The Myth of Interprovincial Trade Barriers and TILMA's Alleged Economic Benefits

by Marc Lee and Erin Weir

Summary

Proponents of the BC-Alberta Trade, Investment and Labour Mobility Agreement (TILMA) claim that it will provide large economic benefits through the elimination of interprovincial trade barriers.

In fact, there are very few obstacles to trade and investment among provinces, and no evidence that such obstacles entail significant economic costs:

- Research conducted for the 1985 Macdonald Commission concluded that interprovincial barriers cost no more than 0.05% of Gross Domestic Product (GDP).
- Relative to distance and market size, Canadian provinces are far more likely to trade with each other than with American states.
- Since 2000, interprovincial trade has been growing much faster than Canada's international trade.

A Conference Board of Canada study commissioned by the BC government claims that TILMA will add $4.8 billion to the province's economy. However, this study is deeply flawed:

- It makes no attempt to list, or estimate the cost of, trade barriers between provinces.
- Rather than using standard economic techniques, the Conference Board infers huge benefits from a tiny survey of business organizations and government ministries.
- The Conference Board doubles its estimate of TILMA's benefits through a simple arithmetic error. Even after correcting this error, most of the projected gains are from industries exempt from the final agreement or from industries that barely engage in interprovincial trade.

Introduction

In April 2006, the governments of British Columbia and Alberta signed the Trade, Investment and Labour Mobility Agreement (TILMA), which will come into effect in April 2007.[1] With encouragement from business lobbies, other provincial governments are considering joining this agreement. The federal government has explicitly endorsed TILMA and identified reducing "barriers to internal trade and labour mobility" as one of its economic policy objectives.[2]

In a companion CCPA paper, *Asking for Trouble: The Trade, Investment and Labour Mobility Agreement,* Ellen Gould outlines TILMA's flaws.[3] The agreement prohibits public-sector activities, other than those specifically exempted, that "restrict or impair" trade, investment or labour mobility, and empowers business to sue governments for alleged violations. The enforcement mechanism is, in effect, a more extreme version of the North American Free Trade Agreement's (NAFTA) notorious Chapter 11. This mechanism will create pressure to weaken existing provincial regulations and standards that serve the public interest. At a minimum, uncertainty regarding TILMA's broad language and how it might be interpreted will deter governments from enhancing regulations or standards.

> There is no reason to expect that TILMA will yield significant economic benefits. In fact, economic, social and environmental costs are likely to outweigh any benefits from the agreement. We recommend that the BC and Alberta governments withdraw from TILMA and that other provincial governments not sign it.

The Conference Board of Canada recently produced a series of reports arguing that this sweeping agreement is needed to eliminate costly interprovincial trade barriers. However, there are few tangible examples of barriers between provinces and no empirical evidence that such barriers entail significant economic costs.

The BC government asserts that TILMA will add $4.8 billion to the province's economy. This astounding figure is from a Conference Board study commissioned by the provincial government, dated September 2005 but not publicly released until January 2007.[4] The study's only evidence is a very small survey of business organizations and government ministries. After arbitrarily "scoring" BC's industries and regions, the Conference Board doubles its estimate of TILMA's benefits through a simple arithmetic error. Even after correcting this error, most of the projected benefits are from industries exempt from TILMA or from industries that barely engage in interprovincial trade.

There is no reason to expect that TILMA will yield significant economic benefits. Based on previous economic studies, we find that the Conference Board estimate is almost 100 times too large. In fact, the economic, social and environmental costs outlined by Gould are likely to outweigh any benefits from the agreement. We recommend that the BC and Alberta governments withdraw from TILMA and that other provincial governments not sign it.

The Rhetoric and Reality of Internal Trade

The myth that large barriers to trade among provinces prevent Canada from being a true "economic union" is widely accepted in corporate Canada. It is sometimes claimed that doing business across provincial borders is more difficult than doing business across the border between Canada and the United States. According to a recent Conference Board of Canada report, "barriers to inter-provincial trade, mobility and investment are at times so severe that they inhibit the kinds of east-west connections that characterize our deep connections outside Canada."[5]

This preoccupation with alleged internal trade barriers routinely surfaces in discussions of federalism. Around the same time as NAFTA (1994) and the World Trade Organization (1995), Canada's Agreement on Internal Trade (AIT) came into effect on July 1, 1995. Corporate Canada was never quite satisfied with the AIT and made several attempts on a multilateral basis to broaden its coverage, strengthen its enforcement powers, and give business a greater capacity to directly challenge government policy. These attempts failed, largely due to the absence of compelling evidence that there was much of a problem to begin with.[6]

TILMA has put internal trade back on the political agenda and promises to deliver what the AIT could not. A full-court press is now on to get other provinces to sign TILMA – a *de facto* expansion of the AIT. The fiction of interprovincial trade barriers allows governments to make political gains by championing their "elimination."

