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Background

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A New Prescription:

*Can the BC-Alberta TILMA
Resuscitate Internal Trade in Canada?*

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The Background in Brief

Interprovincial trade barriers are a drag on Canadian productivity and send an embarrassing message to international investors. Despite some past progress in reducing them, they remain an irritant to our economic union. Trade liberalization as pursued by Alberta and British Columbia in the TILMA is a model that Ottawa and the provinces should pursue.

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At the August meetings of the Council of the Federation, premiers expressed renewed interest in strengthening domestic trade between provinces and territories by implementing a five-point plan for improving the Agreement on Internal Trade (AIT; see Council of the Federation 2007; Internal Trade Secretariat 2007). This renewed attention to internal trade can be attributed in no small part to the Trade, Investment and Labour Mobility Agreement (TILMA) between Alberta and British Columbia, which came into effect on April 1, 2007, and is scheduled to be fully implemented by April 1, 2009 (see British Columbia 2006).

The TILMA's bold approach has shattered the comfortable calm of internal trade negotiations and has forced other governments, including Ottawa, to take a hard look at their commitment to reducing domestic trade barriers. So far, however, other governments have been reluctant to follow the TILMA's lead, preferring to concentrate on mending the AIT. Unfortunately, their plans fall well short of the TILMA's prescription, and miss an opportunity to reduce trade barriers dramatically within Canada.

The AIT closely followed the failed Charlottetown Accord and the near-miss Canada suffered from the 1995 Quebec referendum. Anxious to demonstrate that the federation could work, Ottawa took a lead role in negotiating a comprehensive trade agreement over the objections of some provinces, including British Columbia, whose government was strongly opposed. While the AIT is more a political pact that affirms general principles than a strict set of obligations, it has achieved a certain degree of success, most notably in the area of government procurement. Yet it is widely regarded as lacking the teeth necessary to force recalcitrant provinces to tear down their remaining trade barriers. The AIT's failures are well documented: zero progress in reducing agricultural barriers, the inability to negotiate an energy chapter after 12 years of negotiations, and a failure by governments, when found in the wrong, to adopt six of the eight dispute settlement panel rulings.

The political situation, however, is now quite different from what it was in 1995 when the AIT was implemented. With the creation of the TILMA, British Columbia has changed from an unwilling participant in the AIT to an internal trade crusader. The Council of the Federation, established in 2004 by provincial and territorial premiers but with no federal representation, has emerged as an enthusiastic champion of the AIT and the improved functioning of the Canadian internal market (Council of the Federation 2006a, 2006b, 2007).

As governments assess their policy options, it is worthwhile to review the economic case for reducing barriers to internal trade and to take stock of the critical barriers that continue to impede trade flows in Canada. The TILMA's approach to reducing internal barriers is quite different from that of the AIT and holds great promise. Its contribution to internal trade will depend on two things. The first is how successful BC and Alberta will be in meeting their ambitious negotiating objectives and actually creating a seamless provincial border. The

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second is the extent to which other governments will be able to draw on the TILMA as a model for improving or supplanting the AIT.

The Case for Reducing Trade Barriers

As with nontariff barriers in the case of international trade, interprovincial trade barriers raise the prices local consumers, businesses, and governments pay for the goods and services they purchase. Although suppliers in the protected region benefit from higher prices, the additional revenues producers earn are usually smaller than the extra costs purchasers must pay because of the barriers. The net loss to the economy — which economists call the efficiency loss — arises from the distortions to production and consumption that nontariff barriers cause, and provides the economic rationale for reducing internal trade barriers. In more practical terms, trade barriers mean higher prices and less choice for consumers. In the case of governments, the additional costs associated with trade barriers are passed on to the public through higher taxes, inferior services, or increased debt. Trade impediments reduce overall competitiveness by lowering productivity, raising input costs to business, shielding local firms from outside competition, and restricting suppliers' access to market opportunities in other provinces and territories.¹ That trade barriers come at a cost to industrial performance is illustrated by the example of Canadian wine. Reductions in import barriers in response to pressure from foreign trading partners have been credited with encouraging Canadian wineries to innovate and modernize, with the result that Canadian wine now tastes better, sells well, and garners international attention (Hart 2005).

