Imperfect Markets: Federal Safeguards and Economic Integration in Canada

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Abstract

This paper argues that initiatives to promote market integration have continually floundered, despite constitutional provisions that promote economic union in Canada. Why has Canadian economic integration stalled? Why does Canadian market integration lag that of Europe? This paper addresses the efforts to dismantle internal market barriers in Canada using the European Union as a comparative lens**.** Drawing on the literature on comparative federalism, the paper illustrates how the ‘safeguards of federalism’ to prevent federal encroachment and protect provincial jurisdictions mitigate against efforts to address market fragmentation and foster economic union.

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Introduction

On April 7 2017, Canadian federal, provincial and territorial governments signed a new Canada Free Trade Agreement (CFTA), with the explicit objective of further reducing barriers to internal trade.[[1]](#footnote-1) After twenty-one rounds of deliberations, the new Canadian Free Trade Agreement could be an important step forward for Canada's economic union. The aim is to tackle barriers to trade, investment, and labor mobility to foster cross-border trade in goods and services and promote regulatory cooperation to reduce costs of divergent local regulations and standards. While the Constitution states that "all articles of the Growth, Produce, or Manufacture of any one of the Provinces shall be admitted free into each of the other provinces”, mandating the free flow of commerce, the Canadian economic union is still far from the original vision of the founders of the Canadian federation. Although the federal government may regulate commerce between the states, with the intention of fostering a domestic common market, provincial governments maintain considerable discretion over many areas of regulation pertaining to property and civil rights covering a wide range of commercial transactions. For most businesses, these provincial laws have a greater impact than federal laws on their operations.[[2]](#footnote-2)

Unlike its European counterpart, which benefited from a sustained political initiative to eliminate internal trade barriers, Canadian efforts have proven modestly successful or even suffered setbacks. Yet herein lies the problem. Without concerted action, Canada faces the prospect of granting better market access to those outside their borders, while local rules shield subnational markets from domestic competition (Dawson, 2015). Canada assigned a high priority to complete a preferential trade agreement with Europe, securing the CETA agreement, and sought admission into the Trans-Pacific Partnership (TPP) negotiations (now the CPTPP), as the prospect of Japanese entry generated concerns among Canadian exporters about losing market share to US competitors, especially as both Japan and Europe were major trading partners of Canada. It successfully renegotiated a new NAFTA deal, securing important concessions, despite pressures from the United States to pull the deal. To take full advantage of these recent agreements with Europe, Pacific Rim countries, the United States and Mexico, Canada has to address the ‘substantive focus of trade agreements which is evolving from the removal of tariffs and related border measures to non-tariff, behind-the- border measures, including regulatory harmonization’ across constituent units through a mixture of both positive and negative integration efforts (Goff, 2016: 5) .

Recent opinion polls indicate that Canadians overwhelming support removing restrictions on internal trade (Ipsos, 2017, 2019). Why then has Canada been so unsuccessful in promoting an economic union? How can Canada address the multitude of interprovincial barriers that have resulted in thirteen separate markets, rather than one economic union? Why has Canadian integration lagged that of Europe? The literature on comparative federalism provides an important framework to illustrate how strengthening safeguard measures to prevent federal encroachment and protect provincial jurisdictions mitigate against efforts to address market fragmentation and foster economic union. This paper explores how the balance between the institutional autonomy of constituent units and the power of the central government can adversely inhibit the formation of a common market. The paper makes two central contributions. First, it analyzes Canadian efforts to address internal barriers to trade. This provides the necessary foundation for the second objective, namely understanding what this tells us about the incentives needed to encourage jurisdictions to address the regulatory barriers that hamper internal trade. An important caveat is not to expect convergence towards a European model of integration. This does not preclude utilizing the same modes of governance or specific practices to address internal market barriers. In fact, the Canadian Constitution, as the primary model for a federal economic union, was largely a negative form of integration, prohibiting restrictions to the free flow of goods across provincial borders, and establishing a common tariff, rather than providing for a positive form of integration with express provisions to form a centralized union.

The paper is structured as follows: It briefly reviews the different types of barriers along with an economic assessment of the cost of trade barriers within Canada. This is followed by an overview of prior political efforts to foster an economic union. A third section highlights the argument about the relationship between federal safeguards and economic integration in Canada. The fourth section seeks to explain why Canadian efforts at economic integration have achieved such limited results drawing on the European experience to illustrate how federal safeguards create constraints the result in ‘imperfect markets.’ The final section provides some conclusions about the effects of institutional design of federalism on dynamics of market integration.

ii. *Barriers to Internal Market in Canada*

Canadian business groups and policymakers have expressed growing concern over the tendency of provincial governments to raise trade barriers that undermine the national common market. (Dawson, 2015; Bowdie, 2019; Interviews, 2019). These interprovincial barriers vary; some are the product of natural barriers, such as distance and lack of infrastructure; some are preferences favoring local producers in government procurement and services; and others are differences in standards and regulations among jurisdictions that raise costs of compliance in multiple markets (Whalley, 2007; Grady et al, 2007).