Most serious studies conclude that there are few significant obstacles to trade and investment within Canada. There are no customs inspection stations along provincial borders, nor any kind of tariffs on interprovincial trade. Canadians use the same currency and share common legal, financial and economic institutions. Canadians are free to live and work anywhere in the country. The federal government has constitutional power over interprovincial trade and the courts have consistently struck down attempts by provincial governments to obstruct it.

In *Death by a Thousand Paper Cuts* (2006),[7] the Conference Board identifies only two examples of interprovincial trade barriers: Quebec's prohibition of margarine coloured like butter and Ontario's restriction on vegetable-oil-based substitutes for dairy products. It is not clear that these barriers have significant economic impacts, much less that they constitute the "balkanization of our national economic space."[8] In *Mission Possible: Stellar Canadian Performance in the Global Economy* (2007), the Conference Board refers to "a thicket of provincial barriers" but provides no further examples.[9]

What corporate Canada calls "trade barriers" are in fact differences across provinces in government procurement systems, labour standards, consumer-protection measures, environmental regulations, and taxes. Harmonizing these policies down to the lowest common denominator would certainly reduce the cost of doing business. However, the alleged trade distortions resulting from these differences, and the supposed public benefits of removing them, have been greatly exaggerated. Genuine trade barriers are quite small and exist in only a few areas.

In an era of "globalization" and free-trade agreements, analysts generally accept that international trade barriers are quite low. The relevant economic literature indicates that whatever interprovincial barriers exist are even lower. Trade among provinces is much more intense than Canada-US trade. Relative to distance and market size, Canadian provinces are 12 times more likely to trade goods and 30 times more likely to trade services with each other than with American states. Similarly, investment and migration are far more likely across provincial borders than across the Canada-US border.[10]

Regarding recent research on this subject, UBC economics professor John Helliwell observes:

> *[F]or the four largest provinces, there is no evidence that interprovincial trade is less dense than is intraprovincial trade, and for no province are the interprovincial border effects more than a fraction as large as the international ones. Thus even the provincial differences of language, networks, and regulations have very little importance compared to those across national borders.*[11]

Because "the four largest provinces" include Alberta and BC, this conclusion implies that there are no significant trade barriers between them. Since this conclusion was drawn, gross interprovincial trade has grown much faster than Canada's gross international trade.[12] While interprovincial trade grew by 25% from 2000 through 2005, international imports grew by only 9% and international exports by just 6%.[13] To the extent that interprovincial barriers exist, they do not appear to be restraining interprovincial trade.

> What corporate Canada calls "trade barriers" are in fact differences across provinces in government procurement systems, labour standards, consumer-protection measures, environmental regulations, and taxes. Genuine trade barriers are quite small and exist in only a few areas.

In 1982, the federal government struck the Royal Commission on the Economic Union and Development Prospects for Canada, chaired by Donald Macdonald. In 1985, the Macdonald Commission reported: "The direct costs of existing interprovincial trade barriers appear to be small…their quantitative effect on the level of economic activity in Canada is not sufficient to justify a call for major reform."[14] Indeed, research conducted for the commission concluded that interprovincial barriers cost no more than 0.05% of Gross Domestic Product (GDP).[15] Since then, as a result of the AIT, such barriers have declined further.[16]

Ignoring the Macdonald Commission, the Conference Board claims that a Canadian Manufacturers' Association (CMA) study from 1991 "is the only one that attempts specifically to calculate the cost associated with interprovincial barriers."[17] This study estimated that $6.5 billion – or 1% of national GDP at the time – could be gained by eliminating interprovincial trade barriers.[18] However, it consistently overlooked the economic benefits of government policies classified as "barriers." Taking account of such benefits confirms that the net cost of these barriers is closer to 0.05% of GDP.[19]

The CMA's figure reflected estimated gains of $0.5 billion from removing local-production requirements for alcoholic beverages, $1 billion from eliminating agricultural marketing boards, and the bulk, $5 billion, from liberalizing government procurement. Local-production requirements have since been abolished through the AIT. Whether eliminating marketing boards would enhance economic performance is disputed, as they mostly function to redistribute income. In any case, TILMA exempts marketing boards.[20] The procurement figure refers to potential cost savings for governments, rather than to economic growth due to the removal of trade barriers.[21] To the extent that there are net benefits to governments from liberalized procurement, most of these have already been captured by the AIT.

