



Liberalizing
INTERNAL↔TRADE
through mutual recognition

A legal and economic analysis

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Executive summary

In Canada, provincial and territorial governments have constitutionally enshrined powers that give them considerable jurisdiction over the standards, rules, regulations, and certifications that govern goods and services. These regulatory divergences can and do affect interprovincial trade by making it difficult for goods, services, labour, and capital to flow across borders. These barriers can make it more expensive for consumers in one region to purchase goods and services produced in another, and as a result increase costs and lower Canada's overall productivity.

This paper examines possible approaches to easing these trade frictions and recommends serious consideration of “mutual recognition,” a framework wherein an item of commerce that meets the regulatory requirements of one provincial or territorial government is deemed to automatically satisfy the requirements of another. Simply put, mutual recognition requires a host province to accept the standards set out by the province from which the good or service originates. As a result, mutual recognition can lessen the compliance burdens of goods and service providers and eliminate duplicative testing which makes it a powerful tool for eliminating policy-relevant interprovincial trade costs.

The economic implications of internal trade costs in Canada are significant. Currently, the volume of trade across provincial and territorial borders is equivalent to nearly 18 percent of Canada's GDP. And in certain regions, such as the prairie provinces, Atlantic provinces, or the three territories, internal trade is an even larger proportion of GDP. Meanwhile, trade costs are relatively high, averaging between 8 to 22 percent (depending on the calculation method) when all goods and services are included. Clearly such costs can meaningfully detract from overall productivity and the living standards of Canadians.

Of all the approaches to internal trade liberalization, mutual recognition may go furthest towards easing policy-relevant trade barriers. In its extreme form, mutual recognition would allow any good, service, or professional credential to automatically be considered compliant in any given province if it is already

compliant in another. In this situation, there would be no differences in rules or regulations, and therefore no interprovincial costs beyond time, fuel, and so on.

Measuring internal trade costs in Canada is a challenge because the barriers are not usually explicit charges placed on cross-border transactions. Instead, they represent the costs of complying with rules, regulations, standards, and certifications that vary from one province to another. This paper uses two methods to estimate the magnitude of such unobservable trade costs: an inferential approach that calculates an estimate of costs from the observed pattern of trade based on the Head-Ries Index of trade costs and a model of Canada's economy that incorporates the latest available date (from 2018) to estimate the economic effects of internal trade costs.

The potential economic benefits for Canada from adopting mutual recognition policies are large.

Beyond estimating the scale of the trade cost reductions that mutual recognition could achieve, this paper also estimates the potential economic gains that could result. We find that Canada's economy could increase by between 4.4 and 7.9 percent over the long-term – a significant gain of between \$110 and \$200 billion per year, equivalent to between \$2900 and \$5100 per capita – if internal trade barriers are eliminated by mutual recognition policies.

The potential economic benefits for Canada from adopting mutual recognition policies are large, but there are important trade-offs to consider. Trade liberalization requires that resources, production, and employment shift across sectors and even across regions. Sectors in one province that may not survive competition with lower-cost imports may shrink while sectors that see an increase in export volumes may expand. The same is true across regions. Workers in one location may move to another in response to changes in wages and prices.

Our model suggests that between 1.3 and 1.7 percent of Canada's workforce would migrate across provinces in response to eliminating internal trade costs. In the long-run, these moves are productivity enhancing for the overall economy but are not costless in the short-run for the individuals

involved. Such moves may be particularly costly if retraining is required. These adjustment costs are not captured in our estimates of the economic effect of trade liberalization but are nonetheless critical for policy-makers to consider.

With such large opportunities for additional internal trade liberalization in Canada and the consequent economic and productivity benefits that may result, however, these challenges may not be insurmountable. Pursuing mutual recognition policies within specific areas, such as trucking regulations, food safety, or financial services, may be appropriate. Whatever the best route forward, interest among governments to improve economic growth and liberalize trade may be higher today than any point in recent memory. And mutual recognition should be an important part of the policy conversation.

Sommaire

Au Canada, les gouvernements provinciaux et territoriaux ont obtenu des pouvoirs constitutionnels qui leur confèrent une compétence étendue en matière de normes, de règles, de règlements et de certifications applicables aux biens et services. Or, les divergences de réglementation peuvent nuire au commerce interprovincial en entravant la circulation des biens, des services, de la main-d'œuvre et des capitaux à travers les frontières. Cette barrière peut contribuer à renchérir le prix des biens et des services achetés par les consommateurs d'une région, mais produits dans une autre, ce qui a pour effet d'augmenter les coûts et de diminuer la productivité globale du pays.

Ce document présente une analyse des approches possibles pour atténuer ces frictions commerciales et recommande d'accorder une attention particulière à la « reconnaissance mutuelle », un cadre de conciliation sur les exigences réglementaires entre les gouvernements provinciaux et territoriaux. En termes clairs, la reconnaissance mutuelle exige de la province d'accueil qu'elle reconnaisse les normes établies par la province d'origine du bien ou du service. La reconnaissance mutuelle peut donc alléger le fardeau de conformité des fournisseurs de biens et de services et supprimer les exigences répétitives, ce qui en fait un outil puissant pour éliminer les coûts du commerce interprovincial liés à la politique publique.

Les enjeux économiques dérivés des coûts du commerce intérieur au Canada sont cruciaux. En effet, à l'heure actuelle, le commerce interprovincial et interterritorial compte pour près de 18 pour cent du PIB canadien (en

volume), et cette proportion est encore plus grande pour certaines régions : les Prairies, les provinces de l'Atlantique et les trois territoires. Les coûts commerciaux, de leur côté, sont relativement élevés, se situant en moyenne entre 8 et 22 pour cent (selon la méthode de calcul), une fois tous les biens et services considérés. Il est évident que les coûts de cette nature peuvent nuire considérablement à la productivité globale et au niveau de vie des Canadiens.

De toutes les approches à la libéralisation du commerce intérieur, la reconnaissance mutuelle élimine le plus efficacement les barrières commerciales à caractère politique. La reconnaissance mutuelle suppose, sous sa forme extrême, que tout bien, service ou titre professionnel est réputé être conforme dans une province donnée s'il l'est déjà dans une autre. Dans ce cas de figure, aucune différence n'existe en matière de règles ou de règlements et, par conséquent, les coûts interprovinciaux en sus des coûts liés aux délais, au carburant et ainsi de suite sont nuls.

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Les coûts du commerce intérieur au Canada sont difficiles à mesurer, car généralement les barrières ne tiennent pas à l'imposition de frais explicites sur les transactions transfrontalières, mais plutôt aux coûts de conformité aux règles, règlements, normes et certifications, qui varient d'une province à l'autre. Dans le présent document, deux méthodes sont utilisées pour estimer l'ampleur de ces coûts commerciaux latents : une approche inférentielle pour le calcul de l'estimation des coûts à partir de la configuration observée des échanges sur la base de l'indice Head Ries des coûts commerciaux et un modèle de l'économie canadienne intégrant les dernières données disponibles (à partir de 2018) pour estimer les effets économiques des coûts du commerce intérieur.

En plus de présenter l'ampleur estimée des économies de coûts susceptibles d'être générées par la reconnaissance mutuelle, ce document fournit également une estimation des gains économiques potentiels pouvant en résulter. Il révèle que si les barrières commerciales internes étaient supprimées par des politiques de reconnaissance mutuelle, l'économie canadienne

pourrait enregistrer entre 4,4 et 7,9 points de croissance supplémentaires à long terme – un gain significatif de 110 à 200 milliards de dollars par an, soit l'équivalent de 2 900 à 5 100 dollars par habitant.

Sur le plan économique, il pourrait être particulièrement bénéfique pour le Canada d'adopter des politiques de reconnaissance mutuelle, quoique l'on doive peser les avantages et les inconvénients. La libéralisation du commerce exige que les ressources, la production et l'emploi se déplacent entre secteurs et même entre régions. Les secteurs d'une province incapables de résister à la concurrence des importations à moindre coût peuvent se contracter, tandis que les secteurs bénéficiant de volumes d'exportation accrus peuvent se développer. Il en va de même région par région : les travailleurs sont susceptibles de se déplacer d'une région à une autre, attirés par les écarts de salaires et de prix.

Conformément au modèle présenté, si les coûts du commerce intérieur étaient éliminés, la main-d'œuvre canadienne migrerait d'une province à l'autre dans des proportions allant de 1,3 à 1,7 pour cent. À long terme, ces déplacements amélioreraient la productivité globale, mais à court terme, ils ne seraient pas sans coût pour les personnes déplacées. Ils seraient particulièrement coûteux en cas de besoin de formation d'appoint. Ces coûts d'ajustement ne sont pas pris en compte dans nos estimations des effets de la libéralisation du commerce sur l'économie, mais les décideurs devront obligatoirement en tenir compte.

Compte tenu des amples possibilités en matière de libéralisation du commerce intérieur au Canada et des avantages qui pourraient en découler pour l'économie et la productivité, ces défis ne sont toutefois peut-être pas insurmontables. Il pourrait être de bon aloi d'adopter la reconnaissance mutuelle dans des domaines précis (règlementation du camionnage, sécurité alimentaire et services financiers). Quelle que soit la solution retenue, il est probable que l'intérêt des gouvernements pour l'amélioration de la croissance économique et la libéralisation du commerce soit maintenant plus marqué qu'il ne l'a jamais été de mémoire récente. La reconnaissance mutuelle devra donc nourrir une part importante des débats politiques

Introduction

Canada is a federal nation wherein provincial and territorial governments have constitutionally enshrined powers that endow in them considerable jurisdiction over the standards, rules, regulations, and certifications that govern goods and services. These provincial or territorial measures, which affect items of commerce, can and do differ across Canada. Where these divergences exist there may be legitimate justification owing to local conditions in disparate regions; alternatively, they may arise to insulate against non-local competition. Whatever the reason, regulatory divergences can make it difficult for goods, services, and capital to flow across borders.

As a corollary, trade barriers can make it costly for consumers in one region to purchase goods and services produced in another, and possibly resulting in an inefficient allocation of resources. Federal government policies and legislation can also add to the challenge of trading across provincial and territorial boundaries. Infrastructure capacity or the lack thereof can distort the trade for certain goods, such as pipelines for oil and gas, electricity interchanges for power, or highways and rail for shipping physical goods. Federal inspection regimes of certain agricultural products can also add costs to interprovincial trade. And all orders of government may have biased procurement procedures that give preference to local producers. All of these non-tariff costs can distort trade, detract from the country's overall productivity, and harm the living standards of Canadians. This paper examines certain approaches to easing these trade frictions and estimates the economic gains from doing so.

Efforts to liberalize interprovincial trade span Canada's post-Confederation history. But a new era has arrived over the last quarter-century; domestic political actors have increasingly shifted towards intergovernmental agreements as the means to lessen domestic trade frictions and reconcile technical barriers to trade. This non-constitutional approach to national economic reform has resulted in several multilateral and bilateral trade agreements (collectively, interprovincial trade agreements, or ITAs). These presently include the pan-Canadian Canadian Free Trade Agreement (CFTA), Western Canada's New West Partnership Trade Agreement (NWPTA), and the New Brunswick-Nova Scotia Partnership Agreement on Regulation and the

Economy (PARE), amongst many others. Efforts to further liberalize internal trade within Canada are ongoing, as is interest among some actors to approach new ITAs differently than in the recent past.