In agriculture, provincial governments have quotas on dairy and poultry products that have frozen the pattern of agricultural production and created the most expensive interprovincial barriers to trade in goods (Skogstad, 2008). Provincial dairy marketing boards impose strict limits on interprovincial shipments. Since supply management is a trade irritant for some of Canada’s biggest international partners, there has been considerable political pressure to open-up dairy markets. Still these restrictions are compounded by differences in food standards and labelling in meat, fruit, and vegetables that restrict the sale and distribution of products across provincial jurisdictions. Quebec manufacturers cannot ship unpasteurized cheeses out of their province. Ontario and British Columbia require minimum content for locally grown grapes in their wine. Rampant protectionism in the sale and distribution of alcohol has led to an array of restrictions and limits on cross-border shipments including local content requirements, distribution monopolies, and exclusive sales of local wines in grocery stores.[[3]](#footnote-3)

Non-recognition of credentials across provinces has also impeded labor mobility (Maas, 2017). Occupations and trades require compulsory licensing, with differing provincial qualification requirements and licensing fees covering more than a third of craft workers. Similarly, professions, including engineers, architects, doctors, lawyers, and teachers face different registration and accreditation requirements that impede cross-border labor mobility. Provincial discretion about professional qualifications and residency rights have been amplified by requirements for membership in provincial law and medical societies as a prerequisite to practice in that province. More than six hundred regulatory organizations oversee more than two hundred regulated professions and three hundred skilled trades. Lack of reciprocal arrangements also affects the provision of services. Health care barriers make it difficult to receive cross-border health services and treatment, due to differences in fees and lack of acceptance of provincial health cards, outside of their issuing province. Securities licensing requirements differ in each province, so that regulatory divergence and fragmentation means that financial firms must file for an exemption within each jurisdiction and follow different rulebooks on securities. Ontario’s regulations add an extra cost to selling securities in the province. Smaller capital markets want to protect their more lenient exemption rules, as Western provinces are more willing to take on risk; the regulatory structure has allowed for more relaxed securities laws and less stringent disclosure requirements (Senate Standing Committee on Banking, Trade and Commerce, 2016). Provinces have exclusive jurisdiction over their local procurement markets. Mining and agricultural service providers are required to establish an operation in Saskatchewan to bid on work in that province. Provinces have used public contracts as an instrument for shaping provincial economic development, without federal interference, and may impose corporate ownership restrictions in certain strategic or sensitive industries. In addition, businesses deal with variations in corporate registration processes, insurance laws, and transportation rules making interprovincial trade more costly than necessary.

Measuring the cost of barriers to the Canadian economy has generated a number of gravity‐models assessing effects on aggregate welfare and industry productivity (Albrecht and Tombe, 2016). The Bank of Canada has estimated that removing 10 percent of interprovincial trade barriers could add 0.2 percent to Gross Domestic Product (GDP) (Bank of Canada, 2017: 18). A Senate Report by the Banking, Trade and Commerce, *Tear Down these Walls: Dismantling Canada’s Internal Trade Barriers* found that provincial regulations cost the economy as much as $130 billion a year in lost trade opportunities (Senate Standing Committee Report, 2016). Studies have shown that the effect amounts to the equivalent of a 6.9% tariff imposed on interprovincial trade (Statistics Canada, 2014). Currently interprovincial trade accounts for 20% of GDP, trailing the size and value of exports (Statistics Canada, 2014). While Ontario and Quebec together account for 52% of all interprovincial exports, the value of internal trade to GDP is lowest in Ontario, at about 34%, and highest around 80% of GDP in Prince Edward Island. Thus, the ratio of the value of internal trade to GDP is higher in smaller provinces than in larger jurisdictions. Overall growth rates in internal trade over the past two decades have been the highest in Newfoundland and Labrador, British Columbia, Saskatchewan and Alberta, reflecting an increase in the value of internal trade in natural resources, while whereas Ontario and Quebec are more reliant on their own provincial manufactured goods and services (Statistics Canada, 2014). What is clear is that is that interprovincial trade has grown more slowly than international trade (table 1). With exports of goods and services as a percentage of Canada’s GDP slipping from more than 44 per cent in 2000 to less than 31 per cent in 2017, addressing the barriers to trade between provinces has even greater importance (World Bank, No date). External trade liberalization has also reoriented commerce within Canada from an East-West to a North-South direction, due to integrated supply chains with the United States. Thus, a significant reduction in internal trade barriers could affect productivity as the liberalization of wholesale and retail, finance, agriculture and mining, and food and textiles sectors account for a large share of internal trade (Albrecht and Tombe 2016).

