Sizing Up Provincial Trade Barriers


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There has been intense focus on international trade developments recently, but another significant trade issue warrants continued vigilance in Canada—**freeing interprovincial trade**. Canada has long struggled with various impediments to trade within its own borders that are widely believed to impede growth and productivity. The following is a brief look at this issue and potential positive economic benefits of knocking down some of these internal barriers.

The Importance of Interprovincial Trade

Canadian interprovincial exports of goods and services are now nearly $400 billion per year, or almost 20% of GDP. While trailing international exports ($630 billion in the same period), it is clearly a major portion of total economic activity.

Interprovincial trade also acts as an important buffer. Ontario and Quebec, the two provinces usually deemed most exposed to international trade, are currently running meaningful trade deficits with partners outside Canada—in Ontario's case, that was $33 billion in 2017, according to the provincial GDP accounts. That was entirely offset by a similar-sized trade surplus with Canada's other provinces.

Additionally, provincial exports were a valuable hedge during the 2000-to-2008 commodity boom, when Ontario's international exports were crowded out by the strong Canadian dollar (*Chart 1*). During that period, Ontario's real international exports slipped a cumulative 6%, while real interprovincial exports rose nearly 20%.

Given Canada's highly regional specialization of economic activity (i.e., manufactured goods in Central Canada, energy in Alberta and various commodities in Atlantic Canada), the free-flow of goods across provincial borders is important to support consumer choice, productivity and output through the production chain.

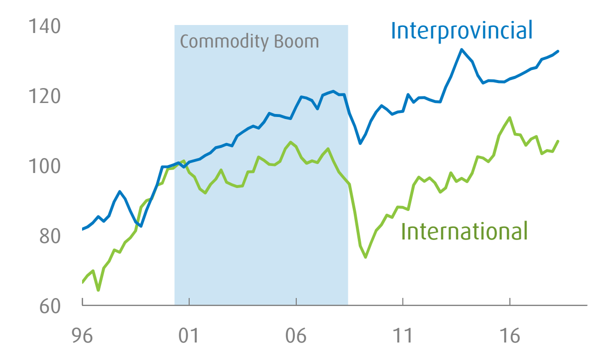
Economic Impact

Estimating the economic impact of fully free interprovincial trade is hardly a precise science. In 2016, the Senate Committee on Banking, Trade and Commerce examined the available research on this front[1] in advance of the 2017 Canadian Free Trade Agreement (CFTA). While estimated impacts ranged from very small (adding less than 1% of GDP) to very large (7% of GDP with all barriers removed), the findings across various modelling methods were unanimous in concluding that **free provincial trade would be a net positive for the Canadian economy**. An alternative approach from Statistics Canada found that **interprovincial trade barriers amounted to the equivalent of a 6.9% tariff** between 2004 and 2012[2]. And, the Bank of Canada

Chart 1
Provincial Trade Buffer

Ontario (2000 = 100)

Real Exports of Goods and Services



Sources: BMO Economics, Haver Analytics

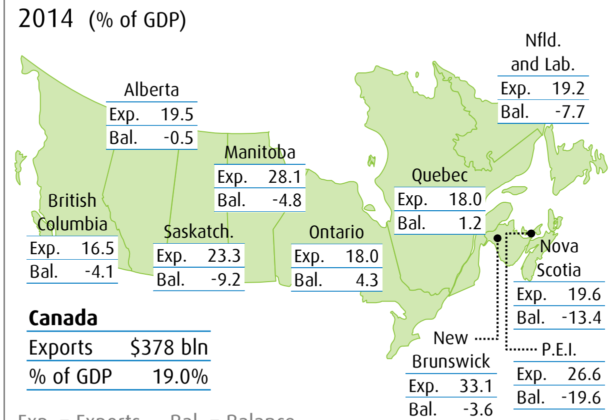
1 *Tear Down These Walls: Dismantling Canada's Infernal Trade Barriers*. Report of the Standing Senate Committee on Banking, Trade and Commerce. June, 2016.

2 *Going the Distance: Estimating the Effect of Provincial Borders on Trade when Geography Matters*. Statistics Canada. Robby K. Bemrose, W. Mark Brown and Jesse Tweedle. September, 2017.

finds that removing interprovincial trade barriers could add 0.1-to-0.2 percentage points to potential output annually[3].

In our view, the real-world economic impact would likely run at the lower end of this range given that (and as we have already seen) provinces will likely remain reluctant to free up all regulations and barriers. But freer interprovincial trade would still be clearly a net positive: Largely concurring with the Bank of Canada's estimates on the growth impact, we **judge that the positive impact from free interprovincial trade would cumulate over a decade to add as much as 2% to national GDP, or nearly $50 billion**. **For <u>Ontario</u> alone, we judge that the net positive addition to output would build to a range of $15 billion-to-$20 billion over ten years**.

Chart 2
Interprovincial Trade Comparison



Sources: BMO Economics, Statistics Canada

There are many channels through which benefits would flow. Seamless transport regulations that don't change at provincial borders would reduce shipping times and costs; consistent packaging requirements would improve productivity and reduce costs; nationwide recognition of professional licenses would improve labour mobility at times when there are large regional market disparities—this would reduce capacity constraints, ease pockets of labour shortages and trim unemployment in weaker regions; and, consumer welfare would improve through increased choice and/or lower prices.

At the regional level, **all provinces would benefit** to some degree from free interprovincial trade. Ontario and Quebec are by far the largest trading partners given their relative size and proximity. But, as a share of GDP, interprovincial exports from those provinces are comparatively low, and thus the impact might be somewhat smaller (*Chart 2*). Freer trade for the remaining eight net provincial importers would likely mean a more streamlined supply chain (e.g., manufactured products moving from Ontario into Alberta's energy sector) and better/cheaper consumer choice.

Why Act?

There are two main reasons why moving to reduce interprovincial trade barriers is a proverbial slam-dunk decision from a policy perspective—the cost-benefit tradeoff and the external environment.

Given that most barriers to provincial trade are largely related to regulation and red tape, the **cost of removing such barriers should be relatively low**. The benefits, however, are substantial, as discussed. And, with Ottawa already running a large budget deficit (and mulling various pro-business policy options that could carry a large price tag), this policy prescription is among the lowest-hanging fruit.

Meantime, while Canada has secured a trade agreement with the U.S. and Mexico, the protectionist agenda carried by Canada's largest trading partner only amplifies the **need to seek alternative growth opportunities**. Canada has made moves to diversify trade in recent years, and improved flows within its own border should be right at the very top of the agenda.

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[3] *Living with Lower for Longer*. Remarks by Stephen S. Poloz. September, 2016.