# Interprovincial Trade Barriers and the TILMA

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## 1 Introduction

Modern democracies are based on the principle of individual freedom. Among other things, freedom implies the right to pursue actions that individuals feel are best suited to their own needs and to the needs of their families and communities. Freedom also implies protection against any illegitimate coercive acts that stem from concentrations of power, be they large governments or coalitions of special interests (including big business and big labour). While freedom is to be valued for its own sake, there also overwhelming empirical evidence to suggest that societies organized along this fundamental principle are the most prosperous as well. A main reason for this is that in a free society, individuals are free to trade.

Of course, belief in an institution of free markets does not imply a belief in the desired absence of government involvement at any level. In a democratic society, governments are supposed to reflect the collective desires of a broad spectrum of individuals. Even the most ardent advocate of free enterprise will admit the desirability of government mandated rules and regulations designed to protect the collective interest against the inevitable constellation of special and outside interests. This desire is reflected in the Canadian constitution, which permits provincial and lower levels of government to, for example, put in place policies that protect the environment, establish workforce standards, and invoke consumer protection laws.

It is an unfortunate fact, however, that any man-made institution is subject to varying degrees of abuse. Governments are entrusted with setting the rules for legitimate ends (where legitimacy is ultimately judged by the electorate). But it is sometimes the case that governments are subverted by special interests, who lobby for rules that are disingenuously passed off as benefiting the collective interest. It is rules of this form that economists label (illegitimate) 'barriers to trade.'

There has been much debate lately concerning the magnitude of interprovincial barriers to trade in Canada. Some have argued that these barriers cost

Canadians billions of dollars per year. Others have argued that the costs are quantitatively insignificant. This wide range of estimates is no doubt the product of different perceptions of what constitutes a legitimate trade barrier. But whether these costs are large or small seems hardly worth debating. It is likely that we can all agree that policies perceived to constitute illegitimate trade barriers should be removed on the principles of freedom outlined above. Governments that implement or remove trade barriers on the grounds of political expediency will ultimately be judged by the electorate. In a democracy, the electorate will ultimately get what it wants (or deserves).

## 2 Interprovincial Trade Barriers

A case could be made that there are few significant obstacles to trade, investment, and labour mobility within Canada. Canadians are, for example, free to live and work anywhere in the country. Moreover, there are no customs inspection stations along provincial borders and provinces are constitutionally prohibited from levying tariffs on interprovincial trade. An even stronger case can be made for the likelihood that any interprovincial trade barriers are dwarfed by an order of magnitude when compared to the trade barriers that exist across Canada and the United States; see Helliwell (2005). But all of this is beside the point.

Provincial (and municipal) governments are free to erect non-tariff barriers (NTBs) to trade. Many of these barriers have broad support from provincial constituents and are, in this sense, legitimate. There are other barriers, however, whose existence is owed primarily to localized or corporate interests at the expense of the broader community. Moreover, even among existing barriers that are deemed legitimate, there may be room for further improvement. Logic dictates that there may also be room for new barriers, as economic circumstances evolve over time.

Exactly what type of trade barriers are we talking about here? One such class falls under the rubric of *local content requirements*. These are rules that in one way or another favour relatively small sets of local producers and local workers at the expense of the larger set of local consumers. For example, Ontario requires that wines sold in private retail outlets contain a minimum of 30 percent per bottle produced from Ontario grapes. In Nova Scotia, a similar restriction was recently increased to 75 percent. In Newfoundland, out-of-province beer products may be denied access to convenience stores. Petroleum and gas projects in Newfoundland are approved only if they result in sufficient local employment and purchases of provincial goods and services. Petroleum exploration rights in Nova Scotia are conditional on an attempt to use local labour and goods and services. In Quebec, a variety of fish and seafood must be processed by companies located in the province.[1] Hay from Alberta cannot feed B.C. cattle unless

[1] These examples are drawn from Darby, Beckman, St-Maurice and Lemaire (2006).

incoming trucks are reloaded to meet B.C.'s shipping standards and vice-versa; and bees from Alberta may not fertilize B.C. crops.[2] Local government contracts for the procurement of goods and services frequently discriminate against lower nonlocal cost suppliers. This list is far from exhaustive.