Table 1 Interprovincial trade and External Trade 1982-2012

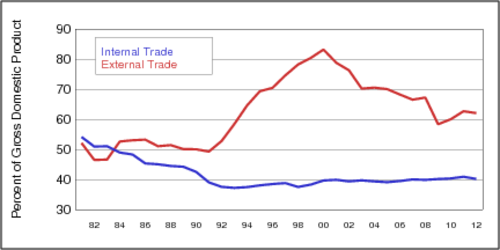


Table 1 Interprovincial Trade Flows in millions of dollars (2014)

Beyond these quantitative studies, the most systematic indicator of trade barriers are the formal complaints brought against specific provinces under the Agreement on Internal Trade (AIT) dispute settlement procedure, revised and updated in the new CFTA. This agreement contains several complaint and consultation processes, applicable across different issue areas, creating a dispute resolution mechanism that applies to domestic trade violations. Of the cases initiated under the dispute resolution process, around 60% were resolved at the mediation and consultation stage, with cases either resolved, deemed inactive, or still pending (Pavlović, et al, 2015: 52). For cases resolved at the consultation phase, the average consultation phase was 35.2 months, while for those cases where a panel was established the average time to dispute resolution was 41.2 months (Pavlović, et al, 2015: 53). Of the fifty-six complaints, labor mobility and agricultural products account for a clear majority of cases between provinces. The AIT dispute settlement process allows for financial penalties with varying amounts across different territories. While these amounts have increased under the CFTA to a maximum of $10 million for violations of the deal, these monetary penalties are not awarded as compensation but applied towards a fund to further promote internal trade. However, the dispute resolution process does expand from allowing only government to bring complaints before a dispute resolution panel to one that allows for business to bring a complaint to their provincial government and then request formal proceedings under CFTA if their provincial government does not act, Canada has implemented more effective dispute resolution rules in international treaty than its obligations in CFTA mechanisms where efforts to resolve domestic internal barriers are weaker and less effective in practice (Interview, 2019).

1. *Prior Internal Integration Efforts*

While internal trade rules have evolved over time, conflicts between provincial and federal laws, as well as divergent provincial laws highlight the decentralized nature of Canadian politics. If the federal government wants to do something in terms of cross-border trade, it needs to secure provincial agreement (Brown, 2002; Trebilock, et al, 1983, Kakuchka, 2015). Even then, there are often political challenges, as well as legal ambiguity, reflecting the initial bargaining between constituent units in terms of the distribution of authority between levels of government. Thus, institutional legacies can profoundly shape outcomes, as entrenched provincial interests have scuttled reform efforts in the past, repeatedly putting in place, incremental, incomplete solutions, while rejecting more comprehensive reforms (Broschek, 2012).

Initially, efforts at regional cooperation sought to address increasing economic disparities between provinces rather than internal barriers to trade. In 1937, the Rowell-Sirois Commission put the issue of regional integration on the national agenda by examining the distribution of federal and provincial responsibilities in relation to social and economic changes (Canada Royal Commission, 1940). The goal was to provide equalization payments to compensate provincial governments that generated less revenue to provide comparable public services. The report did not generate specific changes, so the issue lay dormant, despite growing inequality across regions and fiscal pressures on provincial governments (Smiley, 1962). In 1956, the first meeting of Atlantic premiers was held, as they faced pressure from the federal government to address common problems through a common regional policy to promote economic development. Efforts at promoting voluntary change have also emerged from business and trade associations seeking to deal with growing technological and economic demands. In 1963, the Bryne Commission, though focused on provincial reform in New Brunswick, added at the end of the report a proposal for an economic and political union for Atlantic Canada (Tombin, 1995: 88). In 1968, the Maritime premiers commissioned a study to investigate the merits of economic and political union (Tombin, 1995: 90). In 1970, the Maritime Union Report concluded that administrative and economic union was necessary to address the disruptive competitive effects of power sharing. It recommended that economic integration required new political structures influenced by the rise of the economic integration project in Europe.

The issue resurfaced again in 1980 during the Constitutional deliberations, led by Romanow and Chrétien, when the federal government introduced the “internal-common market” or the Canadian economic union into the constitutional negotiations, much to the surprise of the provinces (Courchene, 1983: 51). In its subsequent report, the federal government sought to strengthen sections 91 (2) and 121 of the British North American (BNA) Act to create an economic union. Their goal was to ensure that “goods, services, capital and labor could move freely, that is without being subject to fiscal and other institutional barriers, and which is endowed with institutions capable of harmonizing the broad internal policies which affect economic development and of implementing common policies with regard to the entity’s external economic relations” (Chrétien, 1980: 1). The report concluded the BNA Act lacked the means to secure an internal market compared to most other federal systems, so it was essential to provide basic operational rules for an economic union, which would require strengthening federal authority (see Chrétien, 1980: 1, 3). The federal government proposals pushed for increased labor mobility, uniform application of laws, proportionality of public interest derogations, and limitations on powers to impede economic mobility through using general provisions. Not surprisingly, provinces strongly opposed the incursions into their regulatory jurisdictions for fear of undermining provincial identities (Courchene, 1983). The federal government argued that the existing degree of economic integration stemmed from their federal jurisdiction over taxation, money and banking, and the actions of provinces were in fact, ultimately responsible for the fragmentation of the internal market. (Chretien, 1980: 2). In fact, market segmentation arose from the enabling legislation of the federal government that allowed provinces to set prices for products and services, notably in agriculture and transportation markets. Economic pressures, including the threat of shrinking federal transfers, led Atlantic/Maritime provinces to consider interprovincial cooperation to reduce trade barriers, although they pushed back against federal efforts to challenge provincial powers, fearing it would undermine their provincial culture and identities. Their decision to revisit the issue given growing economic disparities led to the Macmillan report (1990) designed to investigate new ways to promote interprovincial cooperation, reduce trade barriers, and foster a new agenda. The provinces did not have consensus on whether market-oriented solutions would address the nature of their regional disparity problem and expressed reservations that if they gave up their market regulatory powers, it would be difficult to reclaim them (Tombin, 1995: 102).

