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The Internal Trade Agreement: Furthering the Canadian Economic Disunion?

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THE INTERNAL TRADE AGREEMENT: FURTHERING THE CANADIAN ECONOMIC DISUNION?

*David Cohen**

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I. INTRODUCTION

A defining characteristic of all communities, whether families, tribes, guilds, firms, universities, unions, municipalities or states,

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is the strength and nature of the relationships between their members. Whether these relationships are based on kinship, religious connection, language, mutual economic interest, social class, political affiliation or cultural heritage, whether they are organized hierarchically or polycentrically, it is fair to say that we expect them to be richer, more permanent and more deeply imbedded within the identities of the members of these communities than are the relationships among members of different communities.

The Canadian identity, because of needs generated by a relatively small population, vast territory, dual languages and immigrant heritage, has been defined by the strength and integrity of our relationships with one another as Canadians. Unlike many other nations, we have not defined ourselves as a nation of atomistic individuals, we do not have international ambitions or symbols of international supremacy to draw us together. It is the strength and depth of the internal relations among Canadians which explain why, as Canadians, we respond to the needs of fishers in Newfoundland when the fishery collapses; why we respond to the needs of farming communities in the Prairies in the face of crop devastation or collapsing international commodity markets; why we support the development of Northern communities; why one of our most important national symbols is represented by our sharing of health and medical costs; why we support the preservation and enhancement of the distinctiveness of Quebec culture and language; why we support economic transition strategies in Ontario in the face of changing trade relations; and it is why we struggle with issues of diversity and multi-culturalism in Canada perhaps more than any other country in the world.

The premise of this article on the current status of the Canadian economic union and the meaning of the Internal Trade Agreement (the "Agreement") on that union, is that the union describes the economic relations among individual Canadians. The union is not comprised of the interconnections among political jurisdictions. The Canadian economic union, when conceived as the product of the relations between individual Canadians, is the market. We have decided that our material well-being as individuals and as a community is best served by decentralizing economic power and thereby permitting individuals, whether alone or in groups, to act relatively autonomously in

deciding when, with whom and how they should arrange their affairs in an effort to achieve self-defined goals. The essential nature of the Canadian economic union is one of untold millions of privately arranged economic market relations — subject to regulation, of course, but nonetheless defined by private firms and individuals.

Depending on the context, relatively discrete and identifiable markets will develop within neighbourhoods, within urban areas, between urban areas and rural hinterlands, between remote resource communities and international buyers, and within relatively large geographic regions — ultimately, some markets in Canada will be national in scope and in many cases the Canadian market will form part of a larger international market. Thus the Canadian economic union consists of numbers of individual relations which, in a unitary state and without redistributive policies, would be arranged according to a pattern which individuals believe would maximize their personal welfare as Canadians.

In the absence of governmental policies (whether developed at the federal or provincial level) intended to benefit particular individuals within specific regions within Canada, the scope and scale of market relations within Canada should and will be defined and shaped by population densities, the presence or absence of biophysical resources, by communication and transportation infrastructures, by the availability of capital, by the comparative advantage of the persons comprising particular communities within Canada, and by geography and weather. The Canadian economic union — with whom one trades, when, on what terms and under what conditions — will be defined by private individuals and firms seeking to increase or maximize their respective wealth or welfare subject only to those “natural” constraints which will produce markets, determine their shape and scale, or in some instances preclude their development. The Canadian economic union is, in that sense, the product of individual Canadians trading with one other. The “union” is the absence of the state beyond its role in the recognition of property rights, in providing for the enforceability of contracts, and in correcting for market failures should they occur.¹

¹ The ultimate shape of the Canadian social, cultural and political union will, of course, be determined by important redistributive policies — both through direct and indirect

However, as a federal state, the scope and scale of the Canadian economic union are also defined by the political boundaries of Confederation which were established without regard to the then existing, let alone the present, configuration of markets in Canada. We have decided, for good or bad, to establish sovereign provinces with authority to legislate with respect to exchange relations — contract, property and trade — within the province. Constitutional decisions, almost from the time of Confederation, have vested a considerable portion of potential regulatory authority over markets in provincial governments. The result is a fragmentation of markets which would otherwise be organized without regard to provincial boundaries.² We are thus confronted with one of the essential dilemmas of federalism — when should economic relations exist, be defined or be regulated at the national level, and at the level of subnational political units. In the absence of pressing arguments in favour of market fragmentation, it is my position that national markets — which will include many, although not all, aspects of transportation services; communication services; investment and financial services; the creation, distribution and supply of energy and natural resources; and so on — call for definition and regulation at the national level. The other side of this position is held by “provincialists” — those who argue that the federal government itself will engage in market-fragmenting and market-distorting policies; that local governments can engage in public policy formation which is much more sensitive to local welfare; and that provincial trade barriers and protectionist strategies can be addressed, *ex post*, through voluntary provincial agreements.³

The current debate concerning the Canadian economic union began in the early-1980s negotiations leading up to the constitutional amendments of 1982. In 1983 the Ontario Economic Council published *Federalism and the Canadian Economic Union*,⁴ a collection of essays edited by Professors Trebilcock,

taxation and through social welfare programs. However, the economic union is the marketplace.

