

reducing the uncertainty and the costs created by arbitrary barriers and other irritants to trade and worker mobility. The Ontario-Quebec Trade and Cooperation Agreement was brought about primarily to deal with this challenge.

The liberalization of interprovincial trade in Canada

In 1995, Ottawa played a key role in the negotiation of a cross-Canada trade agreement reducing interprovincial trade barriers: the Agreement on Internal Trade (AIT). The AIT is a political deal that sets out general principles rather than a series of strict obligations. All the same, it has achieved a measure of success, particularly in public procurement, with the opening to a greater number of potential suppliers helping reduce costs and thus the bill to taxpayers. However, the AIT is seen as too loose to force recalcitrant provinces to eliminate their remaining trade barriers.¹²

The AIT's failures are well documented: lack of progress in reducing agricultural barriers (apart from the abrogation in 2008 of a regulation on coloured margarine), inability to adopt a section on energy even after 12 years of negotiations, and inability to force governments found to be in violation of the agreement to comply with five of the eight rulings by special dispute settlement panels.¹³ Although implementation of the AIT has helped reduce the number of barriers to interprovincial trade, many such barriers remain, particularly in regulatory matters.¹⁴

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5. Dragos Ibrim, *The free trade agreements and specialization in the Canadian manufacturing sector*, Statistics Canada, December 1999.
6. Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy*, 3rd edition, Addison Wesley, 1997, p. 161.
7. This covers all obstacles other than customs tariffs imposed on foreign merchandise entering a given country. These range from quotas to less visible barriers such as quality or technical standards and administrative formalities that may be quite complex and costly and that have the effect of deterring imports.
8. According to a poll published in the *National Post*, Canadian business people find restrictions on labour mobility, food and agriculture products and transportation to be the most damaging to the economy. See COMPAS Inc., *Interprovincial Trade Barriers: Seriously Damaging to the Economy and Standard of Living and Almost as Harmful as Canada-U.S. Barriers*, September 2004.
9. Eugene Beaulieu, Jim Gasford and Jim Higginson, *Interprovincial Trade Barriers in Canada: How Far Have We Come? Where Should We Go?*, Van Horne Institute, May 2003.
10. Paul Darby, Kip Beckman, Yves St-Maurice and Dan Lemaire, *Death by a Thousand Paper Cuts: The Effect of Barriers to Competition on Canadian Productivity*, Conference Board of Canada, 2006.
11. International Monetary Fund, *Canada: Staff Report for the 2007 Article IV Consultation*, December 2006, <http://www.imf.org/external/pubs/ft/scr/2007/cr0751.pdf> and Organization for Economic Cooperation and Development, *Economic Policy Reforms: Going for Growth*, 2007, p. 8, <http://www.oecd.org/dataoecd/48/22/38088884.pdf>.
12. Kathleen E. Macmillan et Patrick Grady, *A New Prescription: Can the BC-Alberta TILMA Resuscitate Internal Trade in Canada?*, C.D. Howe Institute, October 2007, p. 1.
13. *Idem*.
14. To go further in liberalizing internal trade, Alberta and British Columbia instituted the *Trade, Investment and Labour Mobility Agreement (TILMA)*, fully in effect since April 1, 2009, with measures going further in some respects than the Agreement on Internal Trade (AIT) or the Ontario-Quebec Trade and Cooperation Agreement. The other provincial governments have been hesitant to follow the course set by TILMA, preferring to focus on bringing correctives to the AIT.

To get efforts going again on liberalizing interprovincial trade, the premiers of Quebec and Ontario agreed, under impetus from the Charest government, to achieve a major economic and trade agreement between the two provinces before the end of 2008. On November 27, 2007, they finally signed a joint statement aimed at negotiating a deal.

Several agreements already exist between Quebec and Ontario, including one on labour mobility in the construction sector, another on public procurement, and a further one on cooperation in varied sectors. The current agreement consolidates these while going further than the AIT in liberalizing trade between Quebec and Ontario.

The new agreement aims to conciliate the two provinces' practices and regulations to the greatest possible extent while eliminating certain obstacles to interprovincial trade, primarily in labour mobility, public procurement, transportation, financial services, agriculture and environment. The agreement also has a section on economic cooperation and the execution of joint projects.

The agreement is based on existing deals in trade, public procurement and labour mobility, giving them an overall framework. The goal is to consider Ontario as a major market rich in opportunities for Quebec companies rather than as a competitor.

What are the tangible achievements of the Ontario-Quebec Trade and Cooperation Agreement? They mainly involve aspects linked to regulation. Both provinces have agreed to harmonize a set of rules covering their commercial dealings.¹⁵

The big winners in this deal are companies doing business in both provinces, for instance transportation firms that employ workers in Ontario as well as in Quebec. Harmonized rules mean lower costs and increased efficiency for them. For example, in the financial sector, the agreement will enable Quebec *caisses populaires* and Ontario credit unions to do business more flexibly in either province. Approaches in the

insurance, securities, mortgage brokerage and credit cooperative sectors will also be harmonized.

