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***Disentanglement, decentralization should be accompanied by enhanced economic union, says C.D. Howe Institute study***

The advantages Canadians derive from common economic citizenship should not be eroded by efforts to disentangle and decentralize overlapping federal and provincial economic jurisdictions, says a *C.D. Howe Institute Commentary* released today.

The study, entitled *Drawing on Our Inner Strength: Canada's Economic Citizenship in an Era of Evolving Federalism*, was written by Daniel Schwanen, a Senior Policy Analyst at the C.D. Howe Institute. He says that the rights of economic citizenship — such as the ability to work in any province and the right not to be discriminated against in competing for business outside one's province of residence — ought to be strengthened in the face of challenges posed by increased regional reliance on north-south trade and pressures for disentanglement and decentralization within the federation. This means reinforcing institutions — in particular, the 1994 Agreement on Internal Trade (AIT) — that underpin Canada's common economic citizenship.

Schwanen notes that the AIT — a unanimous agreement among federal, provincial, and territorial governments — is founded on basic rules of nondiscrimination by governments on the basis of province of residence and harmonization of provincial standards where differences cannot be justified. Unfortunately, however, too many of the AIT's implementation details have been left to future negotiations, sometimes between the very departments whose mandate it is to administer measures not conforming to the AIT in the first place. Moreover, the AIT's effectiveness is hampered by numerous temporary and even permanent exceptions to the rules, the lack of specific deadlines by which obligations must be met, and the need for consensus among all governments before each implementing step is taken.

Schwanen argues that decentralization should be accompanied by increased two-way "vertical" cooperation among the federal and provincial governments in areas such as trade, immigration, and manpower training. Also needed are a strengthening of the "horizontal" obligations of common economic citizenship, such as those contained in the AIT, and well-targeted mechanisms for dealing with spillovers resulting, for example, from the movement of welfare recipients from one province to another. Schwanen also notes that no well-function-

ing economic union exists without some degree of effective common decisionmaking, accompanied by the ability to implement decisions.

Accordingly, Schwanen recommends that a federal cabinet committee be formed to give greater visibility and impetus to current disentanglement and decentralization initiatives within the federation. In addition, a blue-ribbon commission should be set up to report on whether these initiatives are proceeding as thoroughly as possible, and in a way that does not compromise needed policy coordination within the federation.

Schwanen says that the Secretariat set up under the AIT could be given a much greater role in the implementation of the agreement and one more independent of government. In particular, it could assess outstanding issues, monitor and report on obstacles to implementation, propose solutions, and suggest new deadlines where appropriate — for example, on the mutual recognition of occupational standards. In the event of a lack of progress, however, the federal government should be prepared to use its constitutional powers to ensure that undertakings under the AIT are respected.

Schwanen recommends that Canadian governments adopt other policies to enhance common economic citizenship, such as streamlining private sector access to the AIT's dispute settlement mechanism, finding ways to compensate provinces for negative or positive spillovers resulting from labor mobility, and increasing regional representation in federal institutions, in order to increase the real and/or perceived fairness of central government policy.

This publication continues the C.D. Howe Institute's postreferendum research agenda, which comprises two *Commentary* series. The first series, "The Canadian Union Papers," focuses on ways to enhance Canada's political, economic, and social union. The first paper in the series examines some of Ottawa's legal and constitutional options for strengthening the economic union. The second paper presents ways to enhance Canadians' common economic citizenship rights. Other papers will offer analysis and recommendations aimed at improving Canada's political institutions, protecting the social union in a "disentangled" federation, and devolving primary responsibility for language and culture to the provinces.

Complementing this effort is another *Commentary* series called "The Secession Papers," which will examine issues relating to the following areas:

- the terms and conditions of a possible future referendum on Quebec sovereignty;
- the circumstances which the country might confront after a Yes vote, together with the processes by which the secession of Quebec might be addressed;
- the means by which a new Canada without Quebec might be established, should Quebec leave Confederation.

The papers will be guided by the following principles: respect for democratic norms and the rule of law; the necessity for an authoritative decision and a stable outcome; and minimizing the social and economic costs of any transition. In the light of the results of the recent referendum in Quebec, "The Secession Papers" aim to assist Canadians to "think about the unthinkable."

Both series are being published under the supervision of David Cameron, a political scientist at the University of Toronto.

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## ***Le «démêlage» et la décentralisation des politiques doivent être assortis d'une union économique améliorée, soutient une étude de l'Institut C.D. Howe***

Les avantages que les Canadiens retirent d'une citoyenneté économique commune ne doivent pas être érodés par la décentralisation et de «démêlage» des champs de compétence fédéraux et provinciaux, dit un *Commentaire de l'Institut C.D. Howe* publié aujourd'hui.

L'auteur de l'étude, intitulée *Drawing on Our Inner Strength: Canada's Economic Citizenship in an Era of Evolving Federalism* (Compter sur notre force intérieure: la citoyenneté économique canadienne à l'heure de l'évolution du fédéralisme), est Daniel Schwanen, analyste de politique principal à l'Institut C.D. Howe. Il soutient que les droits de la citoyenneté économique — tels ceux de pouvoir travailler dans n'importe quelle province et de ne pas faire face à des pratiques d'affaires discriminatoires hors de sa province de résidence — devraient être renforcés face aux défis posés par un commerce nord-sud plus important et par les pressions pour effectuer un «démêlage» et une décentralisation des responsabilités au sein de la fédération. Ceci veut dire renforcer les institutions qui sous-tendent cette citoyenneté commune, notamment l'Accord sur le commerce intérieur (ACI) de 1994.

M. Schwanen note que l'ACI — un accord unanime entre les gouvernements fédéral, provinciaux et territoriaux — est fondé sur des règles élémentaires de non-discrimination sur la base de la province de résidence, auxquelles doivent adhérer les gouvernements, et sur l'harmonisation des normes lorsque les différences ne peuvent être justifiées. Malheureusement, cependant, trop de détails de mise en oeuvre de l'accord ont été laissés à des négociations ultérieures, parfois entre les ministères mêmes chargés de l'administration des mesures non conformes à l'accord. De plus, l'efficacité de l'ACI est limitée par de nombreuses exceptions temporaires ou même permanentes, par le manque d'échéancier précis dans certains secteurs, et par la nécessité d'atteindre le consensus des parties avant que chaque élément de sa mise en oeuvre soit adopté.

M. Schwanen fait valoir que la décentralisation des responsabilités devrait être accompagnée d'une plus grande coopération «verticale» entre le gouvernement fédéral et les provinces dans des domaines tels le commerce international, l'immigration, et le marché du travail. De plus, il faut renforcer les obligations «horizontales» réciproques de la citoyenneté économique commune, notamment telles que définies dans l'ACI, et entrevoir des mécanismes qui tiendraient compte des «externalités» ou débordements qui résultent, par exemple, des

mouvements de récipiendaires d'aide sociale d'une province vers une autre. M. Schwanen note également qu'aucune union économique ne peut fonctionner sans un degré efficace de mise en commun des décisions, et d'une capacité à mettre ces décisions en application.

Par conséquent, M. Schwanen recommande qu'un comité du cabinet fédéral soit formé afin de donner un plus grand dynamisme et une meilleure visibilité aux initiatives de «démêlage» et de décentralisation présentement en cours. De plus, une commission indépendante devrait être formée pour s'assurer que ces initiatives soient les plus complètes possible, mais en même temps effectuées de telle sorte que la coordination nécessaire des politiques au sein de la fédération ne soit pas compromise.