² See P. Monahan, “At Doctrine’s Twilight; The Structure of Canadian Federalism” (1984), 34 U.T.L.J. 47.

³ See F. Flatters and R.J. Lipsey, “Common Ground for the Common Market”, *Essays in International Economics* (Instit. Res. Pub. Pol., 1983).

⁴ M.J. Trebilcock, J.R.S. Prichard, T.J. Courchen, J. Walley eds. (Toronto, U. of T. Press, 1983). See also, A.E. Safarian, *Canadian Federalism and Economic Integration*, constitutional study prepared for the Government of Canada (1973); The Honourable Jean

Prichard, Courchene and Whalley in which the authors addressed that central question — which level of government should have authority over which economic activities — which defines Canadian economic federalism. That collection initiated a decade-long debate about which level of government was responsible for distortions in the Canadian common market, about the magnitude and distribution of the welfare losses associated with trade barriers, and about the most appropriate political response to the fragmentation of the Canadian marketplace. I am not going to repeat any of what was said then — my sense of the literature is that not much has been added to the very perceptive analyses (descriptive, empirical and theoretical) contained in that collection.⁵

In July 1994 — more than ten years after this seminal series of essays was written — the federal government, ten provinces and two territories signed what is referred to as the Agreement on Internal Trade. The Agreement is presented as an almost mythic “voluntary agreement” symbolizing the ability of ten provinces and the federal government to work co-operatively to further the national good.⁶ It attempts to bring Canada together; to re-orient Canada on its historical East/West axis. However, I argue in this essay that the symbolism of the Internal Trade Agreement, while important, is not enough. The substance of the Agreement offers Canadians, as they define their economic relations with each other within Canada, substantially less than international trade agreements offer Canadians as they define their economic relations with foreign firms and citizens. I also attempt to explain how and why

Chretien, Minister of Justice, *Securing the Canadian Economic Union in the Constitution*, discussion paper published by the Government of Canada (1980); Frank Flatters and R.J. Lipsey, *supra*, footnote 3.

⁵ For more recent work, see William B.P. Robson, *Dynamic Tensions, Markets, Federalism and Canada's Economic Future: Policy Review and Outlook* (C.D. Howe Institute, 1992); J. Quinn, “Federalism and Foreign Economic Relations” (1985), 10 *Can.-U.S. L.J.* 197; *Perspectives on the Canadian Economic Union*, Mark Krasnick, ed., Vol. 60, Royal Commission on the Economic Union and Development Prospects for Canada (Toronto, U. of T. Press, 1986); R. Broadway, *The Constitutional Division of Powers: An Economic Perspective* (Economic Council of Canada, 1992).

⁶ The Agreement was presented by the federal government and the then Liberal government in Quebec as evidence of the “new” flexible federalism which offered increased autonomy for Quebec as part of Canada. Perversely, however, the Agreement may represent a nascent international economic trade agreement should Quebec sovereigntists succeed in their quest to establish an independent Quebec state in North America.

this came about — the explanation is linked to economic, political and constitutional events which cannot be separated from the issue of internal trade.

II. THE INTERNAL TRADE AGREEMENT — AN OVERVIEW

The core of the Agreement is contained in the following principles. First, the provinces agreed to a general “Reciprocal Non-Discrimination” principle — provinces must accord to goods, services, persons and investments of other provinces no less favourable treatment than they accord to their own goods, services, persons and investments. Second, the provinces agreed to recognize the right of exit and entry — provinces may not adopt any measures that restrict or prevent the movement of persons, goods, services or investments across provincial boundaries. Third, the provinces agreed that provincial regulatory measures will not operate to create obstacles to inter-provincial trade. Fourth, the provinces agreed that these trade liberalization principles would be subject to exceptions for legitimate provincial objectives. That is, regulatory measures inconsistent with the above principles are permissible if the purpose of the measure is to achieve legitimate objectives that are not unduly restrictive. Legitimate objectives include the pursuit of public security and safety, public order, protection of human, animal or plant life or health, protection of the environment, consumer protection, protection of the health and well-being of workers and affirmative action programs. Fifth, the parties agreed to a set of non-judicial dispute resolution measures and to continue negotiations in respect of those components of the agreement which were not concluded.

III. TWO COMPETING VISIONS OF THE INTERNAL TRADE AGREEMENT

The meaning of the Internal Trade Agreement can best be understood in the telling of two very different stories — one told by a nationalist, the other by a provincialist. The reader can choose for herself or himself which one accords with one’s sense of the reality of Canada; which of the two stories describes a nation.

The nationalist story begins with the assertion that the Agreement confirms the primacy of the Canadian economic union. The Agreement is evidence that there is no necessary or

logical inconsistency between the extreme provincial political sovereignty which characterizes Canadian federalism and the achievement of a high degree of economic integration. The Agreement confirms that autonomous provinces can voluntarily come together to negotiate a multi-lateral arrangement which will respond effectively to market fragmentation, destructive competition for investment, excessive enforcement and compliance costs and duplication in program delivery. Moreover, the nationalist would view the Agreement as merely the starting point in the process of voluntary, multi-lateral reconciliation and reduction of trade barriers, and the nationalist would identify a number of weaknesses in the Agreement which demand further action.