The general perception is that interprovincial trade barriers cause businesses significant harm (COMPAS 2004). Empirical studies conducted during the 1980s and 1990s found, however, that these barriers impose only a small cost on the overall economy and that removing them would increase Canada's gross domestic product by less than 0.5 percent.² Indeed, since many of the barriers these studies examined — notably preferential procurement measures — have been substantially reduced over the past 10 years, earlier economic research probably overstates the cost of internal trade impediments. Yet the absence of hard economic evidence has not stopped international bodies such as the Organisation for Economic Co-operation and Development (2007) and the International Monetary Fund (2007) from singling out interprovincial trade barriers as a major factor explaining Canada's relatively poor productivity performance. The perception, legitimate or not, that Canada is rife with internal impediments affects the way international investors regard the country. Internal trade barriers may be small but they create a big impression about Canada's commitment to international competitiveness and multilateral trade liberalization.

1 For a more analytical discussion of the costs and benefits of trade barriers, see Krugman and Obstfeld (1997, 195-98).

2 These studies use cost concepts that, to varying degrees, measure economic welfare losses. See, for example, Whalley (1983, 1995); Whalley and Trela (1986); Copeland (1998).

The case for reducing or removing barriers should not require exaggerated estimates of their cost. The existing barriers have long been a sore point with Canadian businesses and with individuals who have encountered them when seeking work in other provinces and territories. Subject to some limitations, section 6 of the Charter of Rights and Freedoms already guarantees the mobility rights of Canadians. The right to work and do business anywhere in Canada as common economic citizens should be all the justification that is required to eliminate remaining barriers to trade and mobility.

The Most Important Remaining Barriers

Business leaders typically identify restrictions on labour mobility, procurement measures, business regulations (notably those affecting transportation and security regulation), and barriers to trade in food and agricultural products as the areas most affected by trade impediments (Canadian Chamber of Commerce 2004; COMPAS 2004; Conference Board of Canada 2006).

Procurement

Procurement is a critical consideration in light of the fact that the federal, provincial, and territorial governments spent more than \$20 billion on goods, services, and construction in fiscal year 2005/06 (MARCAN 2007). The AIT and the subsequent extension of disciplines to the municipal, academic, social services, and health sectors and to some Crown corporations have succeeded in eliminating many of the protectionist measures that existed prior to 1995. Governments have also cooperated in posting procurement opportunities on a common website and in providing for single electronic tendering. The procurement system could be opened even more by including purchasing made by provincial utilities, reducing the list of excluded Crown corporations, and imposing disciplines on government contracting of professional services — such as those of architects, public relations specialists, and physicians — and financial services.

Regulations

Excess and overlapping regulations impose high costs on businesses and can discourage them from seeking opportunities in other provinces and territories (Canadian Chamber of Commerce 2004). Among the most-cited barriers are those pertaining to trucking weights, dimensions, and licensing requirements, financial services, and construction safety. The AIT has made some progress in reconciling regulatory barriers but has been overwhelmed by the sheer number of measures involved. The agreement's bottom-up approach, which involves negotiating on a case-by-case basis, has not been a good model for achieving major breakthroughs.

The regulatory agenda is broader than just interprovincial trade barriers, however, and it is quite possible that much of what businesses consider to be barriers are simply cases of excess regulation. In fact, there are very few remaining provincial or territorial measures explicitly designed with protectionist intent.

Most are annoying regulatory differences and redundancies that could be easily eliminated if the will to cooperate existed. For example, both British Columbia and Alberta require oilfield operations to have first-aid kits on hand, but at one time the two provinces had different requirements for what the kits should contain, necessitating two separate kits for teams operating across the provincial boundary. Once presented with this annoyance, officials from the two provinces quickly came to a common understanding.

The best strategy for tackling regulatory duplication lies with regulatory reform initiatives such as the federal government's SMART regulation and programs such as Service Manitoba and the red-tape exercises under way in Ontario, New Brunswick, and Nova Scotia. In contrast, progress under the AIT's case-by-case approach has been painfully slow.