M. Schwanen explique que l'on pourrait confier au Secrétariat établi par l'ACI un rôle beaucoup plus important et indépendant des divers gouvernements que celui qui lui est présentement dévolu. Plus précisément, celui-ci pourrait évaluer les problèmes en suspens, suivre et faire rapport sur les obstacles à la mise en oeuvre de l'ACI, proposer des solutions et de nouvelles échéances lorsqu'il y a lieu — par exemple pour la reconnaissance mutuelle des qualifications professionnelles ou de métier. En cas d'absence de progrès, toutefois, le gouvernement fédéral devrait être prêt à utiliser ses pouvoirs constitutionnels en matière de commerce intérieur afin de faire respecter l'accord.

M. Schwanen recommande également que les gouvernements canadiens adoptent d'autres moyens d'améliorer l'union économique, tels que celui de faciliter l'accès des agents économiques au mécanisme de règlement des différends de l'ACI, de trouver des moyens de compenser les provinces pour les externalités positives ou négatives qui pourraient résulter de la mobilité de la main-d'oeuvre, et de renforcer la représentation des régions au sein des institutions fédérales, afin d'améliorer la réalité et la perception de l'impartialité des politiques du gouvernement central.

Cette publication s'inscrit à l'ordre du jour des recherches post-référendaires de l'Institut C.D. Howe, qui comprend deux séries de *Commentaires*. La première série, les «cahiers de l'union canadienne», porte sur les moyens d'améliorer l'union politique, économique et sociale du Canada. Le premier document de la série porte sur certains choix d'ordre constitutionnel et juridique dont dispose Ottawa pour améliorer l'union économique. Le deuxième se penche sur la mise en valeur des droits économiques de la citoyenneté. Les autres offriront des recommandations sur l'amélioration des institutions politiques, sur la protection de l'union sociale au sein d'une fédération ayant un minimum de chevauchements et sur la délégation aux provinces des responsabilités afférentes à la langue et à la culture.

Cette série s'assortira d'une autre série de *Commentaires* intitulée « Les cahiers de la sécession », qui reposera sur l'hypothèse que les Québécois voteront pour la séparation. Ces documents se pencheront sur les questions entourant :

- les termes et conditions d'un possible référendum à venir sur la souveraineté du Québec ;
- les circonstances auxquelles le pays fera face après un vote pour le « oui », ainsi que le processus même par lequel la sécession du Québec pourrait être abordée ;
- les procédés selon lesquels un nouveau Canada pourrait se former sans le Québec, si le choix de ce dernier était de quitter la confédération.

Ces documents seront guidés par les principes suivants : le respect des principes démocratiques et la primauté du droit, le besoin d'une décision qui fasse autorité et d'une conclusion stable, et la minimisation des coûts sociaux et économiques de la transition. Étant donné les

résultats du récent référendum québécois, « Les cahiers de la sécession » ont pour but d'aider les Canadiens à « penser à l'impensable » .

Ces deux séries sont dirigées par David Cameron, un politologue de l'Université de Toronto.

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L'Institut C.D. Howe est un organisme indépendant, non-partisan et à but non lucratif, qui joue un rôle prépondérant au Canada en matière de recherche sur la politique économique. Ses membres, individuels et sociétaires, proviennent du milieu des affaires, syndical, agricole, universitaire et professionnel.

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*Drawing on Our Inner Strength: Canada's Economic Citizenship in an Era of Evolving Federalism* (Compter sur notre force intérieure: la citoyenneté économique canadienne à l'heure de l'évolution du fédéralisme), Commentaire n° 82 de l'Institut C.D. Howe, par Daniel Schwanen, Institut C.D. Howe, juin 1996, 20 p., 6,00 \$ (les commandes sont payables d'avance, et doivent comprendre les frais de manutention et d'envoi, ainsi que la TPS — prière de communiquer avec l'Institut à cet effet). ISBN 0-88806-397-0.

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# **Drawing on Our Inner Strength: Canada's Economic Citizenship in an Era of Evolving Federalism**

by

*Daniel Schwanen*

Canadians' common economic citizenship is central to the economic well-being and social mobility of individuals and to the competitiveness of firms within the economic union. Yet the configuration of the union is facing challenges posed by greater north-south trade and the trend toward disentanglement and decentralization of responsibilities. To respond to these challenges, ways need to be found to improve institutions underpinning the economic union — in particular, the recent Agreement on Internal Trade (AIT).

The AIT is a unanimous agreement among the federal and provincial governments to eliminate discrimination on the basis of province of residence in various provincial and federal practices, and to harmonize standards where differences cannot be justified using

objective criteria. The Internal Trade Secretariat set up under the AIT should be empowered to analyze obstacles to the implementation of the agreement and to recommend solutions and deadlines to remove them. Canadian governments should then be required to vote on these recommendations using a qualified majority system rather than the consensus rule now in place.

As well, current efforts toward disentanglement and decentralization should be given greater impetus. But this must be accompanied by efforts toward greater policy cooperation between the various levels of government. Other ways to strengthen the economic union include addressing spillovers that result from high labor mobility and more effective regional representation in federal institutions.

## *Main Findings of the Commentary*

- One of the benefits of Canadian citizenship is “common economic citizenship” in the Canadian economic union, which offers individuals a wide range of opportunities for earning a livelihood, and firms more opportunities to be competitive, than would be the case if the regions of Canada operated as separate economic units.
- In addition to the existing constitutional underpinnings of the economic union, the 1994 Agreement on Internal Trade (AIT), signed by the federal, provincial, and territorial governments, took further steps toward strengthening Canadians’ common economic citizenship, including forbidding federal or provincial practices that discriminate against persons or products based on their origin within Canada and committing governments to push for greater harmonization of standards.
- The AIT’s implementation process, however, leaves much to be desired, since many details have been left to future negotiations with few specific deadlines, and governments have to agree unanimously before any specific implementing step can be taken.
- Increased north-south trade has, for the most part, not undermined the value of Canadians’ common economic citizenship; indeed, pressures toward decentralization of responsibilities within the federation call for improved cooperation in areas where the policies of each government affect the union as a whole, and for more effective institutions to safeguard common economic citizenship.
- A blue-ribbon commission should be set up to report on whether decentralizing and disentanglement initiatives are proceeding as thoroughly as possible, but in such a way that they do not compromise needed policy coordination within the federation.
- The AIT should be reinforced by giving its Internal Trade Secretariat — as opposed to governments — the mandate to evaluate independently reasons for missed negotiating deadlines, to assess outstanding implementation issues, to monitor and report on obstacles to its implementation, to propose solutions, and to suggest new deadlines where appropriate — for example, with respect to the harmonization of occupational standards.
- Governments should have to vote formally on these proposals. Considering they have already agreed to the principles of liberalization, a qualified majority of provincial votes should be sufficient to adopt specific measures proposed by the Secretariat.
- Other policies to strengthen the economic union should also be adopted, such as finding targeted ways to compensate provinces for negative or positive spillovers resulting from mobility — such as having the province of origin pay the cost of welfare recipients moving to another province — and more effective regional representation in federal institutions in order to increase the real and/or perceived fairness of those institutions.

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**T**his Commentary focuses on the means available to preserve and enhance the Canadian economic union in the context of evolving federalism. In particular, it looks at the extent to which the underpinnings of this citizenship are being modified by the globalization of trade and the trend toward the decentralization of power and the disentanglement of responsibilities between Ottawa and the provinces. It explores how policies and institutions affecting the Canadian economic union can respond effectively to these changes.