First, the Agreement is directed primarily at preventing the introduction of new barriers to trade. The fundamental principle which defines the Agreement is not the elimination of existing barriers to trade, but rather merely a commitment in Article 102⁷ that the provinces will not establish new barriers to internal trade. While other very important fundamental principles affirm "equal treatment" of goods, services, people and investment and recognize that provinces will reconcile conflicting standards, the Agreement is fundamentally flawed in its failure to impose or recognize any fundamental obligation to eliminate existing barriers to trade.

Second, the Agreement fails to attend to the issue of duplication of services between the federal and provincial governments. The scope of the Agreement confirms the critical need for further agreements to address the costs of multi-provincial regulatory activity, as well as the increasing competitive costs of government procurement and related incentive programs. The categories of trade barriers addressed in the agreement — non-tariff standard barriers, government procurement policies, local presence and residency requirements for investment, labour mobility, consumer-related measures and standards, agricultural and food goods, alcoholic beverages, natural resources, transportation, incentive programs and environmental protection — overwhelmingly illustrate the breadth of the trade-distorting barriers that

⁷ Article 102(3) provides that the provinces, in the application of the Agreement, shall be guided by a number of principles, including Article 102(3)(a), which mandates that the provinces "will not establish new barriers to internal trade and will facilitate the cross-boundary movement of persons, goods, services and investments within Canada".

have been developed over decades by both federal and provincial governments. However, in many of these areas, the Agreement merely establishes processes and structures for future negotiations which may (or may not) provide for specific measures designed to reduce or eliminate provincial trade barriers and other protectionist strategies.

A third concern of nationalists is the erosion of the principle of internal free trade through a myriad of exceptions to free trade principles which permeate the Agreement. This underlying weakness of the Agreement is best illustrated by Article 102.4:

4. In applying the principles set out in paragraph 3, the Parties recognize:
 - (a) the need for full disclosure of information, legislation, regulations, policies and practices that have the potential to impede an open, efficient and stable domestic market;
 - (b) the need for exceptions and transition periods;
 - (c) the need for exceptions required to meet regional development objectives in Canada;
 - (d) the need for supporting administrative, dispute settlement and compliance mechanisms that are accessible, timely, credible and effective; and
 - (e) the need to take into account the importance of environmental objectives, consumer protection and labour standards.

In the result, three of the five interpretative guidelines support the continuation of trade barriers — even at the outset the parties recognize the need for exceptions to free trade principles, the need for exceptions to meet regional development objectives and the need to take into account environmental, consumer protection and labour standards.

A fourth concern of economic nationalists is the Agreement's inadequate treatment of government procurement policies. While chapter 5 of the Agreement, which deals with procurement policies, includes its own fundamental "reciprocal non-discrimination" provision, Article 504, which specifically refers to equal treatment and most favoured province treatment of construction contractors, operates so as to exclude a substantial number of Crown corporations, municipal corporations and other private/public enterprises from the Agreement's procurement provisions.⁸ Given the economic, social and political significance

⁸ See *Internal Trade Agreement* at pp. 65-83. However, it should be noted that the Agreement includes a commitment to further negotiations to extend the Agreement to these entities (Article 502.4).

of these institutions to the Canadian political economy, their exclusion substantially weakens the force of the Agreement. Moreover, their exclusion suggests that governments have a relatively simple mechanism to introduce new trade barriers in the future. More significantly, Article 508 provides for the indefinite continuation of regional and economic development programs which are exempt from the procurement provisions of the Agreement so long as provinces list the programs, prepare an annual written report on program operations, and conduct a review of the programs by 1998 in light of their regional and economic development objectives. Finally, the Agreement excludes “intra-governmental” contracts entirely from the operation of the procurement regulations.

Fifth, the trade-off between efficient national markets and the preservation of provincial political sovereignty is manifest in two particular provisions of the Agreement. Article 301 provides that nothing in the Agreement alters the legislative authority of the provinces — of course, no contractual agreement could preclude provinces from exercising their constitutional powers to alter the provisions of the Agreement unilaterally.⁹ More specifically, Article 404 of the Agreement permits provincial governments to depart from fundamental equal treatment obligations where they are pursuing “legitimate provincial objectives”:

Where it is established that a measure is inconsistent with Article 401, Article 402 or 403, that measure is still permissible under this Agreement where it can be demonstrated that:

- (a) the purpose of the measure is to achieve a legitimate objective;
- (b) the measure does not operate to impair unduly the access of persons, goods, services or investments of a Party that meet that legitimate objective;
- (c) the measure is not more trade restrictive than necessary to achieve that legitimate objective; and
- (d) the measure does not create a disguised restriction on trade.