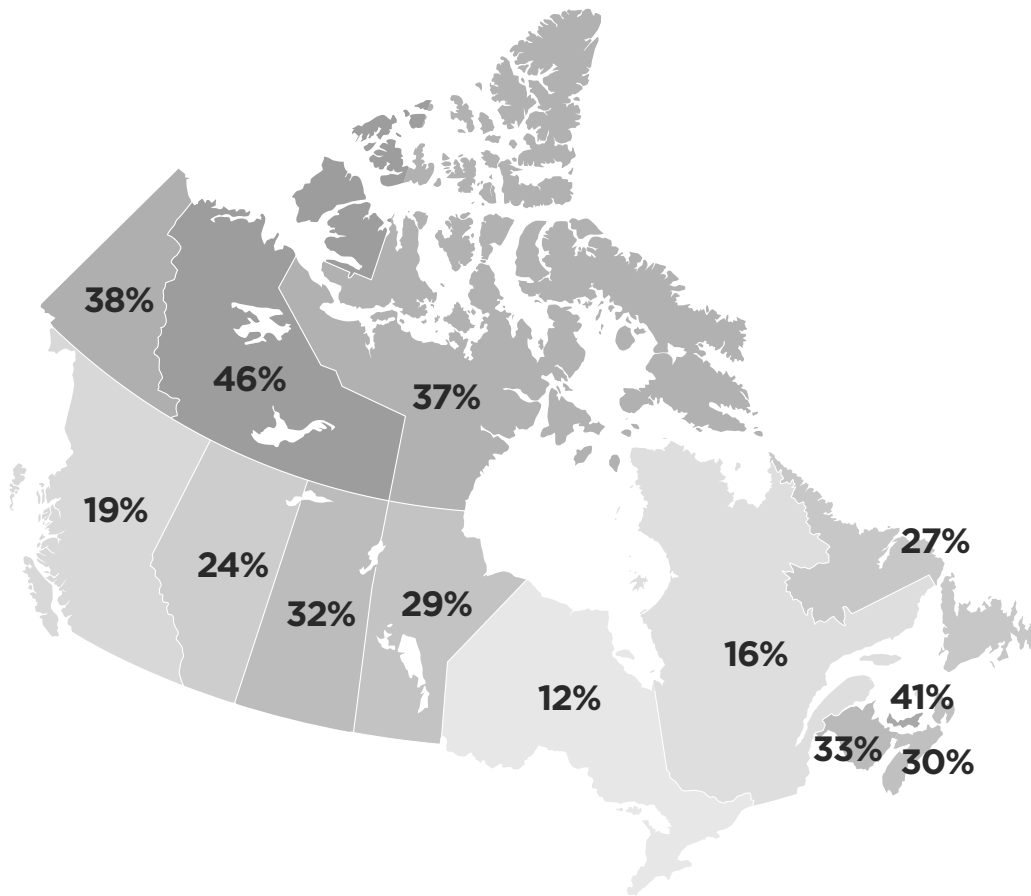
This paper explores one such option: mutual recognition, whereby regulatory requirements met for one provincial and territorial government automatically satisfies requirements for another. This type of policy is a powerful tool to potentially eliminate interprovincial trade costs that result from government policies, which we will refer to as policy-relevant trade costs. After all, the very nature of internal trade frictions are differences in rules, regulations, standards, treatment, and so on. Provinces can harmonize those rules, or they can deem compliance with another province's rules as automatically equivalent to being in compliance with their own. It is an option that federal, provincial, and territorial governments should consider. We begin with the legal implications of such arrangements and then quantify the potential economic effects for Canada.

Currently, the agreements constituting Canada's ITAs are generally underpinned by the national treatment principle, which prohibits provinces from treating out-of-province goods and services, people, and investments worse than their own. The national treatment principle may be considered the least restrictive paradigm for liberalizing interprovincial trade when assessed against the other two paradigms – mutual recognition and harmonization. National treatment is the most protective of provincial sovereignty as a host province is only prohibited from applying discriminatory standards to out-of-province goods and services (Nicolaidis and Shaffer 2005). A host province is otherwise free to set standards it deems appropriate and deny entry to goods or services that cannot satisfy those standards.

Two other paradigms can operate to liberalize trade amongst Canada's subnational jurisdictions. The first is harmonization, which entails the creation of a single rule or standard that applies across political boundaries (Nicolaidis 1997). The second is mutual recognition; as we mentioned earlier, this is the primary focus of this report. The principle of mutual recognition can be said to straddle the two paradigms of national treatment and harmonization as it allows for regulatory differences amongst Canada's provinces and territories to be retained (like national treatment), while also still introducing a single rule for economic actors to abide by (like harmonization).

Though most of Canada's ITAs presently recognize mutual recognition as a means by which the provinces and territories can address domestic barriers to trade, it is generally posited as one of several different possible solutions to interjurisdictional regulatory clash. For instance, under the PARE and the CFTA, mutual recognition is merely one of several potential outcomes resulting from liberalization processes. Presently, in place of mutual recognition, the national treatment principle is the dominant paradigm for interprovincial trade

FIGURE 1: INTERNAL IMPORTS AS A SHARE OF GDP (2020)



Source: Own calculations from Statistics Canada (2021b)

liberalization. Shifting towards mutual recognition for measures governing goods and services may inculcate greater trade liberalization amongst those provinces and territories that engage in such a pivot.

The NWPTA goes the farthest amongst Canada's ITAs in embracing mutual recognition. Article 5 of the NWPTA imposes upon its member governments (presently British Columbia, Alberta, Saskatchewan, and Manitoba) the positive obligation to "mutually recognize or otherwise reconcile" existing standards and regulations. Studies of the way in which the principle of mutual recognition is implemented amongst sovereign nations reveal that the NWPTA's conception is amongst the broadest and all-encompassing. At the international level, mutual recognition ordinarily manifests in the form of mutual recognition agreements (MRAs) that often target specific sectors of the economy (Correia de Brito, Kauffmann, and Pelkmans 2016). Despite

its expansiveness, the NWPTA's mutual recognition obligation and its efficacy for trade liberalization is difficult to ascertain, as is the extent to which it exerts a causal force on regulatory changes by NWPTA members.

In addition to examining the important legal implications of mutual recognition arrangements, we also quantify their potential economic effects. After all, the economic implications of internal trade costs in Canada are potentially significant. Currently, the volume of trade across provincial and territorial borders is equivalent to nearly 18 percent of Canada's GDP. And in certain regions, such as the prairie provinces, Atlantic provinces, or the three territories, internal trade is an even larger proportion of GDP. We display the latest data for 2020 in Figure 1. With a large share of goods and services crossing internal boundaries, even small costs can meaningfully detract from overall productivity and the living standards of Canadians. In addition, lowering internal trade costs would tend to increase competition. As relatively lower productivity producers shrink or exit and higher productivity producers expand, this would tend to increase productivity and living standards nationally.

“The economic implications of internal trade costs in Canada are potentially significant.”

The scope for internal trade liberalization may also be substantial. In the early- to mid-1980s, for example, prior to Canada signing several critical international trade agreements, the share of Canada's overall economic activity accounted for by internal and international trade were similar. More precisely, both internal and international imports as a share of GDP averaged around 25 percent. Following several important international trade agreements, not the least of which were the Canada-US Free Trade Agreement and subsequently the North American Free Trade Agreement, the share of international trade grew. In 2020, international trade was over 31 percent of Canada's GDP. Internal trade, meanwhile, was 18 percent of Canada's GDP in 2020. In fact, since the early-1990s it has never exceeded 20 percent. Mutual recognition is one potential policy option to help ease internal trade barriers.

In this paper, we quantify both the scale of internal trade costs between provinces and territories – detailed by individual sector and using the latest

available data – and use a detailed model of Canada’s economy to estimate what their economic effects may be. We find that trade costs are relatively high, averaging between 8 to 22 percent (depending on the method) when all goods and services are included. Mutual recognition policies are one potential means to mitigate or eliminate many of these costs. This is a point worth emphasizing. While our estimates of policy-relevant trade costs may be subject to error and are contingent on certain assumptions that we will clarify later, they represent the full scope of trade costs that mutual recognition can eliminate. If businesses and individuals need only comply with one province’s rules to automatically be compliant with any other, then there are no differences in rules, regulations, standards, and so on, that bind up any economic decision. In the extreme, full mutual recognition eliminates internal trade barriers.

Beyond estimating the scale of the trade cost reductions that mutual recognition could achieve, we also estimate the potential economic gains that could result. We find that Canada’s economy could increase by between 4.4 and 7.9 percent – a significant gain of between \$110 and \$200 billion per year – if internal trade barriers were eliminated by mutual recognition policies. To be clear, these are long-run gains that would take many years to realize even if trade costs could be eliminated immediately. But the large magnitude of potential gains suggests the increasing effort and attention by policy-makers on this issue is well placed.

In addition, we estimate that provinces moving unilaterally or adopting mutual recognition within smaller blocks could also yield material economic benefits. That is, instead of joint mutual recognition across provinces, one province could act alone and recognize the rules of another even if the second province did not reciprocate. This would facilitate imports, even if it does little for exports. To quantify the benefits of unilateral action, we focus primarily on Alberta. It provides a good case study as it is the jurisdiction that has taken the most recent material and concrete actions to reduce trade barriers. We find that even were Alberta to take unilateral efforts to eliminate the cost of importing goods and services from other provinces and territories, doing so could increase the province’s overall productivity and economy by between 2.5 and 4.1 percent, which is most of the gains available from multilateral action.

Though the aggregate economic implications of trade liberalization are clear, there are many important trade-offs to consider. We highlight several, including equity issues, effects on government finances, and the cost of labour and capital adjusting to a new economic environment. But all these economic effects must be grounded in a detailed understanding of the legal and institutional landscape in which mutual recognition policies might be adopted. We therefore begin there.

The institutional landscape in Canada

Mutual recognition is but one conceptual framework that provinces can use to liberalize interprovincial trade. As a general principle, mutual recognition as applied to Canadian domestic interchange provides that if a good or service can lawfully be sold in Province A, it can be sold freely in Province B. Mutual recognition agreements (MRAs) are narrower, targeted manifestations of the general principle.

The policy choice to pursue politically negotiated MRAs to further liberalize trade is not novel for Canada. In fact, Canada's trade policy community is familiar with and experienced in concluding MRAs. Canada negotiated and is party to several international MRAs, such as the Canada-Israel Mutual Recognition Agreement for Conformity Assessment of Telecommunications Equipment (which provides, in part, for the mutual recognition of both parties' testing laboratories and the test results produced by recognized laboratories). Another example is the Mutual Recognition Agreement between Canada and Switzerland, which covers such goods as pharmaceuticals and medical devices.

Notably, mutual recognition is an integral element of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union. Mutual recognition in CETA covers not only goods but services: Chapter 11 of CETA establishes an extensive framework for the mutual recognition of professional qualifications of individuals by the two parties. It has been noted that compared to other international MRAs concluded to date, CETA has especially broad sectoral coverage (Correia de Brito, Kauffmann, and Pelkmans 2016). Though MRAs may not be commonplace between Canada's subnational jurisdictions, they are found more frequently in Canada's trade relations with foreign nations.