These trends, which are beneficial in themselves, do not obviate the advantages of a well-functioning internal economic union. Instead, they point to the need for better management of the common economic union — one which combines added flexibility and representativeness in decisionmaking institutions with improved policy coordination between levels of government and a greater commitment to build on the guarantees already underpinning Canada's common economic citizenship.

In the first section, I summarize the importance for Canadians of citizenship in a common economic union and review some key institutions underpinning the functioning of this union. In the second section, I address the challenges that current external and internal trends pose to the way Canadians manage their economic union. In the third section, I propose some basic operational principles to deal with these challenges. Specific policy recommendations follow in the final section.

## **The Underpinnings of Canada's Economic Union**

### *The Role of Economic Citizenship in the Lives of Canadians*

All Canadians possess rights of citizenship which, by definition, they can only exercise in Canada. The existing degree of political association among the provinces makes these multidimensional rights quite extensive.

One dimension of these rights is economic, so that we can speak of all Canadians' holding

common economic citizenship. This aspect of citizenship is an important source of economic well-being and social mobility, because it affords individuals greater possibilities for earning a livelihood and firms more opportunities to become competitive than would be the case if each region of Canada were a separate economic entity (see Box 1).

The potential benefits of common economic citizenship for Canadians living in various regions include the following:

- Access to a sizable market and to factors of production (for example, specialized skills) over and above those provided by markets outside the union. This enhances the competitiveness of firms within the union and increases incomes for individuals.
- Economies of scale — hence savings for taxpayers — in performing certain administrative functions, such as representation abroad, policing, or monitoring activities of common interest.
- Insurance against instability. In a regionally diversified economy, when one region benefits from, say, higher resource prices but another is hurt, the blow to the losing region may be cushioned by transfers to it. The reverse is true in the event of a decline in resource prices or demand. The advantages of this are akin to those of holding a diversified investment portfolio.<sup>1</sup> For the same reason, separate currencies for Canada's regions would likely be more volatile than a common currency. The mobility of labor can also be seen as partial insurance for both people and firms against the adverse effects of structural changes in the economy.
- Better protection of interests and increased leverage on international issues — for example, in trade or environmental negotiations. This naturally occurs when different regions have a common interest, but economic union means that the weight of the union as a whole is sometimes brought to bear in the interest of one of its parts in international forums.

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**Box 1: *Economic Opportunities and Citizenship Rights***

The economic dimension of Canadian citizenship means that a student from Quebec can be employed for the summer in a national park in Alberta, a banker from Alberta can gain experience in the Toronto head office of a financial institution of global size, or an Ontario retiree can move to British Columbia and pursue other interests while receiving his pension, all without having to obtain permission from a government or give up other rights attached to citizenship. Indeed, every year, hundreds of thousands of Canadians exercise their right to pursue their livelihood or new interests in a different part of the country.

For firms, common economic citizenship means relatively unhindered access to Canada's diverse human, physical, and financial resources, and the ability to build on success from a home base without having to set up separate subsidiaries. The Canadian economic union is especially important for small and medium-sized enterprises, since it allows them to grow within a relatively large market without having to worry about the intricacies of a foreign legal system, possible protectionist actions under "trade remedy" laws, the need to document the origin of their products, or the difficulties of enforcing judgments against foreign debtors.

### *The Nature of Economic Citizenship*

The benefits of Canadian economic citizenship flow from the ability of individuals and businesses to interact across the country in a relatively unhindered fashion, rather than being forced to confine their horizons to any particular region or rely on more uncertain external markets for growth. These benefits also depend on the willingness of different levels of government to cooperate in facilitating these interactions. This fact has a number of implications with respect to how Canadians should assess their economic union.

First, because many of the advantages of the union for individual Canadians and regions stem from the mobility of people, investments, and ideas and from the ability to spread costs or insure against risk, they can be understood only incompletely if one looks only at the actual amount of trade conducted among the provinces. The volume of interprovincial trade is important, as we will see in the next section, but a better indicator of the benefits of economic union is the relative ease with which trade can be conducted among the provinces, compared with the often much closer and bigger markets to the south.<sup>2</sup>

Second, for the same reasons, the benefits flowing from economic citizenship cannot be

measured by whether a particular province registers a fiscal "surplus" or "deficit" within the federation over a particular period. However, fiscal transfers that permanently redistribute income from one region to the next ought to be justifiable as improving the functioning of the economic union as a whole, and identified as such.

Third, to be able to generate these gains, an effective economic union requires some common authority and/or effective agreements regarding the behavior of governments to ensure that beneficial exchanges can take place and that they apply across the union. This requirement is fundamentally different from the rationale for, say, common social standards. This is because common economic citizenship cannot exist unless firms and individuals are able to transact business or operate across the country, whereas the gains from social policy do not, by and large, involve such interprovincial transactions. Common rules and standards across the country, therefore, are not essential to the conduct of effective social policy in each province in the way they are a necessary underpinning of common economic citizenship.

Fourth, notwithstanding the above, social standards and the benefits of economic citizenship interact. Close economic interaction, particularly if it permits the mobility of people,

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may affect the ability of each province to set its own social standards. Conversely, large differences in social standards can hinder useful interprovincial mobility; it can also generate mobility that is not justified on the basis of available economic opportunities.

These basic implications of common economic citizenship will inform the rest of this analysis of the challenges faced by the Canadian economic union and the basic operational principles that must be put into practice to meet these challenges.

### *Canadian Regions and Common Economic Citizenship*

Despite the need for common rules for trade within the economic union, common economic citizenship should not mean forced uniformity of standards and policies. This is especially true in Canada, where each province faces societal and economic conditions and challenges that are sometimes vastly different from its neighbors'. In this context, creating uniform standards for the sake of easier mobility could just as easily be detrimental to the welfare of Canadians as beneficial. As Trebilcock and Behboodi put it, forced harmonization in areas where the "virtues of more decentralized political arrangements...such as...fuller accomplishment of citizen preferences,...greater accountability of political representation,...and greater room for policy experimentation and innovation" are being denied can in fact lead to a reduction in well-being.<sup>3</sup> This is because the terms of such an economic union would not allow public services tailored to the needs of its members and adequately subject to taxpayers' control. Nor would services be delivered in a way that was flexible enough to be modified to take account of evolving regional or provincial supply and demand realities.

In fact, optimal economic gains from an economic union can occur only if such differences are allowed to attain their full expression and if the gains from free exchange are then allowed to take place as a result. The challenge for Canada is to meet the obligations of com-

mon citizenship without stifling differences based on needs and circumstances.

To achieve this balance, the common institutions of the economic union, while effectively securing the removal of barriers to productive exchanges, must also refrain from imposing uniformity where this would actually run counter to identifiable regional or provincial needs. I aim later to turn this general rule into more specific recommendations. For now, it is useful to review very briefly the institutions currently underpinning Canadian economic citizenship, with added emphasis on the newest and probably least well known of these — the Agreement on Internal Trade.

### *Institutions of the Canadian Economic Union*

#### The Constitution and Federal Powers

Two sections of the *Constitution Act, 1867* attempt to reduce trade barriers. Section 121 states:

All Articles of the Growth, Produce, or Manufacture of any one of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces.

Despite its sweeping tone, this section has proven of limited use, partly because it does not deal effectively with restrictions other than tariffs and similar barriers.

