THE GROWING IMPERATIVE FOR INTERNAL FREE TRADE IN CANADA

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Introduction

The upcoming 2024 US presidential election is generating concern in Ottawa and other national capitals about the prospects of further strengthening of protectionist trade and investment policies on the part of the newly elected US administration. This concern is particularly attached to the prospect of the leading Republican candidate, former President Donald Trump, winning the 2024 election. When he was president, he threatened to take the US out of the North American Free Trade Agreement (NAFTA), imposed tariffs on imports of Canadian steel and aluminum products, and promoted himself as "Tariff Man." Trump has threatened to impose a 10 percent across-the-board tariff on manufactured imports if re-elected. In principle, any such tariff imposed on Canada or Mexico would violate the Canada-United States-Mexico Agreement (CUSMA). However, a review of the Agreement is scheduled for 2026, and it is plausible that a second Trump Administration would refuse to extend the US commitment to CUSMA.

While the likely Democratic candidate, current President Joe Biden has been less protectionist than his predecessor, he has been and will likely continue to be a major supporter of US trade unions and environmental interests. His continued presidency would therefore also pose risks to Canadian manufactured and energy exports to the US. Indeed, one of his first acts after taking office was to revoke the permit needed to build the Keystone XL oil pipeline that would have brought Canadian crude oil to the US.

Prime Minister Trudeau recently announced steps his government is taking to prepare for a possible second Trump Administration including a new 'Team Canada engagement strategy' that will work with businesses, unions, civil society organizations, and state and local levels of government in the US to promote Canada's trade interests with government officials and US business and labour leaders (Robson, 2024). This approach was arguably helpful to discourage the Trump Administration's threatened withdrawal from NAFTA. However, an "America First" approach to US international economic and security relations is arguably stronger today than it was during the Trump Administration. Hence, Canadian government officials and policymakers should take additional actions to enhance the contribution of trade liberalization to Canada's overall economic growth. A worthy initiative in this regard is to eliminate barriers to interprovincial trade along with impediments to the inter-provincial mobility of capital and labour.

Canada's Internal Economic Integration

The economic significance of inter-provincial barriers to trade and labour mobility have been identified in a number of studies. Notably, Tombe (2020) reports that trade among provinces and territories in Canada has stagnated at around 18 percent of Gross Domestic Product (GDP) in recent years, which is nearly 10 percentage points below its 27 percent share in 1981. He estimates that interprovincial trade barriers add between eight and 14.5 percent to the prices of goods and services in Canada, which implies direct economic costs of around $32 billion a year. Barriers to trade and labour mobility also contribute to slower productivity growth from foregone economies of scale and scope (among other factors), which roughly doubles the overall cost of those barriers.[1]

Prominent non-tariff internal barriers to trade and labour mobility include dairy quotas, restrictions on the sale of alcoholic beverages to customers in other provinces, sector specific regulations that differ across provinces/territories, particularly vehicle weight and dimension standards, licensing, and other paper work requirements imposed on businesses that operate in multiple provinces/territories, as well as differences in professional and trade licensing and certification requirements, among others.

There are currently a number of inter-governmental agreements that condition inter-provincial trade arrangements. The geographically broadest is the Canadian Free Trade Agreement (CFTA), which was signed by Canadian ministers representing the federal government and all 13 provinces and territories and which came into effect in 2017.[2] A second prominent agreement is the New West Partnership Trade Agreement (NWPTA) which was implemented in 2013. Current members of the NWPTA include British Columbia, Alberta, Saskatchewan, and Manitoba.

All else equal, liberalizing trade across *all* provinces and territories is preferable to liberalizing trade across a subset of provinces and territories. The primary reason is that broader geographical coverage of trade agreements reduces the risk of trade and investment diversion. Trade and investment diversion refers to situations where it would be more economical for specific economic activities to be carried out in Region A in order to serve Region B but are, in fact, carried out in Region C because the latter has a free trade agreement with Region B. Because tariffs or other barriers make goods and services from Region A more expensive in Region B than are goods and services from Region C, exports from Region C are preferred by buyers in Region B over exports from Region A. The result is that the aggregate income of the three regions is lower than it would otherwise be if all three regions were part of the same free trade agreement.

The trade diversion concern suggests that a preferable strategy for creating a more economically-integrated domestic market is to liberalize trade and mobility restrictions currently in the CFTA. In this regard, Manucha and Tombe (2022) recommend "mutual recognition" as perhaps the most significant initiative to improve the CFTA. If implemented it would mean that any item that meets the regulatory requirements of one province or territorial government is deemed to automatically satisfy the requirements of another province or territory. Mutual recognition therefore obliges a host province to accept the standards set out by the province/territory from which the good or service originates.

Some policy analysts argue that it would be preferable to expand the membership of the NWPTA and implement mutual recognition and related liberalization measures in that agreement given shortcomings of the CFTA—including its long list of sector exceptions—most notably encompassing health care, education, and financial services, as well as its burdensome and protracted negotiation process.[3] While the NWPTA aims to liberalize trade among its four provincial signatories to a greater extent than the CFTA does among its members, expanding provincial/territorial membership in the NWPTA could be a difficult process since Quebec, Ontario, and the Atlantic Provinces—currently non-members—have a greater number of exceptions to the CFTA compared to current NWPTA members.[4]

Conclusion

Leveraging the CFTA or the NWPTA to more closely integrate Canada's domestic market are not mutually exclusive options. Difficulties attach to both options given the reluctance of provincial governments to eliminate public provincial monopolies—such as Ontario's LCBO—and lobbying by interest groups to maintain regulations that protect their economic interests. Federal government leadership to encourage provincial government cooperation in liberalizing trade should therefore be a high priority, especially given growing US trade protectionism. ❖