As a result, provinces may depart from the non-protectionist directive in Article 401 simply by demonstrating that the purpose (and not the effect) of a regulatory measure is to achieve a provincial “legitimate objective”. Legitimate objectives, defined

⁹ This exclusion emphasizes the inherent limitation of using a contractual vehicle to address provincial trade barriers, as compared to earlier initiatives which would have constitutionalized the limitations on provincial authority to enact legislation affecting inter-provincial trade.

in Article 201, encompass virtually all significant areas of provincial regulatory jurisdiction — public safety, public order, protection of human, animal or plant life, protection of the environment, consumer protection, protection of the health, safety and well being of workers, and affirmative action programs for disadvantaged groups. Moreover, Annex 405.2 provides that provinces may adopt and maintain regulatory measures which they “consider . . . appropriate” to achieve a legitimate objective. The combination of these provisions means that provinces are free to engage in a broad range of regulatory policies unencumbered by restraints imposed under the Internal Trade Agreement.

In addition, the Agreement contains an array of exceptions which will result in continuing trade distortions. The exceptions include:

- (a) energy goods and energy services;¹⁰
- (b) restrictions relating to occupational qualifications;¹¹
- (c) procurement practices by a substantial number of government-related agencies and procurement practices relating to regional and economic development purposes;¹²
- (d) economic incentives which do not “directly” result in an enterprise relocating outside a province;¹³
- (e) restrictions on labour mobility which relate to social policy measures,¹⁴ or which are designed to achieve legitimate objectives including “labour market development”;¹⁵
- (f) consumer measures to achieve legitimate objectives which, in this context, include the promotion of economic interests¹⁶ as well as the physical safety of consumers;¹⁷

¹⁰ The chapter of the Agreement dealing with energy simply states that energy will be the subject of future negotiations envisioned in Article 1810.

¹¹ See Article 709.

¹² Article 508.

¹³ See Annex 608.3(4).

¹⁴ Social policy measures include, but are not limited to, different labour standards and codes, minimum wages, unemployment insurance qualification periods and social assistance benefits.

¹⁵ See Article 709. Other legitimate objectives of labour policy include such broad categories as public security, public order, protection of human, animal or plant life or health, protection of the environment, consumer protection, worker safety, affirmative action programs, and provision of adequate social and health services to all geographic regions of a province.

¹⁶ See Article 810. Economic interests are defined in extremely broad terms and include,

- (g) supply-side management programs¹⁸ and other non-technical trade barriers applicable to agricultural products;
- (h) a broad range of barriers, both bilateral and multi-lateral, relating to the wine and beer industry;¹⁹
- (i) management programs relating to natural resources including fisheries, forestry, water and mineral resources;²⁰
- (j) measures respecting culture or cultural industries;²¹
- (k) the regulation of financial institutions and financial services;²²
- (l) a range of regional economic development programs which do not “unduly” impair access of persons, goods, services or investments of another province;²³ and
- (m) a range of regulatory requirements applicable to the transportation sector.²⁴

Various arguments have been offered to support these diversions from the pursuit of the Canadian economic union. First, the provinces argue that provincial sovereignty permits, indeed encourages, regulatory experimentation and competition which produce benefits which exceed those associated with the reduction or elimination of trade restrictions. However, there is considerable evidence that trade restrictions unequivocally reduce aggregate national economic well-being. Proponents of the benefits of inter-provincial regulatory competition should be required to demonstrate the economic benefits associated with that position. Moreover, regulatory experimentation can be

but are not limited to, quality of goods, services and suppliers, information disclosure about the goods, services and suppliers, contractual fairness, access to redress mechanisms, security of consumer deposits, prevention of unfair trade practices and protection of privacy.

¹⁷ *Ibid.*

¹⁸ Indeed, Article 902 obliges the parties to implement an action plan towards the development of sustainable orderly marketing systems in the Canadian dairy, poultry and egg industries.

¹⁹ See Chapter 10 of the Agreement.

²⁰ See Article 1102.

²¹ See Article 1802.

²² Article 1807 excludes measures adopted by governments or agencies which exercise regulatory jurisdiction in relation to financial institutions or financial services.

²³ See Article 1802, “Regional Economic Development”.

²⁴ See Annex 1410.1.

achieved by a resourceful federal government willing to implement trial policies at the regional or local level. Finally, the potential benefits of regulatory competition cannot justify the wholesale exclusion of broad economic sectors from the Agreement's ambit.

A second argument favouring broad exceptions from the Agreement focuses on the diversity of social and cultural values within Canada — regulatory policies which maximize aggregate social welfare in British Columbia or New Brunswick may not achieve that end in Saskatchewan or Quebec. While that position may explain some exceptions (in particular, exceptions for cultural industries), assertions of provincial social and cultural diversity fail to explain or justify differing provincial regulatory policies in areas such as communications, investment, regional development, financial services, government procurement and so on. I think we make far too much of the argument that social welfare will be maximized through decentralized policies which ensure that local public goods, like consumer protection, are designed and delivered at the local level.²⁵ It may very well be that local tastes are simply not as distinct as local and provincial politicians would have us believe them to be. Countries as diverse as Britain, France, Germany and Italy, with consumer markets at least as sophisticated as Canada's and with populations two, three and four times as large, prosper without multiple consumer protection regimes.²⁶

In the end, the Internal Trade Agreement, the nationalist would argue, is an important starting point in the incremental, voluntary reconciliation of trade barriers among provinces. While it is a unique and critical opening move in building a new economic partnership among provinces, it does not go nearly far enough.