Local content requirements obviously have nothing to do with regulations designed to protect the environment, or regulations that set minimum standards for health and safety. They are clearly designed to promote the interests of small special interests at the expense of the general community. A classic and (unusually) well-publicized example is a Quebec law that prohibits the sale of coloured margarine. This law is the product of a lobby effort undertaken by the Quebec Milk Producers Association. As a result of this law, Unilever Canada is compelled to market two versions of its margarine in Canada–an off-white version for Quebec and a butter-coloured version for the rest of Canada. The dual production run costs the company (and ultimately consumers) an extra one million dollars per year. The Quebec milk industry justifies the law with the claim that consumers clearly prefer to buy yellow and are confused when margarine looks like butter.[3]

Critics of free trade are fond of trivilializing the Quebec white-margarine restriction. And in some sense, the example is trivial. In particular, the extra one million per annum in production costs is tiny relative to Unilever's total sales; and the added costs are likely to add up to only pennies per consumer. But there is a very real sense in which the example is far from trivial. Most local content restrictions are not nearly so well publicized. Moreover, if all local producers were to follow this lead, the economic costs associated with millions of 'trivial' regulations of this sort would quickly become noticeable. But the most significant cost associated with such 'trivial' regulations is not so easily quantified. The most significant cost pertains to the encroachment of individual freedom, justified in this case by an agency that is intent on passing itself off as a benevolent protector of a hapless consumer. Evidently, Quebec consumers, unlike their counterparts across the country, are unable to distinguish the words *beurre* and *margarine* on a packaged product. If such a claim can be passed off as justification for government intervention, then logic dictates that the government would be justified in extending its domain over all individual decisions. Experiments such as these have been tried throughout human history, frequently with disastrous consequences.

# 3 TILMA

In April of 2006, the governments of Alberta and British Columbia announced that they had entered into an interprovincial trade pact called the *Trade, Investment, and Labour Mobility Agreement*, or TILMA. The pact was implemented

[2] These two examples are drawn from Kunin (2006).

[3] See: www.cbc.ca/ money/ story/2002/03/25/ margarine020325.html

in April of 2007 and is to be phased in over a two year period.

TILMA builds on the *Agreement on Internal Trade* (AIT) struck between Canada's federal, provincial and territorial governments in 1994. While well-intentioned, the AIT is widely perceived to be flawed along several dimensions. First, the AIT is an agreement that applied only to a limited number of sectors that were expressly made subject to it. Second, the document is virtually incomprehensible. Third, the AIT has for the most part been largely ignored; a result that is likely due to the fact that no effort was made to embed within the agreement any credible enforcement mechanism.

Unlike the AIT, TILMA is an agreement that applies to all sectors of the Alberta and British Columbia economies, unless expressly exempted. At the present time, TILMA does not cover areas deemed within the scope of local public policy, including royalties and taxation, public safety and security, water and the environment, consumer protection, social policy, Aboriginal policy, labour standards and worker health and safety. Instead, TILMA establishes rules that apply to all government measures that affect trade, investment, and labour mobility. Moreover, TILMA is relatively easy to comprehend and specifies an explicit dispute settlement procedure designed to secure compliance.

To cast TILMA as a free-trade agreement is a bit of a stretch. While Part I of its operating principles states as one of its goals to "eliminate barriers that restrict or impair trade, investment or labour mobility," its details are more closely in line with another of its stated operating principles; namely to "cooperate on matters related to trade, investment and labour mobility." The latter objective is substantially weaker than the former.