Section 91 extends the exclusive legislative authority of Parliament to the regulation of trade and commerce and the currency, two key sectors among other federal powers related to the Canadian economic union. The fact that these powers are vested in a common authority is crucial to understanding why the degree of access to opportunities Canadians currently enjoy within their own country is, in most cases, superior to the access that separate countries, even within the European Union, grant each other's citizens. Canada's common currency and clearing system, competition policy, and standards in federally regulated

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industries — all tools which facilitate exchanges among Canadians — flow from these powers.

The courts, however, have not interpreted section 91 as extending federal jurisdiction to the regulation of trade within a province, even when a province's internal policies have a deleterious effect on out-of-province firms or on individuals who wish to conduct business in the province.

Article 6 of the Charter of Rights and Freedoms, entrenched as a constitutional amendment in 1982, guarantees mobility rights for individuals. While this has allowed the courts to strike down egregious limitations on individuals employed in one province from practicing their trade in another,<sup>4</sup> it does not preclude obstacles arising from differences in required qualifications *per se*.

Thus, the Constitution, while ensuring basic mobility rights among provinces, leaves a number of unnecessary obstacles to economic mobility within Canada. These include discriminatory practices in awarding public sector procurement contracts and different standards for professionals or qualified labor not justified by local circumstances. Several factors, however — including the work of the Macdonald Commission in the early 1980s, an increase in scholarly and business interest in the issue of internal trade barriers, and a number of agreements in the late 1980s and early 1990s to remove barriers in certain regions or sectors — led Canadian governments to embark on comprehensive negotiations in 1993, which culminated in the 1994 Agreement on Internal Trade (AIT).

## The Agreement on Internal Trade

The AIT was signed by the federal, provincial, and territorial governments in July 1994 and began to be implemented a year later.

It is important to note that the AIT does not supersede any of the constitutional guarantees or federal powers respecting the economic union. Rather, it is an attempt to address undue barriers to trade and mobility resulting from both provincial and federal practices in a

wide range of sectors (see Box 2). The agreement's general rules require that governments not discriminate against people, goods, services, or investments on the basis of their origin within Canada, nor hinder rights of entry into or exit from individual provincial markets. A government measure can deviate from these general rules if its purpose is to achieve one of a limited number of permissible "legitimate objectives," but in so doing it must be no more trade restrictive than necessary and must not create a disguised restriction on trade. As well, the general rules commit governments to reconcile regulatory and standards-related measures and to sustain transparency with respect to their policies and practices affecting other Canadians.

The AIT in its general rules provides a good balance between acknowledging the full rights of governments to take measures to achieve legitimate objectives in their spheres of authority and ensuring that these measures do not constitute unnecessary obstacles to trade across internal Canadian borders.

It also contains some interesting institutional innovations, such as a dispute settlement mechanism to which — unlike most such mechanisms in international trade agreements — firms and individuals have some access, albeit through a convoluted process involving the complainant's provincial government and/or an independent screener.

Although the AIT made some headway toward removing existing barriers in a number of sectors, in virtually all cases favorable judgments about the liberalizing effects of the agreement must be qualified. This is not because the principles on which the agreement is based are unsound. Rather, too many details of its implementation are left to future negotiations to be conducted by government officials responsible for the particular sectors to be liberalized — some without specific deadlines — and to a rule of unanimity among participating governments on all decisions. As well, the AIT leaves out certain sectors, such as financial services, altogether.

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**Box 2: Examples of Commitments by Canadian Governments under the AIT**

*Public sector procurement:* Governments have pledged not to engage in discriminatory practices among Canadian suppliers, such as imposing conditions based on a supplier's place of business, biasing technical specifications in favor of local firms, or using preferential margins to favor particular suppliers. Specific procedures are to be followed to increase transparency in the awarding of contracts, and there are provisions for a bid protest procedure. These rules will apply to goods, most services, and construction contracts over a threshold amount, but not to certain publicly owned entities that are not accountable to the executive branches listed in the AIT. However, the provisions will eventually be extended to municipalities, academic institutions, and hospitals.

*Labor mobility:* The AIT eliminates residency and other discriminatory requirements for working in a province. The agreement spells out a detailed plan, but without a firm deadline, for the mutual recognition of occupational qualifications and the reconciliation of differences in occupational standards.

*Alcoholic beverages:* Governments have undertaken to eliminate discriminatory and other administrative obstacles with respect to the listing, pricing, sale, and distribution of alcoholic beverages, although change will be slow because prov-

inces can maintain a number of nonconforming measures (listed in the agreement) for at least a few years.

*Road transportation:* Governments have agreed to maintain uniform rules regarding the size and weight of commercial motor vehicles, fully implement the National Safety Code, establish a uniform national bill of lading, create a harmonized mechanism for the collection of taxes and fees, and harmonize or mutually recognize a number of other measures related to road transportation by January 1, 1998.

*Regional development programs:* The AIT restricts governments' ability to use regional development programs as an excuse for denying access to their markets to other Canadians, and institutes reporting requirements regarding the operation of these programs. It contains a code of conduct on incentives, aimed at limiting the use of subsidies in one region that are clearly harmful to another.

*Investment:* Governments have agreed not to use local content, sourcing, or purchasing requirements in their decisions to permit investment, except for regional development purposes in exceptional cases. They have also agreed to reconcile their corporate reporting and registration requirements.

Given their limitations, it is proper to ask whether, in their current form, these institutions can best ensure the economic citizenship rights of Canadians, especially in light of the challenges changing external and internal circumstances pose to the economic union. The next section examines these challenges in greater detail.

## **Challenges to the Canadian Economic Union**

The latest pressures for change on a virtually universal range of policies and arrangements within the Canadian federation fall into two major categories, as described by Courchene.<sup>5</sup> The first is globalization, the most immediately

visible impact of which has been a large increase in Canada's external trade relative to the size of its economy. The second consists of fiscal pressures, which are compelling a re-examination of the degree and manner of government intervention in the economy.

Partly as a result of these two relatively new trends, some long-standing issues — in particular, pressures on the federal government to retreat from provincial spheres of jurisdiction and pressures for political reforms — have taken on a new impetus, and their impact on the economic union must also be analyzed in this new light.

A particular policy or institutional configuration that makes sense under one set of circumstances may not be reasonable under

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another. Flexibility, therefore, is of prime importance in the long-term arrangements of the economic union. I do not explore this dimension here, however; suffice it to say that Courchene has shown overwhelming evidence that such flexibility can be found within the Canadian federal system. Rather, I prefer to explore how this flexibility can be used to enhance Canadian economic citizenship so as to achieve the best outcome for all Canadians.

In order to do this, I attempt to define below the extent to which changes in trade flows between Canada and the outside world and pressures to disentangle and decentralize various policy areas should inform Canadians' view of what constitutes a well-functioning economic union.

### *International Integration*

Over the past 15 years, total trade between the provinces and the rest of the world has increased much faster than trade within Canada. Exports of goods and services to foreigners rose from the equivalent of 27 percent of gross domestic product (GDP) in 1981 to 33 percent of GDP in 1994. Much of this increase is accounted for by increased north-south trade, particularly following the 1989 implementation of the Canada-US Free Trade Agreement (FTA) and the recent sharp increase in Canadian cost competitiveness vis-à-vis the United States. Meanwhile, internal trade fell, in relative terms, from the equivalent of 28 percent of GDP in 1981 to 21 percent in 1994.