The 1985 Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Commission) supported the removal of provincial and territorial barriers, but notably concluded that Canada needed to place greater economic emphasis on its bilateral trade relations with the United States (Kukucha, 2015). It was becoming clear to provinces that international trade negotiations, related to the General Agreement on Tariffs and Trade (GATT) and CUSFTA, were expanding into areas of provincial jurisdiction, creating potential complications for domestic sectoral interests that began pressuring Ottawa to act on internal protectionism (Kakucha, 2015). Although the Macdonald Commission pushed for greater market openness, the traditional regional conflict between the protectionism of the central provinces against the liberalization thrust of the eastern and western provinces, had muted impact due to increasing internationalization of financial and commercial interests in central Canada (Watts, 1996: 183). The reports' advocacy of domestic social and economic policies sought to shore up the benefits of internal market integration with proposals for fiscal equalization and regional development (Watts, 1996: 183). As a result, the federal government established the Committee of Ministers on Internal Trade, along with an Internal Trade Secretariat, which generated formal negotiations in 1993 (Doern and MacDonald, 1999). The Agreement on Internal Trade (AIT) came into force in July 1995 with the intent of reducing or eliminating domestic trade barriers to the “free movement of persons, goods, services and investments within Canada” This would be achieved through principles of non-discrimination, although there were exemptions based on legitimate provincial objectives for specific public policy reasons.

Although the AIT relies heavily on a positive list approach to commitments, covering a range of sectors, there are limitations in the scope of coverage due to general exceptions and transition commitments (Hansen and Heaven, 2010: 197). Even though it has been amended fourteen times since it was signed, there are exceptions for financial services, taxation, regional development programs, and cultural matters, while there have been no commitments in specific areas, notably energy. Despite repeated efforts to upgrade and modernize the AIT, the problems stemmed from too many exclusions and exemptions, as well as the underlying distrust, coupled with regional loyalties, and personal rivalries that made collective agreement difficult (Magnifico, 2014).

Bilateral accords emerged in response to frustration over the pace of reform. Each of these agreements differs in terms of the parties engaged as well as commitments to address internal trade barriers. In 2006, British Columbia signed the Trade, Investment and Mobility Agreement (TILMA) with Alberta, extended then to include Saskatchewan, which led to the signing of the New West Partnership, committing the provinces to the New West Trade Partnership Agreement (NWTPA), which came into force in July 2010. The goal was to promote “full mutual recognition or reconciliation of their rules affecting trade, investment or labor mobility so as to remove barriers to the free movement of goods, services, investment, and people within and between the three provinces” (NWPTA, 2010). Although admittedly less ambitious, Ontario and Quebec concluded the Ontario-Québec Trade and Cooperation Agreement, designed to liberalize trade and reduce barriers between the two provinces in September 2009. Similarly, the Atlantic Procurement Agreement (APA), among the four Maritime provinces in 2008 aimed at reducing barriers to public procurement, while the bilateral New Brunswick-Nova Scotia Partnership Agreement on Regulation and the Economy (PARE) in 2009 sought to reduce barriers to business, trade and skilled labor. Ultimately, the commitment and cooperation required to promote economic union faced pressure to commit resources, especially from smaller provincial territories, as the various bilateral international trade negotiations launched by Ottawa had more allure than addressing internal barriers to trade (Magnifico, 2014). The situation has changed significantly since the signing of the AIT, when Canada had concluded trade agreements with only two countries. Since then, Canada has signed multiple trade agreements with more than forty countries, so the Conservative government wanted to reform the AIT to bring it in line with the market access provisions of the recent international trade agreements (Egan and Guimareas, 2018). The new competitive conditions have raised sensitivities among provinces due to the prospect that existing subnational regulations could act at cross-purposes with negotiated treaty obligations (Omiunu, 2017).

In 2014, the Conservative government published *One Canada One National Economy: Modernizing Internal Trade in Canada*, which called for revisions in specific areas of the AIT with the option of an entirely new internal trade framework (Government of Canada, 2014). In June 2014, the Industry Minister, James Moore, called for corresponding provincial and territorial premiers to modernize the AIT. Although the Committee on Internal Trade promised a new agreement, the Standing Senate Committee on Banking, Trade and Commerce in its report, *Tear Down these Walls*, signaled that the federal government should pursue legal action through the provisions of the Constitution, to settle competing constitutional claims to push forward in addressing barriers to trade. Such federal power will be hard to assert as provincial control has become the default trade power unless Parliament can assert its federal trade power (Monahan, 2001: 19).