TILMA contains seven parts. Part I deals with general operating principles. Part II contains only 16 articles relating to the extent of obligations, general rules, and special provisions. Part III contains seven articles concerning administrative provisions. Part IV contains 11 articles that deal with the dispute resolution mechanism and part V provides a lengthy list of exceptions to the agreement. Part VI relates to transitional measures and Part VII provides a set of legal definitions.

Outside of the dispute resolution mechanism, the substantive articles of the agreement are contained in Part II. Of its 16 articles, article 3 has drawn the most attention:

> Each party shall ensure that its measures do not operate to restrict or impair trade between or through the territory of the Parties, or investment or labour mobility between the Parties.

This article has been interpreted by critics as opening the door to widespread deregulation. But a closer examination of the stated provisions reveals that this is not the case.

Article 4 is essentially a non-discriminatory clause. A provincial government

may, for example, tax or regulate an extra-provincial enterprise or person doing local business, but not in a manner that is any different from local enterprises or persons.

Article 5 concerns standards and regulations. The article makes clear that the objective is not to eliminate standards; but rather, to coordinate them and to prevent the establishment of new standards that inappropriately restrict trade, investment or labour mobility. In particular, note that this article states:

> Parties shall cooperate to minimize differences in standards or regulations adopted or maintained to achieve legitimate objectives.

In addition,

> Parties shall mutually recognize or otherwise reconcile their existing standards and regulations that operate to restrict or impair trade, investment or labour mobility.

Article 6 expressly states that each province may establish protectionary measures necessary to achieve a legitimate objective. This article also requires that any such measure is not more restrictive than necessary to achieve the legitimate objective. In particular, the article seeks to eliminate measures that are thinly disguised barriers to trade (like the Quebec law that prevents the importation of yellow margarine).

Article 11 pertains to investment activity. The thrust of this article is to ask provinces to reconcile their business registration and reporting requirements and to eliminate the need to maintain local offices. It seems clear enough what TILMA is after here. For example, a real estate investment firm in Calgary will be able to invest in Vancouver real estate developments without having to re-register their entity in British Columbia. On the other hand, staunch free-traders may be disappointed to see that this same article states:

> Nothing in this Agreement shall be construed to prevent a Party from maintaining, designating, or regulating a monopoly for the provision of goods or services within its own territory.

Article 13 pertains specifically to labour. Currently, skilled tradespersons and professionals face redundant and costly requalification requirements if they want to work outside their home province. Under TILMA, qualifications for many professions and occupations issued by either province will be automatically recognized in both provinces. It will now be made easier, for example, for a manufacturing firm located in northern British Columbia to recruit skilled tradespeople from northern Alberta, rather than from southern British Columbia.

Article 14 pertains to governmental procurement of goods and services. This article requires that provincial governments provide open and non-discriminatory access to procurements for agents and agencies located in either province. The goal here is to minimize the tax burden associated with government procurements and reward the most efficient agents and agencies in the combined region.

The remaining articles are equally modest. The basic thrust of the agreement is to avoid costly redundancies, to promote the migration of skilled workers, and to minimize discriminatory government practices, while maintaining government prerogatives in key sectors of the economy.

# 4 Addressing the Critics

There is no government legislation that is beyond legitimate criticism and TILMA is no different in this regard. Unfortunately, debate in the western hemisphere of the country appears to be governed more by ideology, rather than a healthy respect for theories, facts, and empirical evidence. While participants on both sides of the debate may be accused of this in varying degrees, the transgressions appear particularly acute from the opposition side; where accusations often border on the inane, and where some claims can believed only under the most cynical of interpretations.

## 4.1 Economic Benefits Have Been Widely Exaggerated

The most cogent case for this claim has been made by Lee and Weir (2007). The authors correctly point out that trade across Canadian provinces is already relatively free. They are likely correct in asserting that proponents of TILMA have exaggerated the economic benefits of the agreement. This is consistent with my own reading of the document which, as I stated above, proposes a rather modest set of reforms and takes care to list several exemptions. But as I have argued above, whether the net pecuniary benefits turn out to be large or small is largely beside the point. The agreement is clearly targeted toward eliminating 'illegitimate' practices that hinder efficiency (prosperity) and individual freedoms.