As this section discusses, not only is the principle of mutual recognition a familiar element in Canada's international trade arrangements, it is also found in certain of Canada's ITAs. The CFTA considers mutual recognition one potential outcome of its regulatory reconciliation process; the NWPTA goes even farther, almost elevating mutual recognition to a positive obligation amongst its members. Certain of Canada's subnational governments have even struck stand-alone MRAs.

This section describes the current institutional landscape for Canadian interprovincial trade and how both the principle of mutual recognition and its particularized form of an MRA, fit within. This section also examines the manifestation of MRAs abroad and discusses the lessons those experiences may have for Canada.

Ascendancy of mutual recognition

For most of the 20th century, the dominant form of economic protectionism was the tariff. Even as late as the 1970s there was no global consensus that non-tariff trade barriers posed a substantial threat to trade liberalization (Ghodsi, Reiter, and Stehrer 2017). However, this viewpoint has changed markedly over the last half-century as tariff rates have steadily declined and the trade policy community has increasingly focused on non-tariff barriers to trade. For context, non-tariff barriers is a broad term that captures those measures that discriminate against imported items of commerce. Though a non-exhaustive list, such measures may be in the form of regulations (i.e., sanitary measures or licensing requirements), government procurement policies, local-hire mandates, policies creating and supporting state-owned enterprises, regional development policies, taxation measures, or subsidy programming.

Many non-tariff barriers, particularly those at the centre of trade disputes, often raise questions about whether regulatory authority is being exercised in the best interests of a polity, or rather is simply a disguised restriction on trade. With increased attention to non-tariff barriers has come a push for new and better tools and principles to distinguish between those measures instituted for legitimate reasons and those implemented to protect and placate a domestic constituency.

The national treatment principle is what undergirds much of trade discipline in arrangements both globally and within Canada. It is a central obligation of international trade agreements such as the General Agreement on Tariffs and Trade (GATT), 1994, as well as the Canada-US-Mexico Agreement. National treatment is a fundamental obligation in Canada's own domestic trade agreements such as the CFTA and the NWPTA (as discussed later in this paper). As a testament to its centrality in Canadian domestic trade, the national treatment obligation was the basis of the dominant share of litigation before Canada's internal trade court under the CFTA's predecessor, the Agreement on Internal Trade (AIT). (There has yet to be a trade dispute under the CFTA resulting in a publicly released decision.)

Although national treatment arguably remains the chief paradigm for managing trade liberalization (both within Canada and internationally), mutual recognition has gained increased attention since the World Trade Organization's (WTO) Uruguay Round. In their research study, Correia de Brito, Kauffmann, and Pelkmans (2016) found that MRAs have become more popular over the past two decades, with 139 having been recorded by the WTO as of 2016. Not only are there many data points, but these trade arrangements that have integrated the concept of mutual recognition, whether in the form of an MRA or otherwise, have also been allowed to operate, in some cases for several decades. And with the passage of time, international trade scholars have been able to glean findings with respect to the benefits (and drawbacks) of mutual recognition, as well as factors for its successful implementation.

The principle of mutual recognition is considered more effective for trade liberalization than national treatment, particularly when it comes to tackling non-tariff barriers. At its core, the national treatment principle merely prevents a host province from applying regulatory measures in a discriminatory manner, but otherwise leaves intact the host province's ability to set the bar of a technical measure as high or as low as it pleases (Nicolaidis and Shaffer 2005). Under the national treatment paradigm, economic actors in exporting provinces remain burdened with significant costs arising from ensuring their goods or services comply with at least two sets of regulatory measures (Schmidt 2007). National treatment also does nothing to address duplicative testing, certification, and inspection that goods and services may be required to undergo in both their home and host province.

In contrast, a broad conception of mutual recognition would require a host province to accept the standards set out by the province from which the good or service emanates. As a result, mutual recognition can lessen the compliance burdens of goods and service providers and eliminate the duplicative testing that lingers under national treatment frameworks. Where policed national treatment falls short is precisely where mutual recognition should be adopted, to the extent that harmonization is not desired or not practical (Nicolaidis 1997).

At a theoretical level, mutual recognition can facilitate greater trade liberalization than national treatment, particularly if it is an enforceable obligation under an inter-jurisdictional arrangement. However, as studies of mutual recognition amongst trading nations (in the form of an MRA or otherwise) demonstrate, the practical way mutual recognition is implemented can whittle away the potential (theoretical) liberalizing force of the paradigm. Exceptions and carve-outs, pre- and post-conditions to mutual recognition, and the narrowing of the scope of mutual recognition to certain sectors of the economy can affect the strength of mutual recognition obligations.

Forms of mutual recognition agreements

Mutual recognition can operate in a limited or broad sense. The strength and extent of the mutual recognition obligation in arrangements amongst political jurisdictions will have a direct impact on its capacity to enhance trade liberalization efforts.

When put into practise, mutual recognition can take the form of either (i) mutual recognition of rules, or (ii) mutual recognition of conformity assessment (Correia de Brito, Kauffmann, and Pelkmans 2016). Mutual recognition in its most expansive form is espoused by the former category (mutual recognition of rules), wherein it is the (A) regulatory objectives or (B) effective results of regulation for goods or services coming from Province A that are regarded as "equivalent" in Province B, and vice versa. The mutual recognition of

conformity assessment is less ambitious, as the mutual recognition relates solely to the capabilities of the conformity assessment bodies (CABs) in Province A to perform testing and certification on items of commerce against the rules, standards, and conformity assessment procedures of Province B, and vice versa (Correia de Brito, Kauffmann, and Pelkmans 2016).

Conformity assessment procedures (CAPs) are undertaken by CABs to determine whether goods or services satisfy proscribed rules or regulations. For goods, CAPs may include procedures for sampling, testing, and inspection. For services, CAPs may include registration, accreditation, and approvals. By way of concrete illustration: within Canada, one example of a CAB is a college of registered nurses (e.g., the College of Registered Nurses of Alberta), and one (of several) CAPs observed by that particular CAB is the Canadian Practical Nurse Registration Exam.



At a theoretical level, mutual recognition can facilitate greater trade liberalization than national treatment.

MRAs negotiated between trading entities most often fall under the latter type described above; they are chiefly aimed at achieving the mutual recognition of CABs and/or CAPs amongst parties (Correia de Brito, Kauffmann, and Pelkmans 2016). An example of such an agreement is the mutual recognition agreement between Canada and Switzerland aimed at liberalizing the trade in certain drug and medicinal products. Under that MRA, Health Canada and the corresponding Swiss regulatory body arrived at a formal understanding that certain of their respective pharmaceutical manufacturing practise requirements and regulations were equivalent. These findings of equivalency provided the covered products with import requirement exemptions. Interprovincial examples of MRAs also exist. For instance, in 2006 Ontario and Quebec struck an agreement for construction sector labour mobility, which in part provided for the mutual recognition of qualifications, skills, and experience.

It should be noted that MRAs need not be concluded directly between governments; the MRA in the Ontario-Quebec construction sector is a case in point. Provincial and territorial administrative bodies that serve as CABs can also conclude MRAs amongst one another. For example, the provincial and territorial regulatory bodies for professional psychologists in

Canada concluded an MRA in 2001 to provide for the mutual recognition of qualifications, and, with certain exceptions and limitations, to allow credentialed practitioners from Province A to obtain a license to practise in Province B without additional training or examination.

In respect of mutual recognition for services and labour, it may also be the case that individuals are not registered by a governmental regulatory body, in which case policy-makers must consider further tailoring of an MRA. For example, licensing and credentialing of labour may also come by way of self-regulatory bodies (Adams 2010). An example of this is the professions of lawyers and paralegals, which in Canada are regulated by self-regulating law societies.

Aside from the unique exception of self-regulatory bodies, there are three types of credentialing frameworks wherein individuals are not registered by a statutory authority, and which as a result can cause other complexities for mutual recognition efforts as Australia discovered recently (Australia Productivity Commission 2015). The first, coregulation, is government endorsement of a licensing scheme by a private sector professional body. One example of this is the credentialing programs administered by the Canadian Securities Institute, a private sector entity that grants the designations for certain occupations in the financial services industry. In the second framework, *de facto* registration, legislation authorizes those who meet certain requirements to practise an occupation without further reference to a registration body. The regulation of certain skilled trades operates in this manner; in Ontario, gas technicians are required by law to obtain certification from a government-accredited training program, but following that, they do not need to belong to an occupational body. In the third framework, negative occupational licensing, legislation permits a person or business to practise an occupation unless they breach statutory requirements. An example is that of certain transport drivers in Ontario, such as dump truck operators.

The significance of these three frameworks is not just academic. After the intra-Australian MRA had operated for 25 years, it became apparent that it is unclear how mutual recognition obligations apply to occupations falling under one of the three frameworks discussed above (APC 2015). More broadly, MRAs for certain subsets of the labour market may need additional tailoring, taking into consideration the precise nature of the applicable statutory schemes.

MRAs have additional axes of diversity. For one, they can be concluded bilaterally or multilaterally. Some national or subnational jurisdictions may even prefer unilateral recognition by incorporating foreign or international standards as part of their regulatory measures (Nicolaidis 1997). Moreover, MRAs can be concluded on a stand-alone basis, which Correia de Brito, Kauffmann, and Pelkmans (2016) found is most often their form. The Ontario-Quebec MRA for construction sector labour mobility is an example of this type. Alternatively, MRAs can form components of trade agreements wherein

an MRA is contained in an annex to the agreement; one example is the Japan-Philippines regional trade agreement.

The complexity of an agreement's approach to a mutual recognition obligation can also range. It can come in the simple form of a general obligation to mutually recognize. Alternatively, it can come by way of comprehensive and detailed frameworks for the achievement of mutual recognition. One example of this latter type is in CETA. At Chapter 11, CETA calls for the mutual recognition of professional qualifications between Canada and the European Union. The agreement goes further than just imposing a general obligation, however; it provides the procedural mechanics that CETA's parties may engage in in order to achieve mutual recognition for labour, and CETA's Annex 11 sets out a meticulous framework for negotiating MRAs for certain licensed professions.

As Nicolaidis and Shaffer (2005) consider and discuss, the form of MRAs can diverge in four further additional ways. The first is whether an MRA establishes conditions that must be met prior to mutual recognition. For example, counterpart CABs may require a period of time to study, assess, and gain confidence in one another's CAPs. The second is the extent to which mutual recognition occurs automatically following implementation. For instance, should an individual duly licensed to practise in her home province, when moving to a host province be allowed to practise her occupation automatically? Or should there be a condition attached to the automatic nature of mutual recognition, such as notification delivered to the host province regulator?

The third way in which the form of MRAs can diverge is the scope of mutual recognition. For example, an MRA may be confined to liberalizing goods or services in particular sectors, or even sub-sectors, of the economy. Temporal considerations may further winnow or enlarge the scope: are temporary workers treated differently from those relocating to the host province permanently? Nicolaidis and Shaffer (2005) identify the fourth area for differences amongst MRAs as the way in which the parties agree to monitor and maintain mutual recognition, especially when regulatory change among any of the participating members occurs. For instance, if Province A statutorily modifies the qualifications for a certain profession, does mutual recognition pause until such time that the CAB of Province B examines the regulatory change?

An MRA is but one way to effectuate the principle of mutual recognition. Moreover, there are diverse forms that an MRA might take, which can influence the liberalizing impact of an MRA. From a policy perspective, the implementation of the mutual recognition principle by way of an MRA ought to incorporate a consideration of its various potential customizations, along with their concomitant trade-offs. As the next section discusses, in the context of Canadian interprovincial trade liberalization, national treatment presently eclipses mutual recognition in usage and popularity.