The federal government has responded by creating a new ministerial post for Intergovernmental Affairs, Northern Affairs and Internal Trade, supported by an Internal Trade

Secretariat and Working Groups, to strengthen the credibility of its most recent effort. The resulting CFTA, based on the principle of non-discrimination, is designed to address unfair market advantages due to provincial regulations, subsidies and procurement. The agreement provides three methods of removing barriers to trade: mutual recognition and equivalence, regulatory harmonization and expanded opportunities for private litigation. Like its predecessor the AIT, the CFTA continues to allow for provinces and territories to negotiate other bilateral or multilateral agreements so long as the secondary arrangement liberalizes trade, investment, or labor mobility beyond the level achieved by CFTA. Although the CFTA shifts to a negative list approach, the agreement has been widely criticized for its exemptions and exclusions.[[4]](#footnote-4) Major sectors, such as financial services and alcohol, will be set-aside for future negotiations, while others such as supply management are not included in the agreement. The agreement includes an open-ended provision that allows provincial governments to apply their own rules for public interest purposes as well as an opt-out clause, leaving open the possibility that provinces can still discriminate against each other more than towards international trade partners. For Canada, structural and judicial safeguards in the original constitutional language and allocation of competences, combined with partisan and socio-cultural safeguards fosters provincial competition and identity politics.

*iii. Federal Safeguards and Economic Integration*

The federal safeguards that hold the Canadian federation together make it more difficult to foster economic union. While scholars of federalism identify structural, judicial, partisan, and socio-cultural safeguards as providing institutional stability, these long-standing compromises to manage intergovernmental relations also weaken efforts at national economic integration in Canada (Keleman, 2007; Bendar, 2009, Wright, 2016; Bolleyer, 2009). Though there are institutions and processes to deal with intergovernmental management, they are often ad-hoc and informal, placing clear limits on what they can achieve in terms of joint decision-making and shared responsibilities (Brown, 2003; Bolleyer, 2009). Provincial preemption may also stave off federal intervention for uniform federal laws, while interprovincial cooperation may be a strategy to avoid federal encroachment. Provincial representation at the federal level is weak, lacking a voice in the federal legislative process to protect provincial interests, through the composition and selection of the federal government. Other structural safeguards include enumerated powers where the division of powers allows provinces exclusive areas of jurisdiction to leverage or prevent federal overreach. As a result, the constitutional entrenchment of competences provides greater leeway for provincial governments to improve their position in horizontal negotiations through strategic maneuvering, especially if provinces are involved with the implementation of federal policy objectives (Bolleyer, 2011; Kakuchka, 2015).

In federal systems, judicial safeguards monitor the division of authority between constituent units and enforce compliance with federal law, strengthening the role of courts to provide judicial review, and assuming all levels of governments will respect their interpretation (Bednar, 2009; cf Goldstein, 2001). Such judicial safeguards encouraged the dismantling of economic boundaries through negative integration in Europe. The Canadian approach is not one of judicial empowerment to facilitate removal of trade barriers, as courts have repeatedly protected provincial jurisdictions. There is no standard method for testing provincial legislation that affects interprovincial commerce. Legal safeguards have provided provincial jurisdictions with substantial regulatory authority, especially in reference to trade in services.[[5]](#footnote-5) Constitutional provisions also give provinces exclusive jurisdiction over property and civil rights, which became the default trade power over local business transactions, often resulting in overlapping and conflicting regulations.

Political parties also serve as partisan mechanisms to safeguard federalism, allowing for collective political action, if a common, complementary identity and culture exist between different political units. Political parties may prevent federal overreach if they are either integrated so the political fortunes of parties at provincial and federal level are linked, creating mutual dependency or decentralized so party system depends on provincial parties for reelection (Bednar, 2009). Canadian parties are not decentralized or integrated. Some political parties are regionally concentrated, while others often have different ideological positions at the federal and provincial levels, so the party regime has less leverage in negotiating cooperative arrangements across the federal divide (Wright, 2016: 21, Watts, 2008). Not all parties exist at the federal and provincial level, and even then, parties are often separate in terms of their ideologies, platforms and nominating processes, so they are at best imperfect safeguards, which in turn hampers their ability to coordinate provincial-federal relations (Wright, 2016: 22). While intergovernmental processes tend to be more complicated if different parties are in power at the subnational level, intergovernmental agreements may be amended or withdrawn if a new party is elected, as it is not bound by its predecessor (Bolleyer, 2011: \*).

In seeking to accommodate distinct socio-cultural identities, bilateral negotiations often tailor to particularistic provincial interests, with highly decentralized and asymmetrical outcomes. If specific provinces have special provisions in terms of legislative powers, rights and obligations, such asymmetry may undermine efforts at economic integration. Canadians remain deeply divided over the issue of differential recognition. Defenders of provincial autonomy, Quebec particularly, and increasingly other provinces such as Alberta, may resist the encroachment of federal programs which engage in redistributive politics (Courchene, 2004). Without such differentiated integration recognizing the distinction between provincial jurisdiction and national identity, there is the threat of secession, or pressure to exit from a specific policy if provincial demands are not met (Wright, 2016; Gagnon and Lacovino, 2007). This contributes to a lack of policy cohesion diminishing the shared sense of identity that is needed to foster common rules and institutions to manage economic interdependence. There is a risk, however, that various regional schemes and specific provincial measures can generate significant legal obligations for the federal government unless safeguarded in an international trade agreement. Even then, these specific provincial accommodations to ensure benefits accrue to the local economy may be subject to legal challenge under international trade agreements, posing challenges to provincial-federal agreements even on highly sensitive regulatory issues. Yet provinces benefit from structural safeguards from international pressures as the financial and legal liabilities of such exclusionary provisions are the responsibility of the federal government.