One of the most glaring examples of governments' failing to cooperate is in securities regulation. The current system requires issuers of securities wanting to do business across Canada to comply with the requirements of 13 different regulators. As the federal finance minister has observed, this system imposes costs and delays on business, makes Canada a less attractive destination for foreign investment, and could contribute to lapses in enforcement (Flaherty 2006). One study concludes that a national regulatory structure with regional branch offices would improve enforcement outcomes in Canada and yield annual savings of between \$16 million and \$57 million per year (Charles River Associates 2003). Recently, two high-profile commissions, one federally appointed, the other commissioned by the Ontario government, agreed on the need for a single regulator and provided specific recommendations on the means of achieving this goal.³ Despite these proposals, however, the system remains fragmented, with little prospect for improvement in the near future.

Barriers to Food and Agricultural Trade

The most pervasive internal trade impediments are in the agriculture sector. Marketing restrictions limit interprovincial shipments of supply-managed commodities such as poultry, dairy products, and eggs. Different food-packaging and labelling rules also discourage trade between provinces and territories. Restrictions on margarine colouring and on trade in dairy blends have been the subject of AIT dispute settlement proceedings and remain largely unresolved. Prohibitions on bulk shipments of fruit and vegetables and overlapping meat inspection requirements prevent shipments to processors in other provinces and territories.

The AIT's work plan with respect to agriculture was far from ambitious. Even so, the parties made no progress in dismantling internal barriers under the agreement, perhaps reflecting a lack of serious intent. Concern over disrupting the supply management system has made negotiators excessively nervous about addressing almost any agricultural measure since the nexus between supply-managed commodities and regulated food products can be too close for comfort.

³ See the federal Committee to Review the Structure of Securities Regulation in Canada (2003) and the Ontario-appointed Crawford Panel on a Single Canadian Securities Regulator (2006).

Agriculture officials worry that trade disciplines affecting products such as margarine and dairy blends might undermine their ability to enforce production and import controls on upstream commodities such as fluid milk, poultry, and eggs. Officials also worry that such disciplines might establish precedents that could later be applied to supply-managed sectors. In defending their lack of negotiating progress, governments argue that agricultural issues have an international trade dimension and can only be dealt with in that forum. The trouble is that the prognosis for agricultural trade reform under the World Trade Organization appears poor and the expectation of such reform can no longer be used as a credible excuse for ignoring internal trade issues. Moreover, Canada's failure to address supply and marketing impediments in agriculture causes its foreign trading partners to question the country's commitment to multilateral trade negotiations (Herman 2007).

Out of frustration with the lack of progress on agriculture achieved under the AIT, the governments of Prince Edward Island, the Yukon, Manitoba, Saskatchewan, Alberta, and British Columbia signed the 2006 Interim Agreement on Internal Trade in Agriculture and Food Goods (see Internal Trade Secretariat 2006). The agreement commits signatories to reduce all technical barriers to trade in food and agriculture products. Like the TILMA, the agreement is open to participation by other governments.

Labour Mobility

Progress has been made under the AIT in eliminating barriers to labour mobility. Residency requirements have been largely eliminated. Licensing, certification, and registration requirements for workers now relate principally to competence and are not more burdensome than those applied to workers inside the province. And three-fifths of the occupations regulated in more than one jurisdiction are now covered by Mutual Recognition Agreements that make it a more routine matter to get credentials recognized in most jurisdictions, while a further third are covered by agreements signed by all regulating jurisdictions. Yet, despite almost 12 years of negotiations under the AIT, a few occupations are still not covered at all.

The TILMA Approach

With the TILMA, British Columbia and Alberta seek to go much further than a mere trade agreement. The culmination of a three-year process of cooperation and engagement, the TILMA includes a number of bilateral arrangements and memoranda of understanding governing such matters as environmental harmonization, child welfare, health surge capacity, tourism marketing, oil and gas regulation, and e-learning. The TILMA's primary objective is to create a seamless border between the two provinces. As such, it addresses a host of regulatory and administrative matters that the AIT does not cover.