Existing interprovincial trade agreements

Recourse by Canada's politicians and policy-makers to interprovincial trade agreements, as a means to address domestic barriers to trade, stems from the general cross-country political consensus provided by Canada's constitutional "free trade" clause at Section 121 of the *Constitution Act, 1867*. Alone, it is alone an inadequate force to prevent interprovincial trade barriers. The text of the "free trade" clause provides that "All Articles of the Growth, Produce, or Manufacture of any one of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces." While a literal reading of that sentence would appear to enunciate a supremely liberalized conception of interprovincial trade, several decisions of Canada's Supreme Court (and those of the Judicial Committee of the Privy Council in England until 1949 when it was Canada's court of last resort) have constrained its meaning.

In 2018 a unanimous court in *R v. Comeau* provided the most recent Supreme Court decision on the meaning of section 121. The case centred on Gerard Comeau, a New Brunswick resident who had his alcohol confiscated by police and was handed a fine when he brought back amounts above the interprovincial legal limit following a liquor run into neighbouring Quebec. In that decision, the Supreme Court provided that section 121 only serves to invalidate those laws or regulations with the "primary purpose" of trade restriction. This reading of the free trade clause left intact New Brunswick's cap on the amount of alcohol that might be brought into the province in one's trunk from neighbouring Quebec (at that time, 12 bottles of beer or one bottle of wine or liquor), the reason being that the cap only "incidentally" (rather than "primarily") interfered with trade.

The primary purpose of the New Brunswick law, according to the Supreme Court, had instead been to facilitate "New Brunswick's choice to control the supply and use of liquor within the province" (*R v. Comeau*, 2018 SCC 15, [2018] 1 S.C.R. 342). As the 2019 Alberta Court of Appeal decision in *Steam Whistle Brewing* showed, section 121 is adequate for dealing with measures that are tariffs (or in that case, effective tariffs). However, post-*Comeau*, the practical reality is that the constitutional baseline for protected "free trade" allows Canada's federal government, provinces, and territories to erect measures that constitute non-tariff barriers, hindering the free flow of goods, services, and people, so long as the relevant government can point to a legitimate justification (Manucha 2022). When compared to the trade discipline provided by the dormant commerce clause doctrine in the United States or the necessity test found in WTO jurisprudence, section 121 (and the affiliated judicial test in Canada's case law) is not as sophisticated or rigorous in dealing with trade barriers.

Members of Canada's political community, and the federal government in particular, attempted to move the goalposts of the constitutional baseline in the early 1990s as part of the package of constitutional amendments

advanced by way of the Charlottetown Accord. During negotiations, the federal government proposed a replacement to section 121 that would have prohibited “any laws, programs, or practises of the federal or provincial governments” that impeded the mobility of goods, services, people or investments (Canada 1991). The federal government also proposed another amendment, section 91A, that would have given it the power to make laws for the “efficient functioning of the economic union” (Canada 1991). However, the provinces were fearful of the impact on their regulatory authority and how these amendments might transfer powers over the federal government (Smith 1993).

After much debate, neither proposal ended up in the final text of the Accord. Instead, what appeared was a hortatory pledge whereby Canadian governments “committed” to “preserv[ing] and develop[ing] the economic union” and they committed to doing so by developing policies that would improve the free movement of people, goods, services, and capital (Charlottetown Accord 1992). The Charlottetown Accord, however, would not go on to garner sufficient support from Canadians in a 1992 referendum, and thus even this pledge would not be formalized.

A pivot towards an internal free trade agreement in the early 1990s in the wake of failed constitutional reform is thus not particularly surprising. Several other factors contributed to the sustained momentum for a pan-Canadian approach to interprovincial trade barriers. A steady stream of economic literature from the 1980s onwards had started to quantify the costs of internal trade barriers on Canada’s economy, which helped make the issue more urgent and salient (Manucha 2022). This was also an era when international trade agreements were in abundant proliferation. As of 1994, when negotiations for Canada’s internal trade agreement began, Canada’s trade policy community had been engaged in nearly 10 years of continuous negotiation, inclusive of the GATT-WTO Uruguay Round, the US-Canada Free Trade Agreement, and the North American Free Trade Agreement (Doern and Macdonald 1999).

In addition, the highly influential Royal Commission on the Economic Union and Development Prospects for Canada of 1985 (better known as the “Macdonald Commission”), most famous for its recommendation that Canada enter into a free trade agreement with the United States, also called for freer internal trade in Canada. Partly owing to this, Canada’s first ministers established the Committee of Ministers on Internal Trade in 1987, a dedicated body of ministers from across Canada’s governments with the clear mandate and resources to liberalize interprovincial trade (Doern and Macdonald 1999). At the same time, Canada’s business community paid increasing attention to the issue of interprovincial trade liberalization, which galvanized Canada’s leaders and ultimately resulted in the Agreement on Internal Trade (AIT).

Agreement on Internal Trade

Brought into effect in 1995, the AIT was a comprehensively negotiated political agreement amongst Canada's 10 provinces, the then two territories, and the federal government. Complex, multi-party negotiations resulted in an 18-chapter agreement that established general rules that would govern domestic trade in Canada. Arguably the most significant trading rule established by the AIT was that of national treatment, which, as a general principle, provides that a host province is to accord to goods and services from another province no less favourable treatment than it provides to its own goods and services. The national treatment principle has been one of the most (if not *the* most) litigated obligations in Canada's internal trade court to date.

Mutual recognition was held out as a possible means of resolving the trade barriers that remained under the AIT, particularly with respect to the trade in goods and regulations around the transportation sector (see Articles 405 and 1408). However, the AIT did not offer an explicit framework for arriving at mutual recognition. That the AIT encouraged the paradigm of mutual recognition (as does its successor, the CFTA) is consistent with other regional trade agreements (RTAs) in other nations.

Canadian Free Trade Agreement

In 2017, following extensive negotiations amongst Canada's governments over a nearly two-year period, the AIT was terminated and replaced by the Canadian Free Trade Agreement (CFTA). One of the most significant changes that came out of this change was the introduction of an institutionalized method to resolve trade barriers. Titled the Regulatory Reconciliation and Cooperation Table (RCT), the newly created RCT offers a designated forum for Canada's governments to come together to resolve regulatory differences.

The framework for the RCT mechanism is laid out in Chapter Four of the CFTA. That chapter describes a process wherein the RCT, composed of appointees from each of the CFTA member governments, leads regulatory reconciliation work streams on behalf of those member governments.

In practise, the RCT will typically designate an extant interjurisdictional body with the relevant technical and policy capacity and assign this entity to develop a plan for reconciliation. For example, in the CFTA's recent RCT process regarding construction codes, the RCT members tasked the Provincial-Territorial Policy Advisory Committee on Codes (PTPACC) to lead the efforts. PTPACC was formed decades ago to harmonize various codes across the country, and the RCT members determined it to be the best specialized body to perform the work.

Work of the RCT appointees is to result in reconciliation agreements, and the CFTA provides that mutual recognition is one of several means for achieving reconciliation. Thus, an MRA could be one possible outcome of the RCT

process around a particular issue. However, mutual recognition is not the only potential outcome. The CFTA offers an open-ended list of solutions to regulatory clashes that includes harmonization, equivalency, or “such other method as the Parties may agree.” This is to say that mutual recognition, and an MRA specifically, is one of several potential methods of resolving trade barriers under the CFTA.

New West Partnership Trade Agreement

The New West Partnership Trade Agreement (NWPTA) finds its origins in the 2006 Trade, Investment and Labour Mobility Agreement (TILMA) concluded between Alberta and British Columbia. In 2010, Saskatchewan joined the TILMA (at which point that agreement was renamed the New West Partnership Trade Agreement), and in 2016 Manitoba became a party as well.

Before the AIT was replaced by the CFTA in 2017, the NWPTA was considered a more liberalizing trade agreement than the AIT. One key reason for this assessment was that the NWPTA adopted a negative-list approach, whereas the AIT was a positive-list agreement. Negative lists automatically commit all policies and all industrial sectors as falling within the scope of the agreement. Exceptions must then be obtained (put on a negative list) to keep certain measures outside of the agreement’s scope. In contrast, a positive list agreement, as was the AIT, requires that a sector or industry be explicitly included for the obligations of the agreement to apply.

On the matter of mutual recognition, the NWPTA demonstrates a stronger commitment than does Canada’s CFTA. In Article 5, the agreement provides that the parties “shall mutually recognize or otherwise reconcile their existing standards and regulations that operate to restrict or impair trade, investment or labour mobility.” There are limits to the ways in which the NWPTA can impose an unbridled obligation of mutual recognition. The first is in the phrasing of Article 5, which provides that the parties shall mutually recognize “or otherwise reconcile” thereby suggesting that mutual recognition is not the exclusive potential solution. The second is a result of the Legitimate Objectives provision in Article 6, which offers parties to the agreement another escape valve by allowing them to maintain a measure inconsistent with the obligation of Article 5. Third, Article 20 always allows a party to leave the NWPTA.

The obligation to mutually recognize under the NWPTA is notable for its breadth and scope. Additionally noteworthy is that the principle is not incorporated through an MRA as is often the case in international agreements; rather, the principle applies across the whole of the parties’ economies, subject to the exceptions listed in Part V. Amongst sovereign nations, mutual recognition is more often put into effect through an MRA and is found as an annex to the RTA itself (Correia de Brito, Kauffmann, and Pelkmans 2016). The MRA may even specify areas of the economy or particular CABs to which

it applies, further narrowing its scope. Parties to the NWPTA made the atypical and active decision not to follow that route and narrow its pronouncement on mutual recognition, arguably using the text of the agreement to signal a strong commitment to trade liberalization.

“*The obligation to mutually recognize under the NWPTA is notable for its breadth and scope.*”

An expansive, all-encompassing obligation of mutual recognition under the NWPTA has parallels to the quasi-constitutional status that mutual recognition has acquired in the EU. The landmark *Cassis de Dijon* decision issued by the European Court of Justice (ECJ), wherein Germany was ordered to recognize French standards for marketing the aperitif known as cassis, is generally understood to have introduced the discipline of mutual recognition amongst members of the EU, and thereafter formed a new “cornerstone” of the internal European market (Purnhagen 2014). Van den Brink (2016) noted that because the principle as endorsed by the ECJ overarches distinct policy areas and applies broadly amongst EU members, it has in effect achieved almost constitutional status. Trade liberalization is furthered in the constating documents of the EU, in particular the Treaty on the Functioning of the European Union, which provides for freedom of mobility and freedom of establishment. However, there is no “unconditional” principle of mutual recognition in EU internal market law (Purnhagen 2014). Similarly, with its Article 5 allowance for parties to “otherwise reconcile” their standards in place of mutual recognition, the NWPTA does not demand mutual recognition in the absolute sense.