²⁵ See A. Breton and A. Scott, *The Economic Constitution of Federal States* (Toronto, U. of T. Press, 1978).

²⁶ If there is an argument for local regulation of consumer markets, it exists at the community or urban level. There are certainly many consumer markets which are quite local in nature and where relevant information which would be necessary for regulation can only be efficiently obtained at the local level. Local regulation in the consumer context would, with few exceptions not likely result in significant trade barriers. Producer interests could not effectively organize at this level of politics. In many cases, even if producer organizational costs were relatively low, the benefits of the trade barrier would be even lower. Finally, few local communities would be able to exercise sufficient leverage, in light of the opportunity costs of excluding entry, to adopt exclusionary regulatory policies affecting consumer goods.

A second, very different story is told by a provincialist who argues that the Agreement goes much too far in obliging provinces to pursue national trade objectives and to further national economic interests, when the appropriate role for the provinces is the pursuit of measures to serve the legitimate, albeit narrower, social interests of their local populations. Provincialists favour inter-provincial competition and argue that those who do not consider themselves better off under particular provincial regimes can exercise a much more effective political voice at the provincial level than they could federally, or can simply “vote with their feet” and choose a more attractive set of provincial policies.²⁷

As well, provincialists argue that the Agreement is inadequate to protect local and provincial interests — provincialists take the position that measures which are designed to benefit local consumers should not be subject to any constraints which, while potentially increasing overall economic well-being in Canada, would almost certainly result in a net loss to local residents. The nature of federalism is that only the provinces can and should address local demands which cannot be effectively communicated or received at the federal level of government. Many regulatory measures, especially in provinces outside of the traditional manufacturing base in central Canada, are intended to address their significant imbalance in economic and political power relative to the “centre”. In the absence of strong federal regulatory intervention, provinces must be able to pursue regulatory agendas which attempt to redress the concentration of economic power in Ontario and Quebec.

A third concern of provincialists is that the Internal Trade Agreement will have a chilling effect on regulatory action at the provincial level. The expected benefits of much regulatory intervention, such as environmental and consumer protection

²⁷ The view of provincialists toward the document is unlikely to be totally negative. In particular, the Agreement applies to the activities of the federal level of government. This inclusion addresses long-standing complaints of several provinces that certain federal government market-distorting policies enacted in the name of the “national interest” have, in reality, been motivated by regional interests acting within the federal government to pursue transfers of wealth from one region to another. In addition, provincialists argue that the Agreement achieves an admirable balance between the efficiencies of national markets and the needs of local communities. They would argue that the “legitimate objectives” exceptions are vital in order to protect values which cannot be calculated in economic terms — including concerns with the distribution of wealth among provincial residents, the preservation of local cultures and so on.

measures, are notoriously difficult to quantify — and thus it may not be possible for provincial governments to demonstrate that the purpose of a particular measure was to achieve a legitimate objective. At the very least, the existence of the provision means that provinces may decide to withdraw from measures which may have long-term benefits to the residents where those benefits are not identifiable and measurable in the short term.

Fourth, the requirement that provinces must demonstrate that measures inconsistent with the agreement but which attempt to meet legitimate objectives are not more trade restrictive than is necessary will lead governments to adopt the least intrusive and perhaps relatively less effective measures. To use consumer protection legislation as an example, less intrusive regulatory measures — such as requirements for performance rather than design standards, insurance requirements and warnings or disclosure requirements rather than licensing or certification measures — may have significant adverse distributive consequences to particular groups of consumers and certainly present a risk of less effective regulatory impact than do the more intrusive regulatory instruments available to governments.

Fifth, Article 806 which prohibits the application of residency requirements on individuals doing business within a province ignores the very real difficulty which consumers and regulators face in effectively controlling the activity of extra-provincial businesses. Those who favour provincial regulatory authority argue that provincial governments must be able to establish residency requirements on natural persons as a licensing or registration condition. Consumers cannot be expected to pursue defendant suppliers outside provincial boundaries, and trade practice legislation and regulatory compliance sanctions in general are most effective when they are applied to individual defendants and not merely to their firms.

The general requirement in Annex 405.1.7 of the Agreement that standards must be developed as performance or competence rather than as design standards will permit uncontrolled experimentation by industry which will be able to comply with regulatory standards at the lowest possible cost, but may use that freedom to design products or services which may simultaneously put the safety and health of consumers at risk. If performance standards are to be utilized, regulators must be able to assess the particular design selected by the industry to determine, *ex ante*, if that design

adequately addresses the risk at issue and to confirm that the design does not generate additional or different risks to consumer welfare.

In the end, the provincialist argues that the citizens of provinces deserve at least the same degree of respect within inter-provincial trade agreements as do citizens of states in international trade agreements. National welfare must take second place to the welfare of local residents, pursued by provincial governments as their agents. Viewed through this lens, the Internal Trade Agreement goes much too far in demanding that provincial governments take into account the interests of firms acting in national or international markets, or in insisting that provincial regulatory authority be circumscribed in order to maximize aggregate national wealth and productivity.