What does this trend mean in terms of the importance of maintaining a common economic union? Is the economic future of Canadian provinces now so dependent on their links with corresponding economic regions in the United States that this future does not depend on — and may even be hindered by — the fostering of strong east-west economic links, as some analysts have suggested?<sup>6</sup>

Instead, I believe the evidence shows that strong internal economic links remain vital to Canadian industry and to Canadians' own personal economic prospects, and that these

links should be strengthened. Consider, for example, that, even though the importance of Canada's external trade has increased lately relative to internal trade, internal trade as a percent of GDP remains more important in Canada than it is in the European Union (see Table 1), despite the considerably greater distances between the provincial markets here than between the national markets there.

The results of this comparison are clearly due to the fact that most European economies are considerably larger than most Canadian provincial ones and hence more self-contained; that is, most European exchanges occur within the borders of the respective EU countries. While perhaps obvious, this observation is not trivial: if the relatively larger EU countries felt that strengthening their economic links through the institution of common economic citizenship was vital to their interests, this should apply all the more to trade among relatively smaller units such as Canadian provinces.

The difference is, of course, that Canadian provinces are also much more open to foreign trade than are European countries. To the extent that their openness to and reliance on foreign markets is greater, they have a correspondingly greater need for policy to take into account their competitive position vis-à-vis foreign markets. This may require some policy differentiation on a provincial or regional basis regarding, for example, sales taxes or labor market training in particular trade-related industries. But there is no reason this kind of differentiation should be incompatible with a more open internal Canadian market.

If foreign markets were completely open, the economic benefits of reinforcing the Canadian economic union would be diminished. In reality, however, foreign and Canadian markets are not perfectly substitutable. Canadian exporters continue to face far more constraints in the US market than they do at home, particularly in the areas of services and government procurement, and continue to face harassment from protectionist lobbies in some important manufacturing sectors such as steel. The need for proof of origin in order to ship

**Table 1: Exports within and outside the European and Canadian Economic Unions, 1994**

	<b>EU Members</b>	<b>Canadian Provinces</b>
	(percent of GDP)	
	Exports within the Union	
Goods	13.5	12.2
Services <sup>a</sup>	3.8	8.6
Total	17.3	20.8
	Exports outside the Union	
Goods	8.3	29.3
Services <sup>a</sup>	2.3	4.0
Total	10.6	33.3

<sup>a</sup> Total services exports of 15 EU member countries represent 6.1 percent of GDP. The breakdown of intra-EU and outside EU exports is the author's estimate, but probably overstates intra-EU trade.

Sources: Statistics Canada, *Provincial Economic Accounts CANSIM* on CD-ROM, 1996-1; International Monetary Fund, *Direction of Trade Statistics Yearbook* (Washington, DC: IMF, 1995); idem, *Balance of Payments Statistics Yearbook* (Washington, DC: IMF, 1995); *Organisation for Economic Co-operation and Development, Main Economic Indicators* (Paris: OECD, Statistics Directorate, March 1996); *United States, Department of Commerce, Bureau of Economic Analysis, Survey of Current Business*, various issues.

goods duty free to other members of the North American Free Trade Agreement and the pitfalls of the US legal system<sup>7</sup> are further examples of external trade hassles that make the much smoother east-west links vital for Canadian firms, particularly small and medium-sized ones, and for the self-employed.

Furthermore, the relative export figures must be interpreted with caution, because two-way trade figures between Canada and the United States can inflate the value-added implications of this trade for Canadian employment and income. Thus, \$10 million in automobile exports to the United States might represent far less value added in Canada — hence fewer jobs and less income — than the equivalent amount of interprovincial trade in

financial services because there is a significant import component to auto exports.<sup>8</sup>

Finally, the movement of certain factors of production, notably qualified labor and capital, is greatly facilitated by opportunities for mobility between Canadian provinces.<sup>9</sup> For example, between 1985 and 1995, 520,000 Canadians left British Columbia for other provinces, while 400,000 went to Quebec from other provinces. These gross population movement figures — on a net basis, British Columbia actually gained 280,000 people from other provinces and Quebec lost 95,000 over the period — show the extent to which individual Canadians and businesses alike rely on a high degree of personal mobility across the country. To a certain extent, this movement of people substitutes for trade between the provinces.

All in all, while the trend points to a greater integration of provincial economies into north-south regions, in many sectors Canadian firms still depend to a large extent on a domestic base for markets and factors of production, which, in turn, depend on the continued maintenance of a strong internal economic union — indeed, on the strengthening of this union where this is not incompatible with regional interests.

### *Disentanglement and Decentralization of Policies*

The benefits of disentangling and decentralizing economic and social responsibilities between the central government and the provinces have been well explored.<sup>10</sup> They include bringing control closer to the citizen, accommodating diversity, increasing political correspondence between beneficiaries and payees, eliminating overlap and duplication, increasing sources of innovation for the union as a whole in terms of policies or delivery techniques, and generally dealing with problems through the most appropriate and cost-efficient means. An important theme in the literature on this topic is that certain things are better left to the market — that is, that they do not require public intervention, or require

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less public intervention than they currently receive.

Certainly, various principles and criteria have been proposed by which the disentanglement of policy instruments — the choice of which level of government does what — could be effected, the most prominent being that of “subsidiarity.” As implemented in Europe, this means, in essence, that the European Union should do only those things that cannot be done as effectively at the national or regional level.<sup>11</sup> Yet one principle alone cannot determine the “appropriate” degree of economic integration within an economic union or indeed among any number of regions or countries. The appropriate degree is inevitably a product of external circumstances and of the extent to which members share political, social, legal, and other traditions and objectives. After all, if access to a sizable market and economies of scale were the only consideration, a logical starting point for Canadian provinces might be to seek to join the United States.

The question is whether association with other provinces rather than with US states provides superior representation for a province’s interests. The answer lies in the degree to which noneconomic characteristics and objectives are shared or are complementary, which then makes sensible the removal of internal barriers to greater integration.

Indeed, in practice, the existence of an economic union need not imply that different regions of the union will all trade heavily with each other. This has prompted Krugman to observe that, in economic terms, “countries are defined by their restrictions”<sup>12</sup> — those that apply vis-à-vis the outside world and are not applied within the country itself or vice-versa (as in the case of taxes) — rather than by the size of their internal trade.

Thus, at the limit, applying the ultimate level of disentanglement — *chacun chez soi* — could be very counterproductive in terms of lost opportunities, and one must not confuse greater north-south orientation and decen-

tralization with a diminished need to coordinate policies within the economic union.

## **Meeting the Challenges: Operational Principles**

The economic union is, then, still an important source of economic well-being and competitiveness for Canadians. This means that, in the current context, just as too much “entanglement” of responsibilities reduces the benefits of the association, a badly handled “disentanglement” could have serious costs. The “deep integration” of policies, which is becoming increasingly evident internationally as a by-product of more open markets for products and factors of production, applies a fortiori in a closely integrated economic union, and must be taken into account. The effectiveness of a central government’s trade and monetary policies, for example, cannot be dissociated from the training policies, purchasing policies, or overall fiscal stance of other levels of government. Thus, decentralization must mean increased efforts at “vertical” cooperation on policies, so that each level of government can more effectively discharge its responsibilities vis-à-vis not only its constituents but the union as a whole.