Given the lack of a corresponding implementation framework under the NWPTA and its wide-ranging applicability, the Article 5 mutual recognition obligation arguably takes on the character of a free-standing entitlement that could be enforced in a NWPTA adjudicatory proceeding. However, there is no publicly available evidence that economic actors have employed dispute resolution procedures to discipline NWPTA members under the mutual recognition obligation. (It is worth recalling once again that, owing to the way in which Article 5 is worded, failure to mutually recognize is not necessarily a breach of the NWPTA as parties may satisfy Article 5 by other means.) In addition, litigation under the NWPTA is generally scant, and lists of claims launched are not publicly accessible, making it difficult to determine the extent to which the agreement’s dispute resolution mechanism and its power to discipline NWPTA members generates policy change.

Insights on mutual recognition from Oceania and elsewhere

Two mutual recognition schemes struck in the 1990s, one an intra-Australian MRA and the other an MRA between Australia and New Zealand, offer insights and lessons on the implementation of the mutual recognition principle. The 1992 *Mutual Recognition Act* amongst the Commonwealth, state, and territory governments within Australia (AMRA) and the 1996 Trans-Tasman Mutual Recognition Agreement between Australia and New Zealand (TTMRA) are both complemented by general laws enacted by their member governments that effectuate the commitments found in the agreements.

An assessment of the former MRA is particularly informative owing to the facts that (i) the federalist foundation of Australia is highly similar to that of Canada, (ii) it grew out of a general dissatisfaction with the fragmented domestic market (Correia de Brito, Kauffmann, and Pelkmans 2016) as is found in Canada, (iii) as a general statement, Australia's governments, much like Canada's in the wake of the Charlottetown Accord, prefer cooperative and voluntary solutions, and (iv) there are very few other domestic MRAs amongst subnational jurisdictions available for study (MRAs are predominantly an arrangement between or amongst sovereign nations).

Under both MRAs, the approach to mutual recognition for goods is that, generally, those goods that can be lawfully sold in one jurisdiction can be sold in another without needing to satisfy additional requirements (APC 2015). Both MRAs cover goods relatively extensively; the TTMRA, for instance, covered approximately 85 percent of the goods traded between Australia and New Zealand in 2015 (APC 2015). Certain goods are subject to explicit carve-outs. Examples in the TTMRA include road vehicles and firearms. Under the AMRA, examples include fireworks and gaming machines. More broadly, under both agreements, the general obligation of mutual recognition may be reduced for certain items of commerce, which can receive permanent or temporary exclusion or exemption from such recognition.

The approach to labour mobility under both MRAs is different than that for goods and is customized for labour market considerations. Generally, both MRAs provide that an individual registered to practise an occupation in her home jurisdiction is "deemed" to be registered to practise an equivalent occupation in a host jurisdiction so long as they notify the applicable host occupation-registration authority. Following this notification, the host government then has 30 days to review the applicant's registration. Should the host government refuse to provide unconditional registration following that 30-day period, the applicant may appeal using the mechanism set out under the applicable MRA. Occupations covered by the AMRA are wide-ranging and include construction and building occupations (architects), transportation (driving instructors), and real estate (property appraisers).

The Australia Productivity Commission (APC) has noted certain challenges arising out of mutual recognition of labour. For example, the government of New South Wales (NSW) suggested that those incapable of satisfying competency standards for security personnel under the NSW competency requirements were first obtaining their credentials in Queensland (where the standards were allegedly less stringent) and subsequently registering in NSW pursuant to the mutual recognition scheme (APC 2015). Such a situation is unsurprising, though it serves as a lesson that mutual recognition schemes require sustained trust amongst conformity assessment bodies and their regulators, and there may be instances where that is not the case (with or without reason), which can imperil confidence and faith in a mutual recognition framework.

In their research study, Carreito et al. (2016) undertook a comprehensive literature review and examined MRAs around the world, including the AMRA and TTMRA. The authors identified factors that made an MRA successful at liberalizing trade. Some of the more salient findings are that the MRA is most successful:

- Amongst parties where social, economic, political, and technological conditions are similar;
- Where sustained high-level political leadership and oversight exists;
- Where the MRA targets regulatory domains that are largely science-driven;
- There exist strong commercial motivations for an MRA for the particular issue or area;
- The MRA covers an area where the parties' regulators (i) benefit from the mutual flow of information, (ii) struggle with similar problems, (iii) generally trust one another, and (iv) share similar regulatory objectives (most likely found in the areas of safety, health, and the environment); and
- Where the MRA incorporates transition periods and confidence-building mechanisms amongst regulators.

The success factors identified above provide potential high-level guidance to those implementing the policy of mutual recognition domestically in Canada.

Economic analysis of mutual recognition

In addition to the legal and institutional considerations, the economic effects of mutual recognition are important to consider when evaluating this policy option. Of all the approaches to internal trade liberalization, mutual recognition may go furthest towards easing policy-relevant trade barriers. After all, as we discussed earlier, interprovincial barriers to trade do not take the form of explicit restrictions to or charges on cross-border transactions. Instead, they normally involve differences in standards, certifications, regulations, inspections, and so on, across jurisdictions that add costs to cross-border transactions even though they may not explicitly be seeking to do so. Mutual recognition, in its extreme form, would allow any good, service, or professional credential to automatically be considered compliant in any given province if it is already compliant in another. In this situation, there would be no differences in rules or regulations, and therefore no interprovincial costs.

In this section, we quantify the magnitude of potential policy-relevant trade costs. In particular, we estimate the extent to which trade costs are not accounted for by geographic features, like distance. We also estimate differences in trade costs related to the direction of trade. If it is costlier to trade from Alberta to Ontario, say, than it is from Ontario to Alberta, then it is not unreasonable to conclude that regulatory differences may be at work. We then estimate the economic consequences of these trade costs for provinces and sectors in Canada. We explore several scenarios, ranging from multilateral mutual recognition involving all provinces, to bilateral mutual recognition involving only a subset of provinces, to unilateral recognition where only one province (Alberta, in our case study) recognizes the standards, certifications, and so on, of other provinces but the reverse is not true. There are important pros and cons to consider, as some sectors benefit while others do not. In the next section, we discuss these and several other important trade-offs for policy-makers to consider.

Review of the economic literature

There is a large literature investigating the magnitude and consequences of internal trade costs in Canada. Most relevant for appreciating the nature of such costs is Beaulieu et al. (2003), who summarized numerous instances of regulatory frictions between provinces. The most recent relevant quantitative research is from Albrecht and Tombe (2016), Alvarez et al. (2019), and Bemrose, Brown, and Tweedle (2020), who have each attempted to estimate the size of internal trade costs in Canada using different techniques. Bemrose, Brown, and Tweedle (2020), for example, found average tariffs-equivalent costs for goods of approximately 7 percent. Albrecht and Tombe (2016), meanwhile,

found that trade costs average between 7.8 and 14.5 percent, depending on the measure. For goods, they found an average cost of less than 5 percent; for services, significantly more. And Alvarez et al. (2019) estimated that average trade costs facing goods in Canada was 19 percent in 2015. In all cases, the existence of economically meaningful and potentially policy-relevant trade costs is not in dispute.

There is also evidence that policy can lower internal trade costs. Though no region in Canada has adopted mutual recognition, several trade agreements may have made a difference. Alvarez et al. (2019), for example, explored TILMA, the 2009 New Brunswick-Quebec agreement, PARE, and NWPTA and found that these agreements lowered internal trade barriers by an average of between 1 and 4 percent, depending on the agreement. This is a meaningful improvement. As we will demonstrate in the quantitative analysis to come, mutual recognition could potentially remove policy-relevant costs far beyond what previous agreements have achieved.

Mutual recognition could potentially remove policy-relevant costs far beyond what previous agreements have achieved.

The consequences of such costs on economic activity in Canada receives less attention in the literature but has been explored before. Albrecht and Tombe (2016) and Tombe and Winter (2021) are the two most recent and relevant studies. The former estimated that Canada's real GDP is between 3.3 and 6.8 percent smaller because of internal policy-relevant trade costs while the latter estimated that figure to be between 3.2 and 7.3 percent. The Bank of Canada also examined the effect of internal trade costs on the growth of Canada's potential output (Agopsowicz et al. 2017). This work suggests that a 10 percent reduction in internal trade costs could increase growth by roughly 0.2 percentage points per year. This additional growth, compounded over several years, would significantly increase the size of Canada's overall economy.

Our work builds on this literature in several ways. We adopt the pre-existing techniques for estimating trade costs but use 2018 data, the latest available. We also adapt Tombe and Winter's (2021) model to this data to quantify the economic consequences of policy-relevant internal trade costs for each of Canada's provinces and territories. To the extent that provincial governments adopting mutual recognition policies can eliminate the policy-relevant trade costs that we estimate, the model provides a credible indication of the potential economic gains that would result.

BOX 1: THE INTUITION BEHIND THE HEAD-RIES INDEX OF TRADE COSTS

Estimating the size of unobservable trade costs is difficult. The Head-Ries Index approach to quantifying these costs uses observable trade flows. Intuitively, higher trade costs mean lower trade flows. Trade costs matter much more for some goods than others. With statistical estimates of how sensitive trade flows are to

trade costs, one can determine how large trade costs must be to match the observed trade flows between two regions. This approach does require certain assumptions, such as similar consumer preferences in both locations, but the method is flexible and consistent with most modern models of international trade that researchers use.

Measuring interprovincial trade costs

Measuring internal trade costs in Canada is a challenge because they are normally not explicit barriers or charges placed on cross-border transactions. Instead, as we discussed in the introduction, they represent the costs of complying with rules, regulations, standards, certifications, and so on, and they vary from one province to another. To estimate the magnitude of such unobservable trade costs therefore requires an inferential approach that calculates an estimate of costs from the observed pattern of trade. This is a common technique in the international trade literature and is based on a highly flexible and effective method developed by Head and Ries (2001), which is generally referred to as the Head-Ries Index of trade costs.

The intuition behind the Head-Ries Index is straightforward, and we briefly describe it in Box 1. It requires two ingredients: first, measures of how provinces and territories allocate their expenditures to producers in different regions, both locally and imported from other regions; second, a measure of how sensitive trade flows are to trade costs. With the observed trade data and a measure of the sensitivity of trade flows to trade costs, one can infer how large trade costs must be to explain the observed pattern of trade. Specifically, the measure compares the share of spending allocated to imports to the share allocated to locally produced goods. If π_{ni} is the fraction of expenditures of buyers in region n allocated to region i then the average trade costs between n and i , denoted $\bar{\tau}_{ni}$, is

$$\bar{\tau}_{ni} = \left(\frac{\pi_{ni}\pi_{in}}{\pi_{nn}\pi_{ii}} \right)^{-\frac{1}{2\theta}},$$

where θ is a measure of how sensitive trade flows are to trade costs. In what follows, we use the empirical measures of this from Fontagné et al. (2022) for goods, which infers this from observed trade costs between countries

(through tariffs, specifically) and international trade flows, and assume an elasticity of 5 for service sector trade, which is not easily measured. This is consistent with standard practise in the literature, though introduces some uncertainty into our results.

To see this formula in action, consider the example of professional and scientific services purchased by buyers in Alberta and British Columbia. In the 2018 data, 65.8 percent of the expenditures on these services by Albertans was allocated to suppliers located in Alberta while 5.1 percent was allocated to suppliers located in British Columbia. Meanwhile, those in British Columbia buying these services allocated 77 percent to local suppliers and 4.6 percent to Alberta suppliers. If trade was perfectly frictionless, the gaps between what BC buyers allocate to Alberta suppliers would not be so starkly different from what Alberta buyers allocate to Alberta suppliers. These differences can then be used to estimate how large trade costs must be to generate this wedge between expenditure patterns across sectors and provinces. If trade flows in professional and scientific services has an elasticity of trade with respect to trade costs of -5 (that is, a 1 percent increase in costs results in a 5 percent decrease in flows) then the Head-Ries Index of trade costs would be 71 percent.