The true purpose of TILMA is not to facilitate interprovincial trade, but to reduce different provincial regulations to the lowest common denominator. A review of the empirical literature on interprovincial trade barriers prepared for the BC government by UBC economist Brian Copeland notes:

Because trade barriers between the provinces are low, efforts to liberalize those barriers that do exist are likely to have only a small effect on trade flows. Much of the debate is not really about interprovincial trade, but rather about how decentralized the policy regime should be in Canada and how much flexibility governments should have to intervene in markets… These are issues which deserve to be debated on their own merits, without the distraction of misleading claims about a crisis in internal trade.[22]

The rationale for a federal system is to allow different provincial governments to enact different policies in response to different local conditions. Regarding the AIT, the C.D. Howe Institute acknowledged this point and that:

[C]ertain barriers exist as a result of the public's preference for government intervention to regulate, discourage, or prevent certain types of activities. Whether or not the benefits of such interventions outweigh their costs, the interventions themselves are a legitimate result of the democratic process.[23]

Even the Conference Board concedes that there is scant evidence of interprovincial barriers, but feebly claims that such barriers are too numerous to measure:

There has been little research to date on the many interprovincial barriers to competition in Canada. These barriers are found in all sectors of the economy and affect trade in both goods and services. No comprehensive listing of these barriers seems to exist – indeed, their sheer numbers present a daunting obstacle to any attempt to compile a full list or estimate the cost of each barrier to the Canadian consumer.[24]

We conclude that, despite the rhetoric, there are few examples of interprovincial trade barriers and no evidence that they entail significant economic costs. Certainly, such barriers are not sufficient to justify a far-reaching agreement like TILMA, which would substantially curtail the capacity of provincial governments to act in the public interest.

The Conference Board Study of BC

The Conference Board begins its 2005 *Impact Assessment of the BC/Alberta Trade, Investment and Labour Mobility Agreement* by noting the high levels of trade and migration that already exist between the two provinces (p. 3).[25] These figures corroborate the above evidence that there are currently few interprovincial economic obstacles.

The report makes no attempt to estimate the magnitude or cost of trade barriers between Alberta and BC. Nor are its few anecdotes particularly compelling. According to the CEO of Enbridge Inc., a Canadian energy company, the duplication of regulators costs his company about $5 million to $10 million per year (p. 24). Even $10 million amounts to less than 1% of Enbridge's annual operating and administrative costs and 0.15% of its annual revenues.[26]

Nevertheless, the Conference Board projects that TILMA will add $4.8 billion, or roughly 78,000 jobs, to BC's economy. These figures seem implausibly large for at least three reasons. First, $4.8 billion is equivalent to the annual value of BC's softwood-lumber exports to the US or to half the value of BC's exports to Alberta.[27] Second, if TILMA expands interprovincial trade, greater exports to Alberta will add to BC's GDP but greater imports from Alberta will detract from it.[28] Third, $4.8 billion was equal to 3.8% of BC's GDP, placing the Conference Board estimate on the high end of estimated gains from *international* trade.[29] For example, mainstream academic literature projected benefits for Canada of around 1% of GDP from Canada-US free trade.[30]

The *Impact Assessment* generates its large estimate by applying a simplistic methodology to a "draft negotiators' text" of TILMA (p. 39). Gains from trade are conventionally analyzed through computable general equilibrium models and could be analyzed using an input-output model, which the Conference Board routinely uses in other studies. Instead, "a list of key stakeholders in the private sector and in the Government of British was provided by the Ministry [of Economic Development]" for the Conference Board to survey. Only 4 of 13 business lobby groups answered the survey (no specific companies or industry-specific trade associations were surveyed). The fact that two-thirds of recipients could not be bothered to respond suggests that alleged interprovincial trade barriers are not a particularly important issue for BC business. More generally, the low response rate and small sample size cast doubt on the survey's validity.