Even when addressing trade restrictions, the TILMA takes a more comprehensive approach than does the AIT, reflecting a greater degree of commitment to reducing impediments. All measures that restrict or impair the

movement of goods, services, investment, and labour between the two provinces are subject to the TILMA's disciplines unless they are explicitly excluded.⁴ By contrast, the AIT disciplines pertain only to trade restrictions that have been explicitly included in the agreement by consensus among all parties.

An important example of the different approach between the TILMA and the AIT is in the area of regulation. Under the TILMA, Alberta and British Columbia have agreed to mutual recognition or reconciliation of all standards and regulations, including technical standards and barriers pertaining to agricultural products. With respect to corporate regulation, the TILMA provides that corporations registered in one province do not need to re-register in the other in order to conduct business. Similarly, commercial vehicles licensed in one province need not be licensed to operate in the other. The TILMA also contains lower thresholds for open and nondiscriminatory access to government procurement than those provided in the AIT, it opens energy markets to producers and distributors in the other province, and it eliminates local-presence requirements as a condition of doing business.

Whereas the AIT's provisions on subsidies focus only on transparency and the prevention of poaching, the TILMA prohibits subsidies that result in material injury to competing enterprises in the other province (although it provides for exceptions for subsidies made in response to those offered by nonparties to the agreement, including the federal government). The TILMA's stricter subsidies code is likely to prove a stumbling block to other governments that are contemplating signing on to the new agreement, since it rules out subsidies to disadvantaged regions and industries. Such familiar programs as support to producers in the aerospace, automotive, and natural resources sectors could be subject to disciplines under the TILMA.

The TILMA's dispute settlement provisions have considerably more teeth than those of the AIT. Under the AIT, the emphasis is on cooperative resolution between governments: private parties have limited access to the system and little hope of effective resolution. Moreover, there is no obligation in the AIT for governments to implement dispute settlement findings made against them, and many have not.⁵ In contrast, the TILMA provides a binding dispute settlement mechanism with tighter time frames, easier access for private parties, recourse to arbitration, and the possibility of monetary awards of up to \$5 million.

The TILMA's approach to dispute settlement has received a great deal of attention, both favourable and unfavourable. Its critics maintain that it undermines the ability of governments to legislate and regulate as they wish (Weir and Lee 2007). Its defenders argue that it addresses only measures that restrict trade in a manner inconsistent with the TILMA and that it enshrines the principle of "national treatment," which does not require that rules be the same across provinces and territories but only that suppliers located elsewhere in Canada be treated no less favourably than domestic suppliers when doing business in a

4 Like the AIT, the TILMA (Article 6) excludes measures that have a legitimate objective. In addition, the TILMA provides a number of exceptions to the general provisions, including measures relating to aboriginal peoples, water, and social policy.

5 The Certified General Accountants Association of Canada (2006) has documented the many failings of the AIT's dispute settlement mechanism based on its own unsatisfactory experience.

province or territory. Advocates of the TILMA also reject the notion that the agreement's dispute settlement system resembles the investor-state provisions of the North American Free Trade agreement. Rather, they maintain that the TILMA's system is closely patterned on that of the AIT but strengthened to encourage governments to respect their obligations and discourage them from ignoring unfavourable panel rulings, as has happened frequently under the AIT.

Can the TILMA Model Be Applied More Broadly?

The jury is still out on how successful the British Columbia and Alberta governments will be in meeting their ambitious commitment to reconcile the literally hundreds of thousands of regulations that apply in health, financial services, construction safety, professional, and occupational certification areas. The political will is strong at the highest levels, but success will depend on the cooperation of others, such as professional licensing associations, who may be less enthusiastic. Indeed, some of the work on reconciling standards might well be pushed past the April 2009 deadline for full implementation of the agreement.