*IV. Why does Canadian market integration lag Europe?*

To understand why Canadian market integration lags Europe, this section draws on the literature above on self-reinforcing federalism. Empirically, the Canadian case illustrates that political safeguards can undermine cross-border exchange and mobility, making it more difficult to harness the regulatory and distributive mechanisms that have been central to fostering market integration in Europe (Courchene, 2004). In looking at the relationship between markets and federalism, Canada has struggled to deal with the structural and institutional context in which governance between two autonomous and interdependent levels of government is still relatively under-institutionalized compared to many federations. This decentralized system creates competition both horizontally among provinces, and vertically between provinces and the federal government (Brown, 1995). Partisan politics and regional dynamics reflect differences in socio-cultural identity and economic interests between different political units in the federation (Brown, 1995; Keleman, 2007). The strong political culture of autonomy and competition, coupled with separate treatment and protection for a linguistic national minority in Quebec, has strengthened provincial jurisdictions. The structural safeguards that limit federal overreach can conversely create differential policy choices or administrative dealings between governments in order to accommodate disparate pressures from constituent units to avoid ‘exit’ pressures (Gagnon and Iacovino, 2007). Such decisions not only reinforce provincial autonomy within the Canadian federation, but also creates asymmetrical federalism in which an opting out mechanism allows provinces to maintain greater autonomy by not participating in a specific provincial-federal shared program.

Internal trade negotiations in Canada are conducted as if between sovereign states, rather than constituent units of the same polity. Canada has viewed the removal of internal barriers as trade negotiations, treating provinces as sovereign entities engaged in mutual concessions (Mesterel,1995: 96).Hence, these internal liberalization agreements have the characteristics of intergovernmental agreements, considered as political texts, rather than binding legal commitments.[[6]](#footnote-6) Thus, the powerful judicial safeguards that enforce internal free trade obligations are much weaker in Canada than in the European Union with its adversarial legalism and decentralized enforcement mechanisms against recalcitrant states (Keleman, 2011). The legal mechanisms to ensure commitments to the Canadian internal market are voluntary. Unlike judicial decisions in Europe, the dispute resolution process renders non-binding panel decisions. Dispute remains a cumbersome legal process which does not cover all government bodies, notably municipalities, nor does it cover all sectors. The legal framework does not have the power to redress infractions for non-compliance or ensuring that commonly agreed obligations are implemented by contracting parties. Instead, the dispute settlement process emphasizes consultation and mediation between governments, followed by informal arbitration in rare instances, convening a compliance panel to determine whether a party has implemented a measure inconsistent with the AIT or CFTA agreement.

Although the CFTA dispute settlement process does make it easier for companies and individuals to seek compensation for arbitrary violations of the agreement, strengthening enforcement activities through financial penalties, a patchwork of regional trade accords that co-exist alongside the AIT and CFTA weakens market integration. Both the New Western Partnership Agreement as well as the Ontario and Quebec agreement have their own dispute resolution regimes. The result is a lack of uniform legal interpretation within the Canadian internal market as well as the absence of a distinct constitutional structure to settle interprovincial trade disputes.

The consensus-oriented style of policy making bears similarities to the soft law mechanisms that have evolved in Europe (Egan and Guimeareas, 2017). There were few legal mechanisms or incentives in the AIT to coordinate policies to prevent new barriers emerging nor corresponding or equivalent means to compel jurisdictions with lower or deficient standards to raise them. The provisions of the CFTA does seek to redress this omission by pushing for a regulatory reconciliation process to align regulatory frameworks. It is expected to address a host of issue areas where market fragmentation hinders interprovincial trade (Interview, 2019). Yet a government can refuse to submit to a reconciliation agreement with others, and its distinctive regulation must then be listed as an exception to the CFTA. To deter new restrictive regulations emerging, the CFTA allows other parties and interested persons comment on the proposed regulation, which mirrors a similar notification process within the European Union (Egan, 2001).

Canada has been less successful in using the same policy instruments of regulatory harmonization and mutual recognition to address internal barriers that have driven market integration in Europe. Canada has provisions to remove conflicting provincial laws through negative integration if both levels share concurrent jurisdiction. But there are no specific legislative provisions or formal regulatory authority to adopt harmonization measures through positive integration; instead this requires voluntary legislative or regulatory action by the provinces (\*Testimony to the Senate Banking Committee on Trade, Investment and Commerce). Consequently, Canada lacks a dormant commerce clause which would provide an implied restraint on provincial power. Despite its purported ambitions, many CFTA provisions have ‘general interest’ requirements allowing for legitimate exceptions, leading to an increase in protective regulation at the provincial level that may be more trade-restrictive than necessary, further impeding cross-border trade. With no assertive judicial safeguard, such practices mitigate against addressing protectionist barriers. Provinces tolerate such provisions for harmonization, only to the extent that they do not weaken their control over domestic matters. Such selective liberalization where provinces can have voluntary opt-outs or opt-ins, has led to an “inchoate collection of rules and restrictions” rather than a model of integration with a unified legal order (Keleman, 2009; 2011; Smith, 2005). Mutual recognition has also generated mixed results. While the Trade, Investment and Labor Mobility Agreement, the New West Partnership Trade Agreement, and the Trade and Cooperation Agreement between Quebec and Ontario promote mutual recognition, as does the AIT, in terms of labor mobility, such commitments require governments to take further action in confirming mutual equivalence of regulations. So far, this has proceeded slowly on a case-by-case basis, mostly in occupational professions, resulting in voluntary recognition schemes, with provinces allowed to exempt select occupations on specific public policy grounds (Maas, 2017). Despite efforts at reciprocal recognition of rules, labor migration to other provinces has dropped from roughly 2.5% in the early 1970s to about 1% in 2015.