The agreement also facilitates the movement of workers between the two provinces through the “permit on presentation of another permit” method. A Quebec worker in a specialized trade (a crane operator, for instance) will be able to work in Ontario without having to pass special examinations beforehand to meet Ontario regulations. A work permit from one province is recognized automatically in the other province. The same approach applies to most professions: nurses whose skills were not recognized automatically in the other province will find now that they are.¹⁶

The agreement also comes with a more stringent dispute settlement mechanism than what currently applies under the AIT. If a government imposes a new trade barrier on its territory, a company can complain to its own government. The governments of the two provinces first aim for a friendly settlement of the dispute. If they fail, the government of the province where the plaintiff company is based submits a formal complaint, and a special panel is formed within a time set out in the agreement. If the special panel rules that a government is at fault, it has one year to comply with the ruling. Failing this, it will

have to pay a financial penalty of up to \$10 million¹⁷ to the government that submitted the complaint. The aim of this procedure is to impose a political cost on a government that seeks to impose a new trade barrier. It is assumed that voters who see their government having to pay millions of dollars because a particular industry wanted to protect its market through regulatory measures would be unlikely to approve of such an approach.

As regards exceptions, the agreement allows certain government policies to be upheld in areas such as culture, labour standards, education, environment, health, regional economic development, consumer protection and native peoples.

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15. The effects of mutual recognition of regulations are hard to measure and vary by traded good and economic sector. However, a study by the Australian government looked into the impact of mutual recognition of regulations between Australian states and territories. The study's results show that this recognition strengthened trading in some sectors of the economy – food products, in particular – by removing regulatory obstacles to trade. This policy also helped develop national standards covering a broad range of economic sectors without causing quality standards to fall to unacceptable levels. On this topic, see Stephen Rimmer, *Impact of Mutual Recognition on Regulations in Australia: A Preliminary Assessment*, Commonwealth of Australia, January 1997, <http://www.pc.gov.au/orr/information/?a=65750>.

16. Nurses benefited up to now from a temporary agreement enabling them to work in the other province. The Ontario-Quebec Trade and Cooperation Agreement will facilitate this mobility.

17. This financial penalty is set at \$5 million in the AIT.

A path worth taking

This agreement is a step in the right direction for liberalizing and enriching the Quebec-Ontario economic space. It is especially welcome because of the dynamic of commercial opening that it creates. This is a courageous approach given the protectionist reflex that often comes to the fore in difficult economic times. We can say that the strategy “setting out a new economic space for Quebec” by liberalizing trade (not only with Ontario but also with Europe) could very well be, in the end, one of the best initiatives of the Charest government.

This does not mean it would not have been possible to go further. Far more effort has gone into harmonizing existing regulations than into truly removing obstacles to trade.

For example, little progress has been made in liberalizing the market for farm products, and supply management is maintained.¹⁸ Also, the agreement does not affect government monopolies, for example in the hydroelectricity and alcoholic beverage sectors.

In this spirit, and as a recommendation for the future, the Quebec-Ontario economic space could look to the Alberta-British Columbia TILMA, especially as regards its basic architecture. The Trade and Cooperation Agreement between Quebec and Ontario is a closed trade agreement, which means that the only areas subject to it are those it lists. In the case of an open trade agreement such as TILMA, all economic sectors are subject to the agreement, except for the exemptions it lists.

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This approach has the advantage of being more transparent by making industries that seek to be excluded from the agreement’s rules highly visible in the public eye. This procedure exerts pressure on politicians, who must then justify these exceptions.¹⁹

These shortcomings should cast a shadow over the agreement’s main strength: preventing any new trade obstacles from being established between the two provinces. If a province persists in establishing new trade barriers, these barriers can be challenged by the other province, and the dispute settlement mechanism is likely to guarantee greater compliance with commitments.

The Ontario-Quebec Trade and Cooperation Agreement also has symbolic value. It can serve as a springboard for future World Trade Organization (WTO) talks and help Canada negotiate bilateral free trade agreements, as it is currently attempting with the European Union.²⁰ From the standpoint of promotion at the international level, eliminating regulatory obstacles within the country as the agreement does helps make Canada more attractive in the eyes of foreign investors who may wish to invest in the country. This advantage is far from negligible in a world where countries are competing fiercely to attract capital and jobs.

Although this agreement remains incomplete, it opens the door to greater liberalization at the interprovincial level. It is to be hoped that our political leaders will follow the path it has laid out.



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18. Supply management is a system resulting from public policies under which certain agricultural producers (of milk, poultry and eggs in Quebec), protected from foreign competition by trade barriers, adjust production levels to keep the prices of their products above the prices that would be set by the free market.

19. Kathleen E. Macmillan and Patrick Grady, *op. cit.*, footnote 12, p. 8.

20. Robert Knox and Amela Karabegovic, “Time to end interprovincial barriers,” *National Post*, May 21, 2009.