IV. WHY SUCH DIFFERENT VIEWPOINTS?

How then does one explain those very different stories? The search for the answer to this question takes one beyond the Agreement itself. To understand why both these stories can be told simultaneously, one is forced to confront one's conception of Canada and to understand what it means to be a Canadian. The answer to the question lies in a decade of fundamental changes in Canada's social, economic and political order during which our modern understanding of trade agreements was being shaped. These changes increased the need and desire for an internal trade agreement while simultaneously ensuring that severe and indeed intolerable limits would be placed on its scope and efficacy.

The Canadian economic union represents only one particular component of the complex internal relationships which define us as Canadians. It is not possible to understand what has occurred to the Canadian economic union without moving beyond the extraordinarily complex, inter-connected exchange relations among economic factors which characterize market economies. The Canadian economic union is part of a social fabric which is comprised of a range of political sovereignties and allegiances associated with multiple jurisdictions in a federal state, the existence of strong regional cultural identities, diverse attitudes at the regional level towards the role of the Canadian state and social security, and conceptions of the role of Quebec in Canada.

Several transforming events occurred during the decade since we started talking about internal trade.²⁸ These events have

²⁸ I use the term "transforming" to describe fundamental, effectively irreversible changes

changed Canada permanently. They are largely responsible for the fact that we finally saw the federal and provincial governments enter into a trade agreement, and, paradoxically, for the fact that the trade agreement accomplished so little. These events have, sadly, worked together to create a nation which may be rapidly disintegrating around us.

1. The Free Trade Agreements

Canada entered into a Free Trade Agreement and then a North American Free Trade Agreement — first with the United States and then with the United States and Mexico. An intense debate occurred within Canada focusing on the winners and losers within Canada created by those trade agreements; on the appropriate transition strategies necessary to respond to changes in the Canadian economy associated with those agreements; on the impact on environmental, social and labour policies associated with competition in a North American market; on how Canadian cultural identity would be affected by open North American markets; and on the future we would face without those agreements.

The trade agreements demonstrated to many (although certainly not to all) Canadians that freer trade could bring substantial economic benefits — and avoid more serious negative economic consequences — to Canadians. The international agreements made the federal government acutely aware that its success in future international negotiations and its ability to avoid challenges to the existing agreements would be jeopardized if it could not assure foreign nations of co-operation by the provinces. The Agreements also created a climate in which trade agreements were seen as part of the current popular political agendas of all main-stream parties. The existence of these agreements increased the likelihood of extra-national challenges to provincial as well as federal policies which, while they might be directed at internal trade issues, would be challengeable under the North American Free Trade Agreement and the Canada-United States Trade

in the way in which Canada is governed and thus changes which define the Canadian political economy. In that sense, elections, treaties, constitutional reform and economic recessions, in so far as they exact far-reaching and relatively permanent changes to Canada's social, economic and political order, are treated similarly.

Agreement as interfering with the flow of goods across international borders.²⁹ All of these developments offered considerable support for those who argued for the development of an internal trade agreement among the provinces.

At the same time, however, there can be little disagreement with the proposition that the two free trade agreements have brought Canadians much closer to the United States than we were a decade ago. In so far as we define ourselves in relation to others, the number and kinds of relations which comprise Canada have shifted from an East/West to a North/South axis and toward nations beyond Canadian borders. Provincialists, from British Columbia, for example, will argue that there is, in truth, little need for a pan-Canadian trade agreement. British Columbia may now, and will certainly have in the future, stronger economic links with Asia and the western American States than it has to much of Canada. Firms in many provinces need effective trade agreements with the United States and Asian countries more than they need agreements with most Canadian provinces. Those extra-national jurisdictions have the technological expertise, populations and resource needs which Canadian firms cannot afford to ignore. With continued progress on World Trade Organization treaties and with the introduction of the Canada-U.S. Free Trade Agreement and the North American Free Trade Agreement over the past decade, the need for a "Canadian" Free Trade Agreement has been significantly attenuated.

Canada's participation in two international trade agreements thus had a two-edged impact on internal trade strategies. It offered support to those who favoured trade agreements in principle and evidence to some that trade agreements could work to the benefit of participating states; but the international agreements simultaneously reduced the interest of, and need for, many Canadian businesses to look to trading partners within other regions of Canada and thus offered support for those who would retain strong provincial barriers within the umbrella of the rhetoric of free trade in the Internal Trade Agreement. Put simply, the sequencing of the international and internal trade agreements was wrong.

²⁹ See Robson, *supra*, footnote 5, at pp. 72-4.