At the same time, differences across the different regional integration efforts mean that Canada has its own ‘spaghetti bowl’ of internal trade agreements. As a result, regional domestic trade treaties may supplement CFTA obligations, and there is concern that they may undermine the national accord. The institutional safeguards to promote integration are moderate at best. There are no specific deadlines in the agreements. Not all territories joined the agreements. Nunavut territory was not originally part of the AIT, though it joined the CFTA, otherwise, it would be part of the political union but not economic union.[[7]](#footnote-7) The consensus rule for decision-making has led parties to interpret and practice consensus as unanimity, rather than general agreement, which tends to produce lowest common denominator outcomes or political gridlock (Magnifico, 2014). Provinces may resist pressure for more horizontal coordination for fear that any kind of locked-in decision making would erode their autonomy, given that federalism is the primary influence shaping political discourse, and political identities (Gagnon and Iacovino (2007). There are few areas of concurrent power, and the lack of well-developed central representation of provincial interests at the federal level makes it more difficult to achieve coordination, in contrast to the strong representation of state interests at the federal level through the US Senate, German Bundestag and European Council (Sbragia, 2002; 2004).

Unlike Europe, Canadian efforts at internal liberalization do not address state aids and distortions. Interprovincial competition for regions investment has enabled the four most populous provinces of British Columbia, Alberta, Ontario and Quebec to attract the bulk of provincial and federal subsidies, distorting market practices, and providing competitive advantages that undermine efforts to create an internal market. Such tax and grant programs have been subject to greater scrutiny in Europe, where centralized monitoring and enforcement restricts investment incentives, including all types of selective government support to business, even state-owned firms (Thomas, 2011). While the AIT does address investment incentives, it is difficult to achieve inter-jurisdictional cooperation, due to low levels of political commitment and legal enforcement compared to Europe (Thomas, 2011). Provinces continue to use subsidies as a means of attracting investment in services, auto and research and investment, while the pressure to promote market integration lacks the conditional transfers and incentives provided by European regional and structural funds. This dilemma has become more important with the shifting patterns of trade flows within the Canadian economy, which has created unbalanced growth. The disparity between interprovincial and international trade is striking, amplifying different regional orientations and growth models. Whereas Ontario’s economy is oriented towards the United States especially given the cross-border automotive manufacturing supply chain, its agricultural products face high barriers to protect their domestic provincial businesses. By contrast, Atlantic Canada and British Columbia have high shares of businesses engaging in interprovincial trade, with interprovincial exports either surpassing or are almost equal to international exports as a share of total real GDP.

The narrative of market integration also tends to overlook the way in which regions have complex and competing interests. The financial economy in Ontario differs from the heavy extractive economy in Alberta, which makes it challenging to provide a commonly agreed system to support domestic trade priorities in trade, investment and labor mobility, with increasing fiscal disparities among provinces and territories. Although the federal government provides unconditional transfers to address horizontal imbalances, these provisions do not commit governments to contributing to or receiving specific allocations of funds (Broadway and Watts, 2000). While fiscal transfers have been important in Europe, such initiatives have been contested as net contributors and net recipients among member states have political interests that run in the opposite direction (Wibbels, 2006). The demands by Quebec, and then Alberta, for greater fiscal autonomy, have made it difficult for the federal government to pursue nation-wide policies. Such fiscal conflict places a strain on intergovernmental relations, while also making it harder to foster commitment towards an economic union. Richer provinces eschew a sense of shared political identity, since their sizeable contributions mean that they are less dependent on federal government programs. Concern about equalization rights and fiscal transfers to poorer provinces matches the debates about distributive policies that often characterize European integration. Despite these fiscal safeguards aimed at providing comparable public services across Canada, partisan politics drives interprovincial revenue transfers which have been used as a means of undermining support for separatism (Interview, 2019).

For Canada, structural and judicial safeguards in the original constitutional language and the allocation of competences, combined with partisan and socio-cultural safeguards fosters provincial competition and identity politics. This has led to a less formalized system of intergovernmental relations, which has made efforts at economic union difficult (Brown, 1995, Bolleymer, 2009). The most recent agreement is more preoccupied with establishing and protecting exceptions to free trade within Canada than fostering economic union. Yet these domestic interprovincial safeguards impact the scope of issues that can be addressed in international negotiations as well. While internal market barriers are considered a trade irritant for some of Canada’s biggest international partners, greater market access in procurement, agriculture, or data localization, for example, have come up short due to opposition from domestic provincial interests. Despite intense pressure in recent international trade negotiations to open markets, domestic free trade agreements such as AIT and CFTA do provide a measure of protection as complaints about market access are only open to domestic firms. Foreign firms cannot circumvent negotiated trade agreements bestowing access such as CETA and CTTPP by using domestic .