“ *Measuring internal trade costs in Canada is a challenge because they are normally not explicit barriers.* ”

We perform this estimate across all 10 provinces, three territories, and 27 sectors for which we have trade data. This yields 3954 unique measures of bilateral internal trade costs in Canada. We do not report them all in this paper of course, but can summarize the broad results. Across all sectors included in this analysis, the trade-weighted average interprovincial trade costs in Canada are 60 percent. This includes both imports and exports. It implies that the cost of transacting across provincial boundaries is equivalent to a 60 percent tax. This is large. To be clear, not all and indeed not even most of this cost will be policy relevant. The time, distance, fuel, and so on, involved in shipping long distances is sometimes unavoidable. The availability of information about products and prices in another location may also be limited by long distances.

Given Canada’s vast geography, much of the interprovincial trade cost we have measured will not be lowered by governments adopting mutual

**TABLE 1: ESTIMATES OF INTERNAL TRADE COSTS IN CANADA
(TARIFF-EQUIVALENT %)**

Industry	Policy-Relevant Trade Costs			
	Total trade costs	Non-distance costs	Trade cost asymmetries	Geometric average
Crop and animal production	56.3	0.0	19.1	9.2
Forestry and logging	48.8	1.2	11.7	6.3
Fishing, hunting, and trapping	133.6	16.1	21.7	18.9
Support activities for agriculture and forestry	136.2	26.7	27.2	26.9
Mining, quarrying, and oil and gas extraction	18.0	.01	13.7	6.7
Utilities	186.9	50.8	20.8	35.0
Residential building construction	-	-	-	-
Non-residential building construction	-	-	-	-
Engineering construction	-	-	-	-
Repair construction	-	-	-	-
Other activities of the construction industry	83.3	17.6	14.0	15.8
Manufacturing	29.0	0.4	5.3	2.8
Wholesale trade	67.0	0.8	29.2	14.1
Retail trade	202.0	58.7	28.3	42.7
Transportation and warehousing	82.6	13.4	19.1	16.2
Information and cultural industries	79.9	37.5	21.6	29.3
Finance, insurance, and real estate	102.4	11.6	48.0	28.5
Owner occupied dwellings	-	-	-	-
Professional, scientific, and technical services	94.0	5.1	38.6	20.7
Admin. and support, waste management	86.0	3.0	38.0	19.2
Educational services	133.0	43.7	27.6	35.4
Health care and social assistance	239.0	45.4	81.4	62.4
Arts, entertainment, and recreation	106.2	7.2	16.7	11.9
Accommodation and food services	116.5	20.8	15.5	18.1
Other services (except public administration)	136.4	15.8	39.1	26.9
Non-profit institutions serving households	215.4	75.2	18.2	43.9
Government education services	216.5	94.3	22.4	54.2
Government health services	295.9	126.5	33.8	74.1
Other federal government services	225.0	90.4	26.0	54.9
Other provincial/terr government services	253.7	99.8	39.9	67.2
Other municipal government services	213.6	67.7	18.6	41.0
Other aboriginal government services	442.7	197.4	18.3	87.6
Total	60.0	8.0	22.0	14.8

Note: Displays estimates of the average internal trade costs in Canada, expressed in tariff-equivalent percentage points. Total trade costs are the full Head-Ries Index. Policy-relevant trade costs estimate the costs that may be due to artificial internal trade costs in Canada. See text for details of each.

recognition policies. Services, however, may not face the same fundamental trade costs imposed by geography. Electronic transmission of professional services, for example, makes distance almost irrelevant. We estimate that the average interprovincial trade cost facing services trade is over 90 percent, and therefore there may be more scope for mutual recognition to lower these costs. Table 1 reports the measured interprovincial trade costs for each sector included in our analysis.

As noted, much of these large internal trade costs are not under the direct control of policy-makers so we need another measure for policy analysis. We follow the recent research literature (Albrecht and Tombe 2016; Alvarez, Krznar, and Tombe 2019) to calculate two complementary measures that may better approximate those interprovincial costs that may be due to policy. We will not go into the full details here, as we merely apply these pre-existing techniques to the latest data from Statistics Canada for 2018.

To summarize, first, we statistically measure the relationship between overall trade costs between each province or territory for each sector for which there is data and the distance between the trading pairs. This distance represents the population-weighted average distance between residents of each region. The portion of overall trade costs that are not accounted for by physical distance is termed the “non-distance trade costs” and may reflect non-geographic factors that are more likely due to policy differences. Second, we measure the extent to which trade costs differ between two regions depending on the direction of trade. If it is more costly to trade in one direction than the other, then policy differences may be the underlying cause. The contribution of these “trade cost asymmetries” to overall trade costs is then another measure of policy-relevant trade costs.

We estimate these policy-relevant trade costs for each of the 27 sectors with positive trade flows in the data. We find the non-distance trade costs average 10 percent for goods and 29 percent for services. We also find the contribution of asymmetric trade costs average 8 percent for goods and 33 percent for services. The (geometric) average between these two policy-relevant measures of trade costs is nearly 15 percent. We report the specific estimates for each of the sectors and each of the measures in Table 1. We also report a summary measure of trade that represents the geometric average policy-relevant trade costs across both measures. These measures are informative and may be interpreted as the potential scope for mutual recognition policies to lower trade costs. We use these in the quantitative analysis to estimate the potential economic implications of such a policy.

Quantifying the economic implications of mutual recognition

Estimating the magnitude of internal trade costs in Canada sheds light on the scope for mutual recognition policies to facilitate the flow of goods and services between provinces and territories. Quantifying the effect from lowering such costs, meanwhile, sheds light on the economic benefits of doing so. We do this using two complementary approaches. First, we present a simple, model-free approach to measuring the effect of lowering trade costs on Canada's real GDP. This is a surprisingly powerful means of estimating the effect of modest cost reductions without requiring a full quantitative model of Canada's economy. Second, we present the results from a rich model of Canada's economy. This is a much more sophisticated approach using the latest computational tools available to researchers and is applied to the latest available data for Canada.

Rule of thumb

While our main quantitative results are based on a rich model of Canada's economy, a simple rule-of-thumb approach may be useful to explore first. Conveniently, it turns out, the effect of small changes in trade costs on real GDP can be easily approximated using recent data on trade flows and the network structure of Canada's economy. We discuss each in detail. And while we do not provide a full derivation of this important result, it is not novel in the research literature (i.e., Lai, Fan, and Qi 2020) and the intuition is straightforward.

Consider first a measure of the importance of trade by sector. In particular, the fraction of expenditures on goods and services that are imported from another province or territory is a measure of how important trade costs are. If the volume of trade is high, then higher trade costs will come with greater economic damage, all else being equal. Nationally, over 15 percent of all expenditures on finance, insurance, and real estate services are imported from another region as are over 22 percent of all expenditures on professional, scientific, and technical services. We report the interprovincial import share for each sector in Table 2, based on 2018 data from Statistics Canada (2021a).

Consider next a measure of a sector's importance for the overall economy. This will quantify how negative shocks to that sector affect the overall whole. If trade costs are high in one sector, for example, then all other sectors that purchase inputs from that sector for use in the production of some other good or service are also affected. The full set of input-output relationships can be used to measure how "central" each sector is in the overall economy. Sectors that supply inputs to many others, such as manufacturing, will have a high measure of centrality whereas sectors that largely supply final goods

to consumers, and therefore few inputs to other sectors, will have a low measure. We call this a sector’s “network centrality” and we base it on a common measure in the research literature that explores how productivity shocks cascade through the economy (Acemoglu et al. 2012; Jones 2013; Carvalho and Gabaix 2013). Importantly, Albrecht and Tombe (2016) show that this measure applies to quantifying the gains from trade as well. Conveniently, the measure can be constructed from readily available data. Specifically, given an input-output matrix A , which collects the intermediate input purchases by column-sector j on inputs from row-sector i , as a share of sector j ’s total output, and given a vector of final demand shares β , then we have

$$\gamma = (I - A)^{-1} \beta,$$

where γ is the vector of centrality measures γ^j . In the input-output literature, this is the Leontief Inverse Matrix times the vector of final demand shares. This can be easily constructed using the symmetric input-output tables from Statistics Canada (2022). We report this measure for each sector in Table 2.

With these two measures in hand, one can show that for small changes in trade costs the aggregate real GDP effect will be approximately equal to the product of a sector’s network centrality and its interprovincial import share. For example, a 1 percentage point reduction in trade costs for professional and scientific services would, according to this rule-of-thumb measure, increase Canada’s real GDP by 0.027 percent. While this may sound small, it represents an increase of over \$713 million annually, given Canada’s over \$2.6 trillion economy in 2022. We report the dollar gain from a 1-point reduction in trade cost for each sector in Table 2.

This simple rule-of-thumb approach is highly relevant for understanding the potential economic implications of adopting mutual recognition policies in Canada. As we reported previously, internal trade costs are potentially large in many sectors. They are especially so for the service sectors. The scope for mutual recognition to eliminate those costs is captured by our measure of policy-relevant trade costs while the gains from doing so are approximated by our rule of thumb. The average policy-relevant trade cost facing professional and scientific services, for example, is over 13 percent. Multiplied by the economic gains that each percentage point reduction may yield suggests that the gains from mutual recognition policies in this one sector alone exceed \$9 billion per year. To be sure, while our rule-of-thumb provides an exceptionally good approximation of the gains from lower trade costs that our full model will quantify, it does so only for small changes in trade costs. We therefore turn to the full model to provide a richer picture of the economic implications of mutual recognition.

TABLE 2: SIMPLE APPROXIMATION OF THE GAINS FROM LOWERING INTERNAL TRADE COSTS

Industry	Network centrality	Interprovincial import share (%)	National gains per 1 p.p cut in trade costs (\$M)
Crop and animal production	0.061	20.4	336
Forestry and logging	0.009	10.3	25.8
Fishing, hunting, and trapping	0.002	58.7	35.2
Support activities for agriculture and forestry	0.004	5.3	5.7
Mining, quarrying, and oil and gas extraction	0.106	35.5	1008.40
Utilities	0.032	7.5	63.6
Residential building construction	0.04	-	-
Non-residential building construction	0.016	-	-
Engineering construction	0.033	-	-
Repair construction	0.03	-	-
Other activities of the construction industry	0.003	12.1	9.2
Manufacturing	0.541	16.8	2441.50
Wholesale trade	0.084	38.1	860.7
Retail trade	0.066	2.4	42.8
Transportation and warehousing	0.103	21.6	598
Information and cultural industries	0.061	17.8	293
Finance, insurance, and real estate	0.234	15.7	988.7
Owner occupied dwellings	0.063	-	-
Professional, scientific, and technical services	0.12	22.1	713
Admin. and support, waste management	0.067	20.5	369.1
Educational services	0.003	7.6	6.1
Health care and social assistance	0.033	3.9	34.6
Arts, entertainment, and recreation	0.008	12.2	27.5
Accommodation and food services	0.031	10.0	82.6
Other services (except public administration)	0.022	11.0	65.7
Non-profit institutions serving households	0.018	1.9	9.3
Government education services	0.042	1.8	20.6
Government health services	0.042	0.8	8.6
Other federal government services	0.029	1.7	13.4
Other provincial/terr government services	0.044	1.0	12.2
Other municipal government services	0.033	2.3	20.2
Other aboriginal government services	0.004	0.1	0.2

Note: This table displays the results of a simple approximation of the aggregate real GDP gains from lowering internal trade costs in Canada. This involves a measure of the network centrality of each sector, which captures each sector's influence on the overall economy through intersectoral input-output connections, and the share of spending on each sector's output that is traded across provincial or territorial boundaries.