2. The Constitutional Crisis

Canadians have lived through a decade of constitutional crises as the Canadian constitution was patriated; as the Meech Lake Accord was developed and then failed; and as the Charlottetown constitutional accord was negotiated and then soundly rejected by Canadians in a national referendum. The failure to bring Quebec into the Canadian constitutional family through constitutional reform has led to measures, including the Internal Trade Agreement, which are presented as efforts to bring Quebec into Canada, albeit as part of an economic compact rather than through a constitutional accord.³⁰

However, while the constitutional agenda might explain the existence of the Internal Trade Agreement, the Charlottetown Accord, in particular, was an extraordinarily decentralizing document. While some participants would have wanted more, even the consensus reached was a product of the federal government agreeing to what would have been an extraordinary degree of provincial authority and autonomy within a loose political arrangement called Canada. While the accord failed the test of a national referendum in most parts of Canada, the underlying governmental politics which it reflected remain extant. Provincial governments (and I might add, First Nations communities) were emboldened by their success in securing the agreement of the federal government to transfer political authority to both groups. That transfer can and has taken place through the incremental withdrawal of a federal government presence in national broadcasting, by reductions in federal funding of and responsibility for social and educational programs, in the optional transfer to provinces of primary control over immigration, and among other areas of economic and social activity. The result is that the provinces were able to exercise considerable leverage in shaping the Internal Trade Agreement to ensure continued provincial autonomy and sovereignty over significant components of the national economy.

³⁰ It is widely known that the existence and certainly the timing of the Internal Trade Agreement were directly related to the then forthcoming provincial election in Quebec. The Agreement was negotiated with the hope that support for a separatist government might be reduced if the then Liberal Quebec government could point to the direct economic benefits of a renewed economic federalism represented by the Internal Trade Agreement. It is impossible to know if that strategy succeeded in fact. It did not, we know, result in the defeat of the challenge presented by a separatist government.

Again, the connection between the Internal Trade Agreement and Quebec independence made the existence of an Agreement inevitable, but simultaneously assured that it could not accomplish the national economic integrative agenda which would have been expected in a trade agreement. Certainly, while the Internal Trade Agreement had to be perceived as bringing Quebec into Canada, it could not interfere with Quebec cultural autonomy and authority to address provincial social policy issues. Meanwhile few provinces would agree to a “distinct economic status” for Quebec in the Internal Trade Agreement, any more than they could agree, given the referendum, to distinct political status for Quebec in a constitutional document.

The Internal Trade Agreement confirms what many suspect — that we have closer relations both with those who live outside of our national borders, as well as those who live within our own respective provincial borders than we do with those who live within other provinces inside Canada’s borders. In so far as we define ourselves in relation to others, the increasingly effective political autonomy and authority of the provinces has meant that the number and kinds of relations which comprise Canada have shifted from a trans-provincial East/West axis to a number of intra-provincial and inter-national axes. It is remarkable how many Canadians, especially in the West, have developed a psychological distance from the rest of Canada — they see themselves as part of a new Pacific Rim economic regional arrangement, as part of a “northwestamerican” culture as much as they see themselves as part of Canada. The result is that while provinces would enter into a trade agreement, they would not agree to forgo the real political power acquired during the past decade.

3. The Transformation of the Canadian State

The past decade has seen a quite extraordinary transformation of the way in which individual Canadians conceive of the role of the modern Canadian federal state. The end of the decade brought with it a recession which was not only the deepest and broadest in 50 years, but which left Canada with unemployment levels among the highest in the developed world. This recession for the first time struck at the manufacturing base of Central Canada, and finally made ordinary Canadians recognize the importance of responding to concerns about regulatory costs, productivity and economic

growth if we were to remain independent as a nation. The social and economic costs of the recession perhaps persuaded ordinary Canadians, as well as their political representatives, of the pressing need to deal with the regulatory costs associated with internal trade barriers between provinces.

At the same time significantly higher personal income taxes in Canada — as compared to those paid by citizens of the United States, our most obvious companion — and a highly visible national sales tax have significantly reduced the ability of the federal as well as provincial governments to engage in new social programs. They have combined to create palpable animosity, towards governments in general and the federal government in particular. For much of the past decade Canada was led by an extraordinarily unpopular government and Prime Minister, resulting, in the most recent federal election, in the virtual elimination at the federal level. Of one of Canada's oldest and most powerful political parties. The disappearance of a national party in Canada occurred as two regional parties experienced meteoric ascendencies and captured substantial numbers of seats in Quebec and Western Canada. If anything, regionalism within federal politics exacerbated the provinces' distrust of federal institutions and magnified provincial concerns that they must be able to anticipate and react to federal regional redistributive policies through the establishment of protectionist trade barriers and other measures.

It seems to me that the provinces, in general, distrust assurances that they will receive a fair share of national wealth if they leave regional redistribution to the federal government. That final point cannot be made too strongly. Provincial trade policy is driven not only indirectly by provincial social policy agendas, but also directly by provincial interests in addressing the distributive impacts of national markets. The issue of federalism and equity — the redistribution of the benefits of the market among Canadian regions — lies at the heart of the dilemma which the Trade Agreement presents. Ideals of economic equality among Canadians, and very real concerns with debilitating tax and expenditure competition among provinces, suggests that equity policies should be addressed federally. However, it seems to me that, in recent years at least, provincial protectionist measures are most sensibly explained as efforts which are directed at ensuring that particular regions receive what they believe is a deserved share of

economic wealth generated within a national economy. According to the provinces, too much of our history consists of federal government policies — so called “equity judgments” — which are directed at moving disproportionate shares of national wealth to particular regions, whether for the most compassionate or basest of motives.³¹

By assuming regulatory authority over specific economic activities and by using trade barriers to direct economic benefits directly to firms acting within their borders, provinces assure that the benefits of those policies flow to and are captured directly by their citizens. The fact that aggregate economic activity at the national level may be reduced as a result of the fragmentation of markets, increased compliance costs, duplication of provincial policies and program delivery, and elimination of economies of scale associated with federal government program delivery, is ignored as provinces compete through protectionist provincial policies for a larger proportional share of a smaller pie.