**Federal Safeguards versus Economic Integration**

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| --- | --- | --- | --- |
| Safeguard | Rationale | Canadian Federalism | Impact of Canadian federalism on market integration |
| Structural | Protect against federal encroachment; demarcation of jurisdictional competences; intergovernmental safeguards provide the provinces the ability to check federal overreach through participation in federal decision-making. | Weak intergovernmental cooperation.  No central representation of states in federal legislative process. | Limited joint-decision-making. |
| Judicial | Remedies; obligations; commitments; judicial review; monitor distribution of power and common understanding of constitutional rules | Exclusive provincial authority to  regulate all subjects (or ‘‘matters”) that fall within their jurisdiction. Jurisdictional federalism. | Weak judicial enforcement of agreements; soft law mechanisms; conflict between competing constitutional provisions. |
| Political | Representation; Mutual dependence; political parties bind politics at different levels so incentive to cooperate. | Political parties with regionally concentrated support; political parties with different platforms at federal and provincial level. | Parties not integrated or decentralized; bifurcated party system; not all political parties exist federally and provincially in all parts of the country. |
| Socio-cultural | Shared political identity and culture | Special privileges; asymmetrical federalism arrangements; distinct cultural and linguistic identities. | Differentiated integration; exclusions, exemptions; safeguards to protect economic interests. Provincial burden distributed to others. Asymmetrical federalism. |

*Conclusion*

The latest effort at Canadian market integration will hinge on the ability to garner the political will needed to invest in domestic reforms as specific goods, services and labor face barriers in crossing provincial borders. While the initial driving force for greater economic union stemmed from pressures for improving regional economic development, the more recent efforts have focused on the gap between internal and external liberalization. The impact of more ambitious free trade agreements has increasingly raised concerns about the effects of domestic market fragmentation on Canadian competitiveness. What is clear is that Canada's growing commitment to international trade liberalization has unleashed both economic and political pressures that are encouraging greater attention to domestic market liberalization. Canadians are concerned by the prospect of granting better market access to those outside their borders, while local rules continue to segment and insulate provincial markets.

Yet Canada has chosen not to emulate the European single market, with its strong legal commitments and reformed decision rules. Instead, Canadian domestic structural reforms represent a politically fraught effort to deal with the complexities of economic interdependence. Initiatives to eliminate internal trade barriers, such as the Agreement on Internal Trade (AIT) or the Canadian Free Trade Agreement (CFTA) in Canada, have proven modestly successful or even suffered setbacks. Canada faces a dilemma in encroaching on provincial regulatory jurisdictions due to the federal safeguards that create self-enforcing limits on federal power. Compared to the central role of judicial activism in Europe, which has crucially promoted the effort to reduce trade barriers, Canadian efforts have lagged as non-judicial mechanisms have been the policy choice to address internal market barriers. A strong political culture of autonomy and competition, with threats of secession, can undermine collective action due to asymmetrical preferences and exemptions. Consequently, provinces seek to avoid being locked into decision-making process that would erode their autonomy. The structure of party politics has also not been conducive to provincial-federal cooperation. The weak system of intergovernmental relations, coupled with the non-binding status of intergovernmental agreements, with no repercussions for non-compliance undermines credible commitments. The exemption of specific policy areas, compromising the level of ambition, inevitably leads to differentiated market integration, which will likely be an enduring characteristic of Canadian single market.

Although there is substantial scholarship about the dynamics of European market integration, less academic attention has been given to the creation of single markets in other federal systems (Egan, 2015). The Canadian case highlights how the institutional design of federalism can create safeguards that may prevent encroachment on provincial sovereignty and authority, but in doing so, undermines efforts to facilitate cross-border exchange and cooperation to address internal market barriers. In addition, these safeguards mean that provinces have constitutional authority to exercise their strategic bargaining power to influence the content and deliberations of international trade negotiations as they are responsible for implementation of any trade commitments that encroach on their regulatory competences.

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1. see https://www.cfta-alec.ca/ [↑](#footnote-ref-1)
2. The British North America Act of 1867 grants exclusive federal control over twenty-nine areas (section 91 powers) and exclusive provincial control over sixteen areas (section 92 powers). [↑](#footnote-ref-2)
3. The CFTA did not include a chapter on alcohol, opting instead to create a working group to address issue. [↑](#footnote-ref-3)
4. CFTA has more than 144 specific exemptions across energy sector, natural resource development, and alcoholic beverages. [↑](#footnote-ref-4)
5. 1921 case of Gold Seal Ltd. v. Alberta (Attorney-General); more recently limits by the Supreme Court on federal authority on securities Reference re Securities Act, [2011] 3 S.C.R. 837 and beer in R vs Comeau, SCC 15, 2018. [↑](#footnote-ref-5)
6. Northup Grumman Overseas Services Corp. v. Canada 2009 SCC 50. [↑](#footnote-ref-6)
7. Nunavut did not exist when the AIT came into force in 1995. When the Northwest Territories was divided into two territories in 1999 (Nunavut and Northwest Territories), the AIT was not a huge priority given the relative disconnect between their economy and rest of Canadian internal market. [↑](#footnote-ref-7)