In what is otherwise an excellent article, Lee and Weir betray their own personal prejudices by stating:

> What corporate Canada calls 'trade barriers' are in fact differences across provinces in government procurement systems, labour standards, consumer-protection measures, environmental regulations, and taxes. Harmonizing these policies down to their lowest common denominator would certainly reduce the cost of doing business.

This statement embeds within it many disingenuous remarks, some of which

I shall address below. Here, I cannot help but noting (with some amusement) that to Lee and Weir, a local government that refuses to accept a lower bid from a non-local contractor is simply and benignly practicing a 'different procurement system.' A detached observer may be forgiven for interpreting such practices as discriminatory against other Canadians and fiscally irresponsible as far as the local taxpayer is concerned.

## 4.2 TILMA is the Product of a Corporate Agenda

Economic historians tend to look on the corporation as one of mankind's great innovations. To some, however, the word 'corporation' is synonymous with 'robber baron.' But corporations are not people; they are legal entities that organize production on behalf of their stakeholders, including shareholders, bondholders, management and workers. Successful corporations are the ones that keep their customers and stakeholders satisfied; i.e., they are the ones that serve the interests of the broader community.

Presumably, the critics who make reference to a 'corporate agenda' are referring to the allegedly conspiratorial actions of corporate managements to exploit the broader community on behalf of their shareholders. If this is true, then the blame must be laid squarely at the feet of the owners of corporate Canada. As the ownership of Canadian business equity is widely held in the portfolios of Canadians, the charge of conspiracy is ultimately levelled against a wide segment of Canadian society. Or perhaps the charge is only meant to pertain to owners with large holdings of capital. One of the largest capitalist organizations in Canada (indeed, the world) is the Ontario Teachers' Federation. Perhaps this union is behind TILMA?

Unfortunately for those who advocates of conspiracy theory, there is little evidence to suggest that TILMA is the product of corporate lobbying. In fact, the evidence suggests quite the contrary. Danielle Smith (2007), for example, argues persuasively that big businesses are currently one of the main beneficiaries of existing trade barriers, as they are more able to lobby for special grants, subsidies, and regulations that put their smaller competitors at a disadvantage.

## 4.3 TILMA Will Lead to a Regulatory Race to the Bottom

Lee and Weir, quoted above, suggest that TILMA is little more than a clever ploy designed to harmonize regulations to their lowest common denominator. It is more than a little ironic that their article, which makes a legitimate argument against overblown claims, succumbs to the same temptation. To begin, part V(1) of TILMA expressly excludes: Aboriginal peoples, water services and investment, taxation and royalties, regulated rates established for the public good, and social policy–including labour standards and codes, minimum

wages, employment insurance, social assistance benefits and workers' compensation. Several other exceptions are listed as well, pertaining to various aspects of the environment, transportation, forests, fish and wildlife, government procurements, energy and metals, business subsidies, and so on.

Murray Dobbin (2007) offers a more precise statement concerning the prospect of a regulatory race to the bottom:

> Under mutual recognition, companies doing business in a province can choose between two different standards, and follow the standards where their head office is located if this is more advantageous to them. The TILMA therefore does not so much make two provinces out of one as it makes them compete in a regulatory race to the bottom.

There is a certain logic to Dobbin's statement; but it is nevertheless misleading. First, what are the regulations that we are talking about here? As I have mentioned above, TILMA expressly allows each provincial government to establish, maintain, and even expand regulations in several key sectors. The 'mutual recognition' to which TILMA refers is rather limited in scope. In terms of investment, Article 11 asks for reconciliation of business registration and reporting requirements, and that redundant offices be eliminated. In terms of labour, Article 13 asks that the provincial certification of a small group of professions and occupations with similar certification requirements be mutually recognized. In terms of energy, Article 15 asks that standards-related electricity measures are not incompatible with generally accepted North American standards. In terms of transportation, Article 16 asks that vehicles licensed and registered in one jurisdiction be recognized as such in the other jurisdiction. Exactly how is harmonization along these dimensions to lead to a regulatory race to the bottom?