Interestingly, the Conference Board questions some of the positive claims made about TILMA in the survey. Benefits identified by respondents in the construction industry would not be forthcoming since there is already interprovincial recognition of construction credentials. Similarly, perceived benefits in the agricultural sector related to federal initiatives that TILMA would not affect. The survey also touched on some of TILMA's shortcomings:

> *The responses from the private sector were very positive, while the government responses varied. The reasons given for the negative responses by some government respondents were: there are legitimate reasons for different standards and regulations, stakeholders will object to the agreement, local businesses along the border may suffer losses to Alberta firms, the specific regional and sector benefits may not outweigh the costs, the agreement does not recognize that the growth or management of the provincial economy is a legitimate objective and that the lack of local office residency requirements will make it difficult and/or costly to initiate court actions (pp. 29-30).*

In the second stage, the Conference Board divides BC into seven regions and 11 industries, "scoring" each on the following arbitrary scale of speculated impact on GDP:

-3 = reduction of more than 10%
-2 = reduction of between 5% and 10%
-1 = reduction of between 0% and 5%
0 = no change
+1 = increase of between 0% and 5%
+2 = increase of between 5% and 10%
+3 = increase of more than 10%

The Conference Board does not assign a negative score, or a score of "+3", to any industry in any region.[31] The omission of negative scores presumes that BC's economy will not experience net losses in any industry or any region. The scoring of estimated benefits is completely arbitrary; no literature, data, interviews with companies, or lists of alleged barriers are presented.

The regional/industrial scores are then weighted by employment shares to produce the following conclusion:

> *[T]he overall score for B.C. rounds to 0.76, which is a small positive impact. A score of 0.76 does not translate into a full five per cent impact, but 76 per cent of five percent, or an impact of 3.8 per cent on real GDP. Real GDP (at basic prices) in 2004 in B.C. was $127.9 billion; so the total impact of the agreement is estimated to be 3.8 per cent of total GDP, which equals $4.8 billion (p. 38).*[32]

Even on its own terms, this analysis is flawed. A score of "+1" does not equal an increase of 5%, but an increase of *between 0% and 5%*, implying an average increase of around 2.5%.[33] Of course, 76% of 2.5% is 1.9%, which equals $2.4 billion of BC's 2004 GDP. By fudging its own scale, the Conference Board doubles its estimate of TILMA's benefit.

Because the *Impact Assessment* is based on a draft text of TILMA, it projects gains in sectors that are wholly or partly exempt from the final agreement: utilities, energy, mining, forestry and fishing.[34] These industries could conceivably still benefit from lower transport costs, although different trucking regulations may be needed given BC's rougher terrain. To the extent that these regulations should be harmonized, doing so hardly requires a sweeping agreement like TILMA.

Energy, mining, forestry and fishing must constitute most of the Conference Board's "primary" category (p. 36). This category and "utilities" account for 29% of TILMA's projected benefits in Northeast BC and for between 8% and 17% of these benefits in three other regions. Moreover, subtracting these nonexistent benefits for tradable industries reduces the credibility of forecast spin-offs for industries that barely engage in interprovincial trade. According to the report:

At least 60% of TILMA's estimated *province-wide* benefits are based on industries that are exempt from the agreement or that barely engage in interprovincial trade. Factoring out these industries indicates that, even if we accept the study's bizarre methodology, TILMA's projected benefits are less than $1 billion, or significantly below 1% of provincial GDP.

> *The commercial services and wholesale and retail trade industries will benefit from [TILMA]. Increased trade liberalization will result in a more efficient allocation of resources between the two provinces, which in turn should lead to higher real incomes for residents of both provinces due to productivity advancements and lower prices as costs fall. Higher incomes will in turn lead to more spending, benefiting the commercial services and retail sectors (p. 35).*

Indeed, 90% of TILMA's projected benefits for Vancouver Island and more than 50% of these benefits for five other regions arise from "retail/wholesale" and "commercial" (p. 36). Considering these industries alongside the "primary" sector and "utilities" reveals that at least 60% of TILMA's estimated *province-wide* benefits are based on industries that are exempt from the agreement or that barely engage in interprovincial trade.[35] Factoring out these industries indicates that, even if we accept the study's bizarre methodology, TILMA's projected benefits are less than $1 billion, or significantly below 1% of provincial GDP.