Moreover, provincial and federal deficits grew enormously throughout the decade, resulting in a substantial portion of tax dollars having to be redirected to debt repayment and a withdrawal of federal government resources from the provinces. Both of these developments meant a visible diminution of the role of the Canadian state in social policy. A trade agreement, to the degree that it is effective, undoubtedly restricts governments in pursuing interventionist social policies. The trade agreement that now defines the Canadian economic union, to the extent that it is effective, will have that effect. However, there are few governments which have the resources or political will to pursue aggressively interventionist social policies at the federal or provincial level even if they had an interest in doing so. An internal trade agreement which preserves most historical trade barriers produced by existing social and economic policies represents minimal political costs to most provincial governments, given that they are unlikely to pursue aggressive social policy agendas in the near to mid-term future. Thus the diminution of the role of the state in Canada, in part associated with an economic crisis unparalleled in 50 years, provided support both for those who argued for the development of an internal trade agreement and for those who

³¹ In fact, s. 36(2) of the Constitution Act, 1982, now constitutionalizes a commitment to interregional equity, albeit unenforceable through legal processes.

knew that an agreement which merely froze barriers would cost provincial governments very little in forgone opportunities to achieve provincial social policy objectives.

Finally, the past decade saw the introduction of a Charter of Rights and Freedoms which simultaneously shifted power away from representative institutions to the judiciary, transformed political and public dialogue into legal and curial litigation and contributed to an emerging Canadian identity as a community of individuals exercising rights to ensure that we are protected from each other. The meaning of Canada as a pan-continental community subject to peace order and good government has been transformed to a sense of Canadians as individuals protected from that same government by personal rights as we pursue self-defined goals unconstrained by the state. The individualization of the Canadian identity is consistent with an internal trade agreement which focuses on economic growth at the expense of provinces' abilities to pursue social policies. At the same time, however, the diminution in the role of the state associated with the Charter made it difficult for the federal government to act forcefully in an effort to reduce trade barriers at the provincial level.

V. CONCLUSION

Thus the past decade during which the very public dialogue about the Canadian economic union took place was, at the same time, a decade which saw Canada and its citizens balkanized, turned on its axis towards the south, individualized and transformed into a nation of distrustful cynics toward the role of the Canadian state and, in particular, toward the place of the federal government's role in establishing and preserving "internal" national relationships and institutions.

It has been argued that the fragmentation of markets, duplication in program delivery, excessive enforcement and compliance costs associated with federalism could, in theory, be overcome by *ex post* negotiation between provinces. With few exceptions, these negotiations, perhaps because they are so visible, or perhaps because the losses to well-organized producer interests would be so visible and highly focused, may not occur. The Internal Trade Agreement, in so far as it represents what one could expect from *ex post* negotiations, confirms that voluntary agreement designed to adjust to the costs of federalism do not, in reality, offer Canadians very much at all.

The gaps, exclusions and overall weakness of the Internal Trade Agreement — at least when compared to the North American Free Trade Agreement — are a product of the historically and increasingly decentralized nature of Canadian federalism, the practical and political inability of the federal government to use its legal authority to act unilaterally to create a common market in Canada, and the need to offer substantial benefits to all 10 provinces in a multi-lateral bargaining process. Moreover, the palpable distrust of the federal government which has developed in recent years,³² the mutual distrust of other provinces and an economic lens which is now focused outside of Canada, all confirm the rapidly disintegrating relations among some provinces and among many ordinary Canadians, as the national economy, like other national institutions, fails to receive the support it requires.

Put most bluntly, too many provincialists believe, either as politicians, producers or consumers (but, in my view, mostly as provincial politicians) that they will be better off if they can exercise power at the provincial, regional or even local level. In an era of globalization, of rapidly transforming international market-places for goods, services and credit, and of increased mobility of capital and labour even within Canada, I do not fully understand how Canada as a society will be better off if regulatory authority is exercised in Regina or Winnipeg, Edmonton or Halifax rather than Ottawa. Most remarkable and disconcerting of all is that the Canadian Internal Trade Agreement, an intra-national agreement supposedly representing the collective interests of all Canadians, should look so much like, but which perhaps accomplishes so much less than, the North American Free Trade Agreement — an international agreement between three sovereign nations motivated only by national self-interest.

³² See E. H. Fry, "The Role of State and Federal Governments in Canada-U.S. Sectoral Integration" (1985), 10 *Can.-U.S. L. J.* 169 at pp. 176-82.