Model-based estimates

While the rule-of-thumb approach is simple and informative, it is limited to quantifying the overall real GDP effect of small changes. Our full computational general equilibrium model of Canada's economy can simulate any arbitrary change in internal trade costs and quantify the effect on economic activity, wages, prices, inter-provincial migration, federal revenue and expenditure changes that naturally result from changes in underlying economic variables, and other outcomes. By exploring several simulated changes in internal trade costs, the model can estimate the economic benefits of policy reforms like mutual recognition agreements that would dramatically improve internal trade.

We do not present the detailed mathematical structure of the model in this paper as we simply adopt Tombe and Winter's (2021) model, but a summary of its general structure would be helpful. First, the model exactly matches the observed level of internal trade flows in Canada for 2018, the observed distribution of employment across provinces and territories, the pattern of federal revenue and expenditures, and the complete set of intersectoral input-output linkages between each of the 32 separate sectors that we model. Firms and consumers in the model optimally choose where to source their purchases from, selecting either locally produced goods and services or imports from some other location. Trade costs affect these decisions, and reductions in trade costs will tend to increase the fraction of expenditures allocated to imports.

As the share of imports rises, the import-competing firms within a province that may not be competitive will shrink or leave the market while the export-oriented and highly productive producers expand. This tends to increase productivity, which is the ultimate source of overall gains from trade. In addition, workers can move across regions in response to changes in wages and prices. And federal revenue and expenditures, which in many ways are tightly connected to local economic conditions, also respond. It is a rich model at the frontier of the research literature.

With this model in hand, several counterfactual experiments may be conducted to quantify the effect of changes in trade costs. Essentially, we ask the model to solve for a new set of trade patterns, migration flows, wages, prices, and so on, in response to any desired change in trade costs. We explore the outcome if all provinces together eliminate trade costs, if a single province (in this case, Alberta) moves alone, and if individual sectors are targeted for internal trade liberalization.

Multilateral liberalization

Lowering interprovincial trade costs between all provinces will tend to increase productivity and economic activity. Production will shift towards

TABLE 3: MODEL-IMPLIED REAL GDP GAINS FROM LOWERING INTERNAL TRADE COSTS

	Region	
	Alberta	Canada
(a) All provinces and territories liberalize		
Uniform 10% reduction in interprovincial trade costs	6.6%	6.7%
Remove non-distance trade costs	3.9%	4.4%
Remove trade cost asymmetries	3.0%	7.9%
Remove non-distance trade costs in service sectors only	3.7%	4.2%
Remove trade cost asymmetries in service sectors only	2.9%	4.6%
(b) Alberta liberalizes unilaterally		
Uniform 10% reduction in interprovincial trade costs	5.2%	1.4%
Remove non-distance trade costs	2.5%	0.9%
Remove trade cost asymmetries	4.1%	1.6%
Remove non-distance trade costs in service sectors only	2.4%	0.8%
Remove trade cost asymmetries in service sectors only	2.9%	1.0%

Note: This table displays the change in real GDP for Alberta and Canada following several scenarios that lower internal trade costs in Canada. Results are generated from a full computable general equilibrium model of Canada's economy. It features 32 individual sectors, with full input-output connections between each, and 13 provinces and territories and the rest of the world

locations that have a particularly high comparative advantage in those activities relative to others, which will lower production costs and therefore prices. The increase in demand for labour by those sectors may also increase wages. Together, the purchasing power of the average individual will increase, though likely by different amounts in different locations. To quantify these gains, we explore several scenarios and report all results in Table 3.

To intuitively illustrate some of the relevant magnitudes, we begin with a simple exercise: lowering trade costs by 10 percent uniformly across all sectors and all provinces and territories in Canada. We report the results in the first row of Table 3. We find that this action increases Canada's overall economy (as measured by real GDP) by 6.7 percent. These gains do not materialize instantly, to be clear. This represents the long-run gains from this reduction in trade costs and may in practise take many years, or even decades, to materialize fully. We find similarly large gains for Alberta's economy, which grows by 6.6 percent. This provides an important sense of scale or, to put it another way, it reveals the sensitivity of the economy to changes in trade costs. It also reveals this sensitivity to be large.

Adopting mutual recognition policies would, in the extreme, eliminate all policy-relevant trade costs associated with differences in rules, regulations, standards, certifications, and so on, that exist between provinces. We estimate the gains from removing both the non-distance trade costs and the contribution from asymmetries in trade costs. Both are informative, though the latter may be particularly so. After all, if trade costs are higher in one direction (say, from Alberta to Ontario) than the other (from Ontario to Alberta) it may be more likely due to regulatory costs than something more fundamental, as discussed earlier. We find Canada gains between 4.4 and 7.9 percent, depending on the liberalization scenario, and Alberta gains between 3.0 and 3.9 percent. We report these in the second and third rows of Table 3. These are large gains. Nationally, it is equivalent to between \$2900 and \$5100 per capita. In Alberta, it is equivalent to between \$2300 and \$3000 per capita.

Much of the gains from liberalization are in the service-producing sectors. This is not only because service sectors face larger interprovincial trade costs than do goods-producing sectors, but also because many services are important inputs in the production of goods and other services throughout the economy. Professional and scientific services, finance and real estate, wholesale trade, insurance, transportation, and so on, are inputs used extensively throughout the economy. Gains to productivity in producing these services will therefore have large spillover benefits elsewhere. We find that removing policy-relevant trade costs in service-producing sectors yields gains of between 4.2 and 4.6 percent nationally and between 2.9 and 3.7 percent in Alberta. As before, these are large gains. These results also suggest that efforts by policy-makers to explore mutual recognition of service sectors standards, professional certifications, and so on, could yield the largest economic benefits.

Unilateral liberalization

Adopting a policy of mutual recognition, as the name clearly suggests, involves more than one jurisdiction. But a single jurisdiction could deem compliance with the requirements of any other jurisdiction as equivalent to satisfying its own requirements. Such unilateral recognition would lower trade costs for buyers within the province, but not for sellers from that province who are satisfying demand in another. While the effects may be more limited than broader mutual recognition, such a move could still lower prices and production costs within the jurisdiction that is unilaterally recognizing. We quantify these gains for Alberta specifically through several scenarios and report the results in panel (b) of Table 3.

The unilateral elimination of policy-relevant import costs yields considerable economic gains, though they are smaller on average than they would be with full mutual recognition. We find that eliminating non-distance import costs into Alberta would increase provincial real GDP by 2.5 percent, which

is approximately two-thirds of the gains that would accrue if all provinces eliminated such costs. Removing trade cost asymmetries, but only on imports into Alberta, yields even larger gains of 4.1 percent to the provincial economy. Removing import costs for service sectors alone would yield gains of between 2.4 to 2.9 percent. There are also national gains, but of a considerably smaller magnitude than if all provinces jointly liberalize.

Mutual recognition blocks

An intermediate policy option between full mutual recognition between all provinces and territories and unilateral recognition by a single province could involve a smaller group of provinces and/or territories agreeing to mutually recognize each other's rules, regulations, certifications, and so on. Such trading blocks have typically been the way in which internal trade barriers are eased in Canada, through such agreements as the NWPTA. Such agreements could generate meaningful economic benefits to participating provinces and territories.

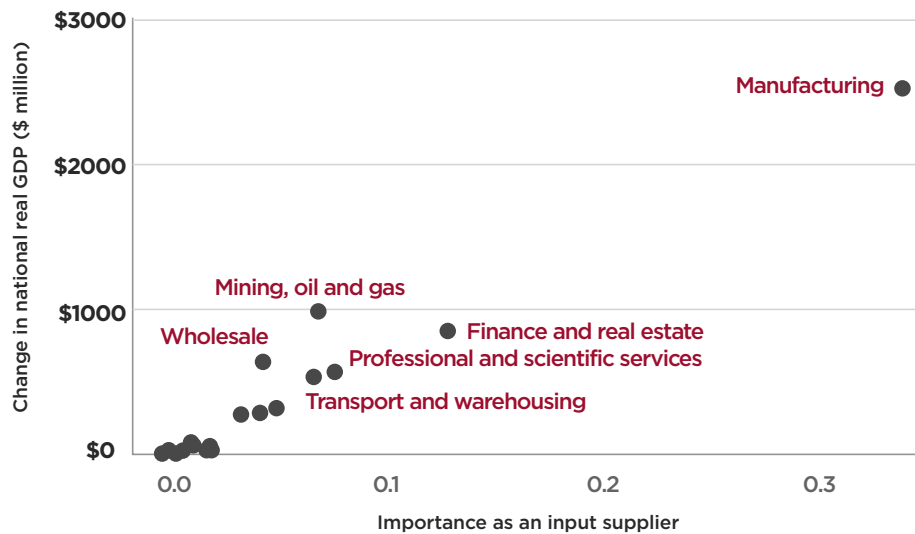
To quantify the potential gains from a set of provinces joining a mutual recognition block, we simulate the removal of policy-relevant trade costs between the four western provinces of British Columbia, Alberta, Saskatchewan, and Manitoba. This reflects the current membership in the NWPTA. We find overall real GDP rises by between 2.9 and 6.5 percent. If an average of our two measures of policy-relevant trade costs are removed, gains are at the lower end of this range at 2.9 percent. And as with our national results, the two smaller provinces, Saskatchewan and Manitoba, gain the most.

Sector-specific mutual liberalization

Instead of economy-wide mutual recognition, which may be an unrealistically heavy lift for policy-makers, we explore sector-specific liberalization. In some areas, such as professional and scientific services, for example, it may be easier for governments to agree on mutually recognizing other provinces' credentials and professional certifications. This would lower costs in this important service sector. In the finance and real estate sector, provincial governments may do the same. Understanding the potential economic effect of targeted mutual recognition policies may be an important guide to allocate scarce policy-making effort and attention.

To quantify the effects, we simulate lowering internal trade costs by 1 percent one sector at a time. Though the full model presents a much richer picture of the Canadian economy, the results are very similar to the rule-of-thumb approach we described earlier. In fact, we find the correlation between the model-implied gains to Canada's real GDP from a 1 percent reduction in internal trade costs are nearly perfectly correlated (0.994) to the rule-of-thumb approach. This exercise also reinforces that the most economically important sectors to target in trade liberalization efforts are those that are relatively

FIGURE 2: ECONOMIC GAINS FROM SECTOR-SPECIFIC 1% TRADE COST REDUCTIONS



Note: This figure displays the change in Canada's real GDP in response to a one percent reduction in internal trade costs for that sector. Each sector's importance as an input supplier is measured by the difference between its network centrality (described in the text) and the sector's share of final demand.

central within Canada's complex web of input-output connections. In Figure 2, we display this result by plotting the model's real GDP boost to Canada for a one percent reduction against a measure of how important that sector is as an input supplier to others. Specifically, we use the difference between each sector's network centrality measure, which we described earlier, and that sector's share of final demand.