## *Obligations of Economic Citizenship*

As well, in a union from which members expect a combination of economic and social benefits, each member should behave in a way that does not negate these benefits for other members or their citizens. Thus, just as the autonomy of one level of government may be limited in a “vertical” sense by the need to secure cooperation in certain areas with another level, in practice the exercise of state or provincial powers ought, in some areas, to be subject to “horizontal” obligations of economic citizenship vis-à-vis other members of the association. These obligations can be divided into four types.

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## Mobility, Nondiscrimination, and Transparent Treatment

The first type of obligation refers to rights to mobility, nondiscrimination, and transparent treatment. These rights protect the ability of citizens, firms, services, products, and investments originating in one area to do business in or move to another area and be treated there in a transparent way and on par with their local counterparts. These rights do not affect the ability of governments to legislate specific standards within their jurisdiction, but only require that citizens of the union be treated equally with respect to local policies and standards wherever they go. Thus, they are a basic right of economic citizenship, and not an infringement on the ability of jurisdictions to be responsive to local needs. As such, they should be generally applicable. Most economic unions — indeed, in certain specific areas, free trade agreements as well — require that persons and firms within the union have these rights of “national treatment.”

## Harmonization of Standards and Policies, Where Possible

Another obligation of economic citizenship is to harmonize standards and economic policies throughout the union. Obstacles to mobility — due, for example, to differences in standards on food labeling, certification, or emission standards — should be effectively limited to those that are demonstrably necessary to satisfy local demands for different levels of protection or different competitive circumstances. In the absence of any such demonstrated need, obstacles should be regarded as merely protectionist and thus contrary to the spirit and obligations of the economic union.

## Dealing with Externalities

A third type of obligation of economic citizenship is to put in place effective mechanisms to prevent or compensate for externalities. These

externalities can be negative, as when policies in one region are implemented without regard for the costs they impose on another, or positive, as when expenditures end up benefiting a province other than the one incurring the expenditure. As I have indicated, these effects are potentially important in a union that is economically well integrated, yet in which public standards or expenditure levels with respect to, say, social policy or education can differ considerably from one part of the union to another.

For example, a reduction in public services in one province may impose costs on another if people move to the other province simply to continue receiving a government service. It is also possible that one province will, out of its own resources, provide a public service that benefits other provinces. Examples include the movement of an educated workforce from one province to another or the provision of health care for visitors from another province. If the province is not compensated in some form, it may stop providing a valuable service.

These issues can be dealt with in various ways. One is to use federal law to obligate each province to deliver a certain level of public services. Another way is to use the federal spending power. But these federal instruments can be too blunt — ultimately reducing public welfare by infringing on the right of provinces to deliver services tailored to the specific needs of their residents — and risk introducing regionally differentiated expenditures which actually prevent economically and socially useful mobility.

Another, more targeted way would be to “internalize” these costs through the use of interprovincial compensating mechanisms. If a province bears the cost of the negative spillovers it creates but reaps the benefits of the positive ones, then the externality problem — sometimes thought of as a “race to the bottom” or the “underprovision” of public services in certain regions — would be reduced without the need to resort to federal standards or spending.

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## Redistribution

The fourth type of obligation of economic citizenship generally involves some central redistributive mechanisms. Most often, these are meant to insure against the risk of economic downturns, or when temporary or permanent structural transfers are required to help maintain services or population in areas that might otherwise experience severe poverty or outmigration or even leave the union, to the detriment of the well-being of all.

In Canada, this obligation is recognized in the equalization program. To maintain a workable economic union, one in which all members subscribe to certain reciprocal obligations, it is necessary to correct for the fact that some provinces' tax bases allow them to mount social programs which others cannot afford, a capacity they would share if these programs (and the revenues to pay for them) were national in scope.<sup>13</sup> It makes sense to share some of this capacity to finance basic public programs (in the same way, for example, that police in rural Ontario and schools in rural Alberta are financed by economic activity in these provinces' metropolitan areas).

In other respects, Canadians may care more about whether a particular province reforms its health care or education system or cuts its welfare rates than about how a US state would deal with similar issues. But these pure "caring" aspects can lead to counterproductive intervention on the presumption that the interests of some are the interests of all. For example, some national programs, such as unemployment insurance and the Canada Health and Social Transfer, contain regionally redistributive elements as well, in that different rules for the receipt of these transfers apply to different regions, but the redistributive components of these programs may actually undermine their purpose.<sup>14</sup>

## *Institutional Considerations*

These four principles suggest that, as government responsibility for policies affecting Cana-

dians' economic well-being become more diffuse, there needs to be greater cooperation and a stronger subscription to a range of reciprocal obligations on the part of all members of the economic union. What kinds of institutional mechanisms could bring this about?

In principle, there is a wide range of such tools, including the courts, if governments are prepared to bind themselves legally to an arrangement; tools under the control of either Ottawa or the provinces; or perhaps "federalized" institutions comprising the two levels of government or even the provinces alone. Such federalized institutions would be most useful in areas that call for common decisionmaking or for policy coordination and consultation between the constituent parties, but that are not necessarily required to be under the authority of a central government. (One example of such an institution is the Council of the European Union, which, for all intents and purposes, is made up of member states' governments, and is not effectively controlled by the European Parliament.)

In turn, these tools can exhibit various degrees of coerciveness, according to whether they are constitutional obligations binding on all governments, legislative or regulatory instruments, binding or nonbinding intergovernmental agreements to harmonize, compensate, cooperate, or consult. Some obligations might also apply only to some of the members — for example, in cases where some might want to institute common administrative practices in certain areas, while others pursue a different route (the asymmetry implied in the concept of a "two-speed" Europe).

All economic unions exhibit a mixture of such mechanisms, and the international differences in the mix are instructive.<sup>15</sup> Inevitably, however, some degree of effective decision-making, followed by the ability to enforce these decisions, is required. In no economic union is consensus required under all circumstances, and in none can governments, organizations, or individuals disregard the obligations of common economic citizenship without other

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members' being able to seek a correction of the situation.

In some countries, notably the United States, the central government is the ultimate arbiter of what constitutes a policy not in accordance with the terms of common economic citizenship. This may not be realistic in Canada's case, however. First, there are objective reasons related to the sometimes disparate economic interests across the country. Second, to the extent that some regions perceive that common decisionmaking institutions do not adequately represent their interests, they tend to view centralizing initiatives — even those that could, in principle, be better conducted from the center — with suspicion. The danger is that this perception could lead to less effective federal economic policies. If current discussions on the shape of Canada's political institutions resulted in a sense that regional interests were better represented in the economic union, the union would work more effectively.

The overall conclusion to this section of the paper, then, is that, if the reduced costs that would come from disentangling federal and provincial responsibilities for economic and social policy could be combined with the maintenance or increase of benefits provided by better management of vertical and horizontal policy interactions, Canadians will have made the best of the tradeoffs inherent in an economic union among decentralized parts.

### **Choosing the Right Policies and Tools**

Canadian governments should commit themselves to building a common economic citizenship that complements the advantages of both increased international trade and the decentralization of policymaking — that is, that helps Canadians benefit from these trends. Following from the analysis above, I suggest that this goal can be achieved through:

- enhanced “vertical” policy cooperation among levels of government as a response to more diffuse decisionmaking;

- clarifying and strengthening the “horizontal” rules of economic citizenship, including nondiscrimination on the basis of provincial origin and the elimination of unnecessary obstacles to trade and mobility;
- greater attention to the potential effects of negative and positive policy spillovers in an era of lessening federal involvement, particularly with respect to social policy; and
- strengthening the common institutions that manage the economic union.