In the meantime, other governments across Canada are examining their options. The TILMA was undertaken pursuant to Article 1800 of the AIT, which permits the creation of a bilateral or plurilateral agreement provided the signatories are prepared to extend the arrangement to other parties willing to accept its terms. It is thus open to other governments to sign on to the TILMA in its entirety. The prospect of joining the TILMA, however, has caused other governments considerable angst. To reject the TILMA might create the impression that they are opposed to an improved internal market, something they are obviously reluctant to suggest. Yet the TILMA is generally seen as being rather too tailored to the Alberta and BC situation, particularly as it relates to the energy and agriculture sectors, to find an easy fit elsewhere. Its sections on subsidies and agriculture are considered unpalatable by those provinces and territories that provide regional economic development support or business incentives or that have sizable supply-managed sectors. The one government that had shown considerable interest in the TILMA was that of Saskatchewan; however, after public hearings that focused considerable attention on the TILMA's subsidy provision (Saskatchewan 2007), the province has decided not to sign on.

The TILMA poses a particular dilemma for the federal government since it, too, could become a signatory. Ottawa has been criticized in the past for its reluctance to use its constitutional power over interprovincial trade and commerce to dismantle interprovincial barriers (Trebilcock 2001). Similarly, it could have been more aggressive in demanding provincial cooperation on such matters as a single national securities regulator as the *quid pro quo* for resolving issues of importance to the provinces, such as the so-called fiscal imbalance. Ottawa has also been hesitant to address interprovincial barriers within its own area of jurisdiction, such as by amending federal legislation prohibiting interprovincial shipments of meat and other agricultural products. Signing on to the TILMA or to the Interim Agreement on Internal Trade in Agriculture and Food Goods would require the federal government to take a stand on supply management, something it appears reluctant to do. For the present, it would rather follow than lead, in

contrast to the strong leadership position it exerted during negotiation and implementation of the AIT.

Even without the formal participation of other governments, the TILMA could still rejuvenate internal trade in Canada. The recent Council of the Federation plan for improving the AIT borrows directly from the TILMA by directing ministers to consider establishing monetary penalties of up to \$5 million to be applied to parties that do not comply with AIT dispute settlement body rulings (Council of the Federation 2007). The TILMA could also serve as a model for other plurilateral agreements. It and the Interim Agreement on Internal Trade on Agriculture and Food Goods are a departure from the AIT model of unanimous consensus among all governments, and it is quite possible that like-minded governments will form similar associations that, while less ambitious and comprehensive than the TILMA, could still serve to liberalize trade in specific sectors or geographic areas. This possibility raises concerns that the TILMA might give rise to a series of preferential bilateral or plurilateral trading blocs that could distort trading patterns and create inefficiencies — bilateral deals are clearly second best to multilateral arrangements. Yet, with multilateral will apparently lacking at present, the TILMA could do much to advance the cause of freer internal trade, particularly in important areas such as regulatory duplication.

The Way Forward

The TILMA has come at a good time. The demands of major project development and accompanying skill shortages are straining provincial and territorial economies, particularly in the West. Governments are concerned less with job protection and constitutional imperatives, as had been the case when the AIT was negotiated, and more with ensuring that provincial and territorial labour and investment needs are met. Facilitating the free flow of goods, services, and labour makes good economic sense.

To some extent, the TILMA has invigorated the internal trade debate even before coming into effect. Governments have returned to the AIT with more energy and resolve to make further progress. The Council of the Federation has taken up the challenge with an ambitious work plan to improve the AIT and even to incorporate some of the TILMA's provisions. The TILMA, however, challenges other governments to go further than this.

As they assess their policy options, governments should look especially closely at the TILMA's prescriptions pertaining to technical standards and regulations (including those affecting agriculture and food) and its improved dispute settlement provisions. Importing these provisions into the AIT would vastly improve its chances of success, and governments that are sincerely committed to freer internal trade should have little argument with what the TILMA provides in these areas.

The TILMA's real breakthrough, however, is its basic architecture. By presuming that all measures fall within its scope unless explicitly excluded, the agreement promises to have a more profound impact on internal trade than any amount of tinkering with the AIT could ever achieve. The TILMA approach, which puts the onus on regulators to justify any exceptions to the common standard,

holds great hope for breaking the gridlock that has plagued negotiators in the AIT. It could address what many consider to be a disconnect between the will of ministers to dismantle barriers and the ability of negotiators to deliver on this promise. As future AIT negotiating deadlines come and go, ministers would be well advised to look considerably more closely at the TILMA model for improving internal trade.

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