The strong overall correlation between gains from trade liberalization and a sector's importance as an input supplier is clear. Drilling down, we find that manufacturing and resource sectors are particularly important. Trade costs facing the resource sector are largely related to infrastructure, so may not be greatly affected by mutual recognition policies. Trade costs for manufacturing may involve direct regulatory costs, such as product standards differing across provinces, that could be eliminated through mutual recognition. Beyond goods, many service sectors are important sources of economic gains from internal trade liberalization. Finance and real estate, wholesale trade, professional and scientific services, and transportation and warehousing top the list. These four service sectors are also particularly important suppliers of inputs to most other sectors in the economy. Exploring mutual recognition policies in these areas would therefore be particularly beneficial economically.

Discussion

Although we find unambiguous and large economic benefits from eliminating internal trade costs in Canada, there are important trade-offs to consider.

Adjustment costs

Trade liberalization requires that resources, production, and employment shift across sectors and even across regions. Sectors in one province that may not survive competition with lower cost imports may shrink while sectors that see an increase in export volumes may expand. The same is true across regions. Workers in one location may move to another in response to changes in wages and prices. Indeed, we find (consistent with other researchers) that the gains from eliminating policy-relevant trade costs are larger for smaller and lower productivity regions, on average, than they are for higher-income regions like Ontario, Alberta, and British Columbia.

Our model suggests that between 1.3 and 1.7 percent of Canada's workforce would migrate across provinces in response to eliminated internal trade costs. In the long-run, these moves are productivity enhancing for the overall economy but are not costless in the short-run for the individuals involved. There are also large reallocations within provinces. In Alberta, for example, we find between 1.7 and 5.0 percent of the workforce would change the sector in which they work. Such moves may be particularly costly if retraining is required. Importantly, a larger share of economic activity is reallocated within a province that opts to enact unilateral recognition than if all provinces adopted mutual recognition. These adjustment costs are not captured by our model-based estimates of the economic effect of trade liberalization but are critical for policy-makers to consider.

Fiscal redistribution

If only some regions adopt mutual recognition policies – such as a province moving unilaterally or a group of provinces liberalizing only within a block – then other regions of the country may lose. Eliminating trade costs within the NWPTA, for example, may lead to modest reductions in Ontario's real GDP. And employment would tend to shift away from the other provinces and territories as some workers opt to move into the NWPTA provinces due to higher real wages. There are mechanisms in Canada's federation that compensate for this, however. Federal taxes would raise more from regions experiencing economic gains and federal program spending would tend to redirect such revenues towards relatively lower income regions. The model, following Tombe and Winter (2021), accounts for this and we find that even in regions where real GDP declines the real incomes of residents increases. Some of the gains of even partial liberalization would therefore

be shared with other regions in Canada. This redistribution has always been a source of political friction, however, especially in recent years. And to the extent that partial liberalization increases the degree of federal government financial redistribution, this friction may increase further. Though it is a non-economic consideration, the political dynamics that result from federal fiscal policy cannot be ignored.

Equity concerns

Mutual recognition policies have overall benefits for provincial economies according to our model-based estimates. However, these gains are not distributed evenly, and some individuals or firms may be harmed by such policies. Consider the simple example of used car inspections. Currently an individual who moves to Alberta from another province is required to have their vehicle inspected before it may be registered with the province. This is true regardless of the car's age. Since newer vehicles that are deemed safe in British Columbia are no doubt also safe in Alberta, this is a barrier to labour mobility that is unnecessarily costly to both the individual and the broader economy. Auto service centres, however, would lose revenue if vehicle certifications elsewhere were recognized as automatically compliant with Alberta certifications. They may therefore need to scale back operations and staffing levels, and displaced employees would need to shift to another employer, occupation, and perhaps even location. These adjustment costs are relevant for policy-makers to consider and not unique to this specific example. Sectors for which local consumer demand is increased in a province by interprovincial trade barriers would tend to shrink once mutual recognition policies were enacted.

Conclusion

Canada's experiment with domestic political arrangements to liberalize internal trade commenced in 1995 with the Agreement on Internal Trade. The various agreements amongst the nation's provinces and territories that have been spawned since then and which presently constitute Canada's ecosystem of domestic trade arrangements are largely underpinned by the paradigm of national treatment. Mutual recognition could further domestic liberalization efforts with its more stringent obligation on the part of one province to generally accept the technical regulations of another for goods or services. Arguably, recourse to and adoption of mutual recognition is a natural progression for Canada's interprovincial trade advancement.

Mutual recognition can manifest in myriad ways and with broad or narrow scope. Experience elsewhere, particularly that of Australia with the AMRA, and Australia and New Zealand with the TTMRA, suggests that the factors for a successful MRA may exist domestically in Canada. However, policy-makers must consider the diverse forms that the principle of mutual recognition can take when put into practise. This will require careful additional analysis and intergovernmental negotiations.

In addition, though we demonstrate that the potential economic benefits for Canada from adopting mutual recognition policies are large — on the order of between \$110 and \$200 billion per year in additional economic activity — there are important trade-offs to consider. These include adjustment costs for workers and businesses that shift across sectors, occupations, or regions in response to the changing competitive landscape, potential interactions with fiscal policy when funds are transferred away from regions experiencing faster growth, and important equity concerns if displaced sectors are in economically depressed regions. Mutual recognition also, by design, eliminates the ability of provincial or territorial governments to enact and enforce different rules, regulations, standards, and so on, which constrains their ability to design policy around local circumstances.

With such large opportunities for additional internal trade liberalization in Canada and the consequent economic and productivity benefits that may result, however, these challenges may not be insurmountable. Pursuing mutual recognition policies within specific areas, such as trucking regulations, food safety, or financial services, may be appropriate in the future. Whatever the best route forward, interest among governments to improve economic growth and liberalize trade may be higher today than any point in recent memory. And mutual recognition should be an important part of the policy conversation.

About the authors



Ryan Manucha is widely published and a frequent commentator on the topic of Canadian interprovincial trade. His writing on the subject has appeared in *The Globe and Mail*, the *Ottawa Citizen*, *Maclean's Magazine* and the *Canadian Lawyer Magazine* in addition to leading peer-reviewed legal journals such as the *Osgoode Hall Law Journal*, the *Canadian Business Law Journal*, and the *Canadian Journal of Administrative Law & Practise*. He is the author of

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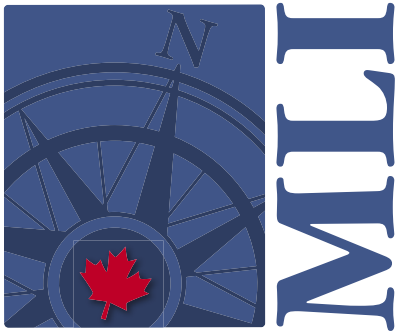
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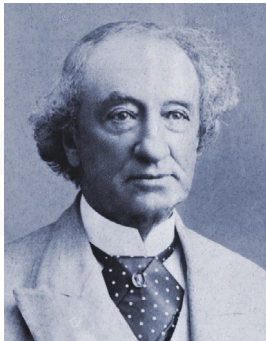




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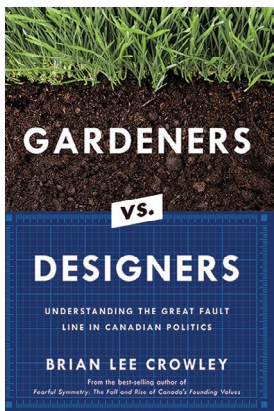
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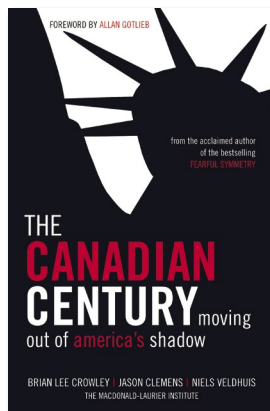
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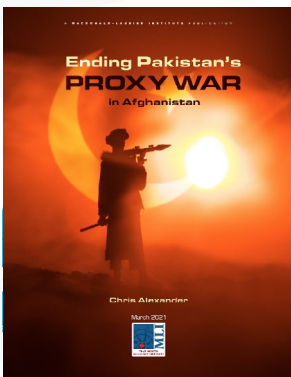
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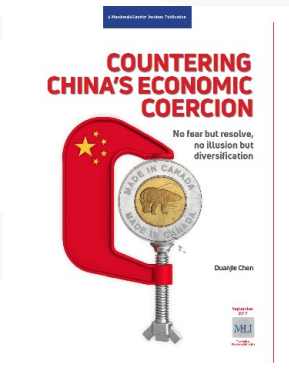
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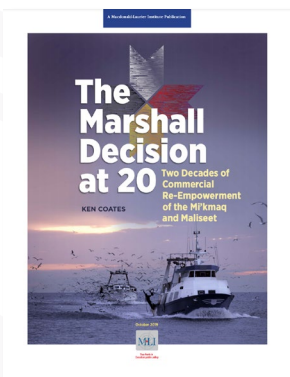
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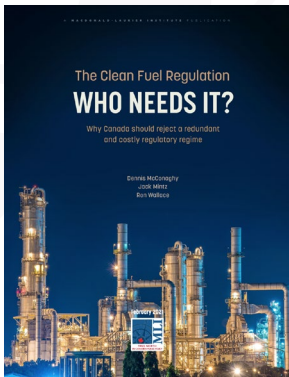
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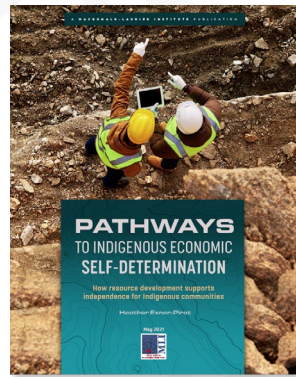
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The Right Honourable Paul Martin

I want to congratulate the **Macdonald-Laurier Institute** for 10 years of excellent service to Canada. The Institute's commitment to public policy innovation has put them on the cutting edge of many of the country's most pressing policy debates. The Institute works in a persistent and constructive way to present new and insightful ideas about how to best achieve Canada's potential and to produce a better and more just country. Canada is better for the forward-thinking, research-based perspectives that the **Macdonald-Laurier Institute** brings to our most critical issues.

The Honourable Jody Wilson-Raybould

The **Macdonald-Laurier Institute** has been active in the field of Indigenous public policy, building a fine tradition of working with Indigenous organizations, promoting Indigenous thinkers and encouraging innovative, Indigenous-led solutions to the challenges of 21st century Canada. I congratulate **MLI** on its 10 productive and constructive years and look forward to continuing to learn more about the Institute's fine work in the field.

The Honourable Irwin Cotler

May I congratulate **MLI** for a decade of exemplary leadership on national and international issues. Through high-quality research and analysis, **MLI** has made a significant contribution to Canadian public discourse and policy development. With the global resurgence of authoritarianism and illiberal populism, such work is as timely as it is important. I wish you continued success in the years to come.

The Honourable Pierre Poilievre

The **Macdonald-Laurier Institute** has produced countless works of scholarship that solve today's problems with the wisdom of our political ancestors. If we listen to the **Institute's** advice, we can fulfill Laurier's dream of a country where freedom is its nationality.

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