Conclusion

Trade agreements have costs as well as benefits. The Conference Board of Canada's *Impact Assessment* vastly overstates TILMA's likely economic benefits. Since interprovincial trade barriers are already very low, the gains from further reducing them would be minute. However, as Gould demonstrates, TILMA's costs could be frighteningly high. By giving investors wide latitude to sue provincial governments over differences in public-interest regulation, this agreement will place downward pressure on provincial standards.

A more sensible approach to internal trade would begin with business organizations compiling publicly-available lists of interprovincial barriers. Citizens could respond by assessing the social, economic and environmental purposes of the alleged barriers. Provincial governments could then co-operate to remove barriers that entail economic costs, but do not serve important policy objectives. Whatever minor barriers to internal trade that do exist should be addressed through a democratic process rather than by the dictates of TILMA tribunals.[36] Through the Council of the Federation, governments are already working to harmonize licensing by professional bodies to enhance labour mobility. Canada needs a transparent, incremental approach focused on particular problems rather than TILMA's sweeping provisions.

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Notes

1 Government of BC 2006.

2 Government of Canada 2006a and 2006b.

3 Gould 2007.

4 Conference Board 2005.

5 Hodgson and Shannon 2007:v.

6 See Lee 2000 for a critique of the AIT and proposed changes to deepen it.

7 Darby et al. 2006.

8 Hodgson and Shannon 2007:v.

9 Ibid.

10 Helliwell 1999:93-95.

11 Helliwell 2002:30.

12 Weir 2005:23-27.

13 By definition, total interprovincial imports equal total interprovincial exports. Statistics Canada 2006:18 (Table 2).

14 Government of Canada 1985:133-134.

15 Cited in Copeland 1998:15.

16 Laidler and Robson 2005:147;165;169.

17 Darby et al. 2006:36. The CMA has since become Canadian Manufacturers & Exporters (CME).

18 Rutley 1991.

19 Copeland 1998:31.

20 Government of BC 2006:21-22. Almost all of the estimated cost of marketing boards arises from *international* barriers as opposed to *interprovincial* barriers. Copeland 1998:20-23.

21 Copeland 1998:23-31.

22 Copeland 1998:4.

23 Trebilcock and Schwanen 1995:3-4.

24 Darby et al. 2006:17.

25 Page references in this section analyze the Conference Board report *An Impact Assessment of the BC/Alberta Trade, Investment and Labour Mobility Agreement*.

26 Enbridge Inc., *2004 Annual Report*.

27 Institut de la statistique du Québec 2006. In 2002, the last year for which data is available, BC exported $8.8 billion of goods and services to Alberta.

28 In 2002, Alberta exported $8.5 billion of goods and services to BC. Therefore, the trade surplus that TILMA could expand was equal to $0.3 billion, or one-sixteenth of the $4.8 billion.

29 The Conference Board used 2004 GDP at basic prices, which is lower than the typical GDP at market prices. GDP at market prices includes taxes less subsidies whereas GDP at basic prices does not.

30 Stanford 2006.

31 The business and government survey asked respondents to rank TILMA on this scale, but did not provide them with the scale's speculated GDP impacts. Conference Board 2005:10;30;36;43.

32 The notion that TILMA will create 78,000 jobs is based on dividing $4.8 billion by BC's average GDP per employee ($62,091).

33 Since the Conference Board assigns "+1" to any industry that might conceivably benefit in any way from TILMA, the true average value of this score is probably less than 2.5% of GDP.

34 Government of BC 2006.

35 Factoring out "primary," "utilities," "retail/wholesale" and "commercial services" reduces the projected benefit scores for Vancouver Island from 0.50 to 0.05, the Lower Mainland from 0.85 to 0.38, Thompson-Okanagan from 0.69 to 0.25, Kootenay from 0.66 to 0.17, Cariboo from 0.71 to 0.25, North Coast from 0.60 to 0.16, and the Northeast from 0.87 to 0.28.

36 Indeed, the Royal Commission on the Economic Union and Development Prospects for Canada proposed a *political* process of formal inter-governmental engagement on economic issues rather than a *judicial* process of tribunals applying financial penalties to governments. Government of Canada 1985:137-140; and Laidler and Robson 2005:141;150.

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