Ellen Gould (2007) makes an even bolder assertion:

> TILMA can only result in pressures to deregulate. The requirement to reconcile regulations and standards is subject to enforcement by private investors, who are far more likely to launch complaints over regulations because they are too high rather than because they are too low.

Ms. Gould is not likely to be comforted by the fact that her opposition to TILMA would be shared by the most ardent opponents of government regulation, but for a very different reason. A current hot topic in Europe concerning the EU is how to coordinate fiscal policies in a manner that avoids a regulatory race to the bottom. When capital is free to move across jurisdictions, it will tend to flow to the jurisdiction will the fewest regulatory hurdles. Jurisdictions within a common market (like the EU or Canada), who do not coordinate their

policies, are compelled to compete for mobile capital by reducing their standards. That is, a regulatory race to the bottom occurs *because of a lack of harmonization* of policies. Hans-Werner Sinn (2003), one of Europe's leading policy economists has argued persuasively that coordination and harmonization of government policies across European states is absolutely essential to maintain regulations at desired levels.

## 4.4 TILMA May Result in Junk Food Being Sold in Schools

This demonizing claim has been levelled by (the apparently shameless) Ms. Gould (2007).

The claim is in reference to the fact that the B.C. government has recently banned the sale of junk foods in schools and hospitals; a regulation that does not currently exist in Alberta. Evidently, under TILMA we are to expect vending machine operators to argue that the local ban on junk food sales constitutes an impairment to investment. The argument is silly because TILMA expressly allows each provincial government to implement regulations tailored to local preferences and policy objectives. What TILMA would preclude is a law that allows local vendors to sell their wares, while precluding non-local vendors from doing the same. Since both B.C. and Alberta vendors are prohibited from selling junk food in B.C. schools, such a regulation does not violate TILMA.

## 4.5 TILMA Undermines the Democratic Process

There have been several charges claiming that TILMA was negotiated under a cloud of secrecy and that its provisions serve to undermine the democratic process. While it appears true that negotiations leading up to TILMA were not well advertised, the same could be said of most new legislation that is passed.

In any case, according to the TILMA website, negotiations occurred over several years. In 2004, the provinces signed a Framework Agreement, which set out the goals and time frame for negotiating a comprehensive trade pact. The governments claim to have informed the public of their intentions. From 2003 to 2006, the two provinces also held a series of joint cabinet meetings pertaining to TILMA and the results of these meetings were evidently highlighted in news releases. None of the proposed elements of TILMA were debated in the legislatures of the provinces (perhaps they should have been), but the ministers are claimed to have acted on the authority delegated to them under provincial laws and parliamentary traditions. Nevertheless, a legitimate claim could be made that the process should have been made more open to public scrutiny.

But for those who are concerned that the democratic process is at risk, note that Article 20(2) states clearly that "A Party may withdraw from this Agreement on 12 months written notice to the other Party." Moreover, Article 21(1) states that "The Parties may enter into negotiations to amend this Agreement."

In short, there is nothing in TILMA that binds the populace to the agreement in perpetuity. The agreement may work out well or it may not. In the event that the agreement is perceived to do more harm than good as time unfolds, its stipulations will be amended or the agreement terminated according to the will of the electorate.

## 5 Conclusion

TILMA constitutes a modest proposal to eliminate or mitigate trade barriers that have emerged owing to a lack of coordination and special interests intent on securing gains at the expense of the broader community. It is not a document that calls for massive regulatory reform. Its proponents have likely exaggerated the pecuniary gains that are likely to flow from this minimalist reform, but the net benefits are likely to be positive. If this turns out not to be the case, the agreement allows for future amendments and the possibility of termination.

## 6 References


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