In my view, the recommendations that follow, which are listed by these objectives but meant to be taken as a whole, would foster such an outcome.

### *Enhance Vertical Policy Cooperation*

A number of welcome disentanglement and decentralization initiatives are currently at work in the Canadian federation. In 1993, the federal government and nine premiers launched an “Efficiency of the Federation” initiative aimed at eliminating overlap and duplication in the provision of certain services between the two levels of government. The recent Environmental Management Framework Agreement, also involving the federal government and nine provinces, adopted the same principles.<sup>16</sup>

These initiatives are hampered somewhat by their relative obscurity, which deprives them of potential public support, and by the refusal of the Quebec government to participate in them, even though they eliminate overlap and duplication and limit federal involvement to areas of common interest to all Canadians. Nevertheless, such initiatives should be explored systematically in other broad portfolios — particularly natural resources, culture, tourism, sports and recreation, housing, and labor market policies — which have long been candidates for decentralization.

As a rule, however, broad areas should not be devolved wholesale without ensuring that

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decisionmaking in areas of common interest remain with the federal government, where there are no a priori expectations of benefits from greater regional flexibility or where significant economies of scale would be lost. In forestry, for example, greater provincial control over most aspects of the timber industry should not preclude nationally mandated standards for paper and wood products to make them easier to sell internationally. With respect to culture, the federal government would naturally be entrusted with the promotion of “Canada,” but other cultural involvement should be left to the provinces. And while the provinces may be the most efficient overseers of programs related to, say, sports and recreation, few Canadians would wish this to mean the end of a national Olympic program. And in the area of labor policy, the overall needs of the union must be reflected in providing information on pan-Canadian employment opportunities or maintaining the existing national industry sector councils.

Furthermore, while disentanglement and decentralization along these lines should result in savings for the public purse and better targeted policies, there is a risk that potential synergies favorable to the development of coherent national policies will be lost. As a case in point, if most aspects of labor training were devolved to the provinces, while immigration policy required an improved focus on skills requirements, then just maintaining the current degree of coherence in Canada’s immigration policy would require greater provincial involvement in its formulation even as the federal government retains ultimate responsibility.

Indeed, issues of greater federal-provincial policy coordination can probably be dealt with in the same way external trade policy is now being conducted — with increasing provincial input through fairly formal mechanisms, but with the federal government firmly at the helm in steering national policy.<sup>17</sup>

This proposal is a two-way street. With the provinces taking or regaining greater control over a wide range of previously shared policy areas, it will be important that they interact

with the federal government and each other to increase these policies’ compatibility with national goals (for example, with respect to taxation issues).

To give the various disentanglement initiatives a higher profile and a steadier impetus and to explore the need for coordination mechanisms, I recommend that — in addition to existing federal, provincial, or joint initiatives — a cabinet committee on decentralization composed of the federal ministers of Intergovernmental Affairs, Industry, Finance, and Human Resources be formed with a mandate to launch a more complete program than has so far been the case. As well, a blue-ribbon commission made up of business, consumer, and labor representatives and unaffiliated citizens should be set up to report on whether decentralizing and disentangling initiatives are proceeding in a comprehensive, well-thought-out fashion, and to identify areas where these initiatives will generate a need for greater coordination of policies.<sup>18</sup>

### *Clarify and Strengthen “Horizontal” Economic Citizenship Rules*

In addition to existing constitutional guarantees respecting the economic union, there is, as we have seen, another tool with which to entrench the rights of economic citizenship — namely, the 1994 Agreement on Internal Trade.

The AIT embodies the essential concepts of and key commitments to a stronger economic union, while fully preserving flexibility of action in areas of provincial jurisdiction where this is not inconsistent with a common economic citizenship.

Thus, at a minimum, the federal government should insist that these basic principles be followed — including implementation of the decisions of dispute settlement panels. Failing this, Ottawa should use the constitutional means at its disposal to implement them.<sup>19</sup>

Over the longer run, the basic principles of economic citizenship contained in the AIT should be entrenched in the Constitution.

As well, the harmonization of policies and standards should be fostered wherever possi-

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ble. Thus, the provinces should be held to their basic commitment to recognize each other's product, services, and labor standards where these are compatible, to develop common standards in other areas, and to justify their failure to do so in terms of objective criteria contained in the AIT. In this area as well, the federal government should explore its options to intervene as a last resort if the provinces do not implement the agreement.

### *Pay Greater Attention to Policy Spillovers*

If Canadians want to maintain and improve the labor mobility underpinning the economic union and the provinces' ability to adopt policies and standards best suited to their own circumstances, then the issue of compensation for positive and negative spillovers should be looked at. Given Ottawa's reduced role as purveyor of monetary transfers and standards setter in the social policy arena, the potential spillovers may become more pronounced and may induce provinces to take steps to reduce reciprocal access to occupational markets in order to preserve their ability to provide locally tailored programs. In the two key areas of education and welfare, at least, there are possible antidotes to this situation:

**Education.** If graduates of publicly funded institutions consistently must look outside their province to find jobs (as is the case for many graduates of Newfoundland and some Quebec universities), a reduction in federal involvement may, over time, result in the provinces' reducing their funding for these institutions to a level that would reduce their contribution to the economic union as a whole. However, if, through the federally run personal income tax, these provinces had first call on the provincial income taxes of these graduates, even if they moved, up to the point where the province's investment in their education is recouped, then there would be no incentive to underfund education from a national welfare perspective.

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**Welfare.** A province that cuts back welfare rates may create negative spillovers in another province, which might then feel justified in imposing residency requirements that would impede the efficiency of the economic and social union. One way to deal with this issue would be to have the "sending" province continue to be responsible for these cases, at least for a set period of time. The same concept could apply if a province were to enrich its welfare program and attract recipients from another province.

Finally, a national body focused on social policy could, as my colleague Bill Robson has suggested,<sup>21</sup> play a useful role in gathering and disseminating information on the effectiveness of social policies across the provinces, so that "from the bottom up" comparisons can be made and rendered public, which would maximize political incentives for voluntary

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harmonization and reduce problems associated with policy spillovers.

### *Strengthen Common Institutions*

In order to achieve these goals, I recommend that the following steps be taken to strengthen the AIT:

- Governments should take advantage of the terms of the AIT and expand the role of the Internal Trade Secretariat as much as possible to help implement the agreement. Its role could be akin to that of the European Commission — though on a much more modest scale, since the Canadian economic union is already significantly more integrated than that in Europe — and consist of monitoring and reporting on obstacles to implementation of the agreement, and proposing solutions. The Committee on Internal Trade — that is, the representatives of the federal and provincial governments — must formally vote on these proposals.
- With respect to AIT undertakings that do not yet have a deadline, the Secretariat should be empowered to suggest such time limits as it sees fit, on which the Committee on Internal Trade should also be required to pronounce.
- The Secretariat should issue an annual report on the implementation of the AIT's various chapters, including an evaluation of the reasons for missed deadlines and an assessment of outstanding issues. This report should subsume or summarize all other reports which governments are committed to provide under the terms of the AIT, including those on progress toward harmonizing labor standards and on the operation of their regional development programs.
- The current consensus rule on measures to implement the AIT should be replaced by a qualified majority voting rule, as is the

case in the European Union.<sup>20</sup> After all, the federal and provincial governments have already agreed to the principles contained in the agreement, so no one government should be able to block its implementation at this stage.

- The Secretariat should report on whether and how the principles of the AIT can be extended to sectors (such as financial services) and policies not currently covered. In other words, can a “second round” AIT be launched?
- The AIT's dispute settlement mechanism should be streamlined and strengthened, principally by making access to it easier for individual citizens and businesses.

In addition, if provinces or regions feel their interests are underrepresented at the center, they will naturally want to constrain the role of the federal government more than is necessary. In particular, they may be reluctant to accept that, in some areas of the economic union (for example, in ensuring accords such as the AIT are implemented), Ottawa's role may have to be strengthened, rather than weakened.

Therefore, reform of federal institutions to allow greater representation of regional views in national policymaking should be of great interest to those who wish for a better-functioning economic union. Proposals for reform are numerous and range from provinces' naming directors of the Bank of Canada<sup>22</sup> to more ambitious ones such as an elected and effective Senate. All such proposals are likely to improve the functioning of the economic union and should be encouraged.

### **Conclusion**

Canadians benefit greatly from their economic union. In part, this is because the terms of the union, with respect to ease of access to markets and mobility of people, are far superior to those Canadians are offered in other markets. But it is also because, to the extent that Canadians have distinct social and political stand-

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ards, common economic citizenship allows us to benefit economically from access to a fairly sizable and diversified market without having to compromise those standards.

Many analysts have suggested that, in some respects, the Canadian federation still operates in an unnecessarily centralized fashion given the different needs and constraints of its regions. Although this needs to be corrected, how the correction occurs is bound to affect significantly whether Canadians can maintain — and enhance — the benefits of their economic union. The good news is that, in principle, further decentralization and disentanglement of responsibilities can actually

enhance the benefits of the union, by allowing a better translation of regional preferences into specific policies. The bad news is that decentralization and disentanglement could cause a disengagement from the vertical and horizontal integration necessary for the success of the economic union and jeopardize the economic health of the country.

Canadians therefore should demand that the decentralization and disentanglement of responsibilities currently under way among the different levels of government improve their access to economic opportunities and that governments strengthen their commitment to common economic citizenship.

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## Notes

- 1 For some of the implications of this approach, see Michael A. Goldberg and Maurice D. Levi, "A Portfolio View of Canada," *Canadian Public Policy* 20 (December 1994): 341–352.
- 2 See John F. Helliwell and John McCallum, "National Borders Still Matter for Trade," *Policy Options*, July–August 1995, pp. 44–48.
- 3 Michael J. Trebilcock and Rambod Behboodi, "The Canadian Agreement on Internal Trade: Retrospect and Prospects," in Michael J. Trebilcock and Daniel Schwanen, eds., *Getting There: An Assessment of the Agreement on Internal Trade*, Policy Study 26 (Toronto: C.D. Howe Institute, 1995).
- 4 See Mollie Dunsmuir, "Mobility Rights, the Economic Union and the Constitution" (Ottawa: Library of Parliament, Research Branch, January 1990), mimeographed.
- 5 See Thomas J. Courchene, *Celebrating Flexibility: An Interpretive Essay on the Evolution of Canadian Federalism*, Benefactors Lecture, 1995 (Toronto: C.D. Howe Institute, 1995).
- 6 The possibility has been suggested by some sovereigntist economists in Quebec. See, for example, Pierre-Paul Proulx et al., *Intégration économique et modèles d'associations économiques Québec-Canada* (Montréal: INRS-Urbanisation, 1995).
- 7 See Brian Milner, "Canadian firms fear U.S. justice: legal horror stories abound as Tilden awaits day in court," *Globe and Mail* (Toronto), May 9, 1996, p. B1.
- 8 See James McCormack, "The Impact of Exports: An Input-Output Analysis of Canadian Trade," Staff Paper (Ottawa: Department of Foreign Affairs and International Trade, December 1994).
- 9 On the mobility of capital, see David M. Brown, "Efficiency, Capital Mobility, and the Economic Union," in David M. Brown, Fred Lazar, and Daniel Schwanen, *Free to Move: Strengthening the Canadian Economic Union*, The Canada Round 14 (Toronto: C.D. Howe Institute, 1992).
- 10 See, for example, William B.P. Robson, *Dynamic Tensions: Markets, Federalism, and Canada's Economic Future*, Policy Review and Outlook, 1992 (Toronto: C.D. Howe Institute, 1992); and Michael J. Trebilcock, *The Prospects for Reinventing Government*, Observation 38 (Toronto: C.D. Howe Institute, 1994).
- 11 See G. Bruce Doern, *Europe Uniting: The EC Model and Canada's Constitutional Debate*, The Canada Round 7 (Toronto: C.D. Howe Institute, 1991).
- 12 Paul Krugman, *Geography and Trade* (Leuven, Belgium; Cambridge, Mass.: Leuven University Press and MIT Press, 1991).
- 13 See Dan Usher, *The Uneasy Case for Equalization Payments* (Vancouver: Fraser Institute, 1995).
- 14 See, for example, Thomas J. Courchene, "Chaste and Chastened: Canada's New Social Contract" (Paper prepared for "The Welfare State in Canada: Past, Present and Future" Conference, Mount Allison University, Sackville, New Brunswick, April 1996); and Kenneth J. Boessenkool, *The Illusion of Equality: Provincial Distribution of the Canada Health and Social Transfer*, C.D. Howe Institute Commentary 80 (Toronto: C.D. Howe Institute, June 1996).
- 15 On this question, see the brief review of the main tools used to manage the economic unions of the European Community, Australia, the United States, and Germany (the last three being federal states) in Daniel Schwanen, "Open Exchange: Freeing the Trade of Goods and Services within the Canadian Economic Union," in Brown, Lazar, and Schwanen, *Free to Move*.
- 16 Under this agreement, Ottawa's authority would be recognized in national and transboundary measures, the conduct of international environmental relations, environmental matters related to federal lands, relationships with aboriginal peoples, and, in cooperation with the provinces, the protection of nationally significant ecosystems. The provinces would assume primary jurisdiction in most other areas. See Robert Matas, "Sweeping environment pact transfers powers to provinces," *Globe and Mail* (Toronto), January 20, 1996, p. A9.
- 17 For an excellent exposition of these mechanisms, see Douglas M. Brown, "The Evolving Role of the Provinces in Canadian Trade Policy," in Douglas M. Brown and Murray G. Smith, eds., *Canadian Federalism: Meeting Global Economic Challenges?* (Kingston, Ont.: Queen's University, Institute of Intergovernmental Relations, 1991).
- 18 I am particularly indebted to my colleague Ken Boessenkool for his reflections on this section of the paper.
- 19 For a review of the legal force of the obligations contained in the AIT, and of the federal government's options for securing a stronger economic union, see Robert Howse, *Securing the Canadian Economic Union: Legal and Constitutional Options for the Federal Government*, C.D. Howe Institute Commentary 81 (Toronto: C.D. Howe Institute, June 1996).
- 20 In an earlier paper, I suggested that such a "qualified majority" could comprise 19 of 29 provincial votes distributed as follows: Quebec and Ontario, four each; Alberta and British Columbia, three each; Prince Edward Island and the territories, one each, and all other provinces, two votes. See Schwanen, "Open Exchange."
- 21 William B.P. Robson, "Getting Radical: Federalism's Only Hope," *Gravitas* 3 (spring 1996): 9–12.
- 22 As proposed by David Laidler in *How Shall We Govern the Governor? A Critique of the Governance of the Bank of Canada*, The Canada Round 1 (Toronto: C.D. Howe Institute, 1991).