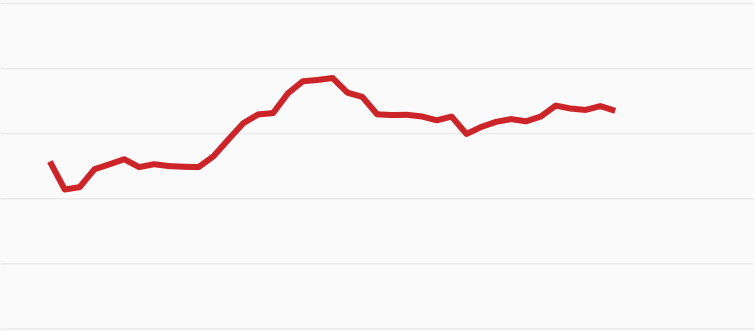
The Canadian Free Trade Agreement and Interprovincial Trade

Trevor Tombe (University of Calgary)

Queen's Institute for Trade Policy, November 2020

How Important is Internal Trade in Canada?

Figure 1: Internal and International Trade as a Share of GDP (1981-2019)



Source: Own calculations from Statistics Canada data table 36-10-0222.

How Important is Internal Trade in Canada?

Figure 2:

Senate of Canada Report, 2016

Supreme Court of Canada Rulings (R v Comeau 2018 SCC 15)

Measuring Internal Trade Costs

The Head-Ries Index of Trade Costs

Pair observed trade data with empirical estimates of trade elasticities to infer the magnitude of unobservable trade costs.

The Head-Ries Index of Trade Costs

The Head-Ries Index of Trade Costs

Pair observed trade data with empirical estimates of trade elasticities to infer the magnitude of unobservable trade costs.

The Head-Ries Index

$$\bar{\tau}_{ni} \equiv \left(\frac{\pi_{ni}\pi_{in}}{\pi_{nn}\pi_{ii}}\right)^{-1/\theta} \tag{1}$$

where π's are trade shares and θ is the elasticity

Intuition: 75% of AB egg spending is local, 15% to SK producers. Meanwhile, 83% of SK egg spending is local, 6% to AB producers. Elasticity of egg trade is -3.8 (Fontagne et al., 2019).

The Head-Ries Index of Trade Costs

Pair observed trade data with empirical estimates of trade elasticities to infer the magnitude of unobservable trade costs.

The Head-Ries Index

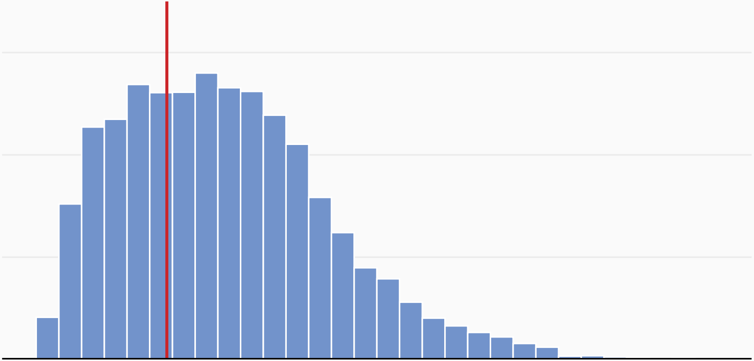
$$\bar{¿}_{ni} ˘ µ \frac{\cdot\cdot ni \cdot\cdot in}{\cdot\cdot nn \cdot\cdot ii} ¶^{¡1/µ} \tag{1}$$

where …'s are trade shares and µ is the elasticity

Intuition: 75% of AB egg spending is local, 15% to SK producers. Meanwhile, 83% of SK egg spending is local, 6% to AB producers. Elasticiti35w66 Tf 8o.1 (ar)20.005 (e)-214.996 5.001 (spendi-)414.9Tm 3.8e

The Head-Ries Index of Trade Costs

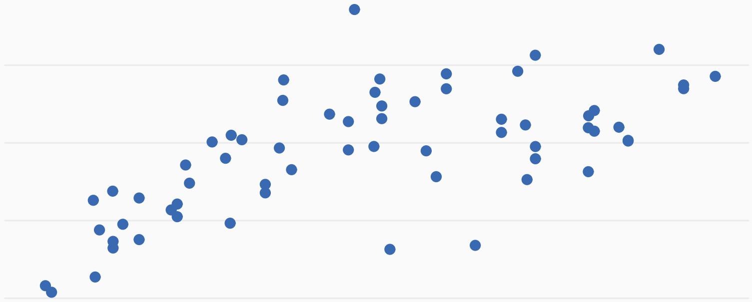
Figure 3: Tariff-Equivalent Internal Trade Costs in Canada (2016)



Source: Own calculations from various Statistics Canada tables.

Geographic Determinants of Trade Costs

Figure 4: Head-Ries Trade Costs vs Physical Distance (2016)



Note: Displays the average trade-weighted trade costs versus distance between pairs, controlling for product-specific factors. Specifically, this plots the residuals from a regression of log trade costs on product-specific dummy variables against the distance between Origin-Destination trading pairs in Canada.

Estimates of Policy-Relevant Trade Costs

The best estimates of non-geographic internal trade costs: Bemrose, Brown, and Tweedle (2020), Going the distance: Estimating the effect of provincial borders on trade when geography (and everything else) matters, Canadian Journal of Economics

Estimates of Policy-Relevant Trade Costs

The best estimates of non-geographic internal trade costs:
Bemrose, Brown, and Tweedle (2020), Going the distance: Estimating the effect of provincial borders on trade when geography (and everything else) matters, Canadian Journal of Economics

Their Main Aggregate Estimates for Goods: 6.9 8.1%

Estimates of Policy-Relevant Trade Costs

The best estimates of non-geographic internal trade costs:
Bemrose, Brown, and Tweedle (2020), Going the distance: Estimating the effect of provincial borders on trade when geography (and everything else) matters, Canadian Journal of Economics

Their Main Aggregate Estimates for Goods: 6.9 8.1%

Other estimates:

- Albrecht and Tombe (2016, CJE): 7.8 14.5% overall, average for agriculture and manufacturing is less than 5%

Policy Options to Lower Internal Trade Costs

Canadian Free Trade Agreement

Agreement in force on July 1, 2017 (Happy 150!)

Establishes rules and procedures to encourage easier goods and services flows across subnational borders.

- Broad coverage: 80% of GDP
- Stricter procurement rules
- Stronger dispute settlement (sort of... but... not really)
- Maintains momentum through various working groups

Canadian Free Trade Agreement

Agreement in force on July 1, 2017 (Happy 150!)

Establishes rules and procedures to encourage easier goods and services flows across subnational borders.

Regulatory Reconciliation and Cooperation Table (RCT)

The RCT Process: Structured Intergovernmental Bargaining

1. Identify a potential barrier. F/P/T governments only.
2. Governments negotiate. A reconciliation agreement is (hopefully) reached. Can take many forms.
3. Implement the agreement (following whatever method was negotiated: mutual recognition, harmonization, etc.)

To date: 10 agreements have been reached.

- Construction codes; energy efficiency standards; aquaculture; corporate registrations; upholstered and stuffed articles; first aid kits; wide-base single tires ...

The Gains from Internal Trade Liberalization and a New Method to Prioritize Policy Effort

Caveats to Keep in Mind

Caveats to Keep in Mind

- Long-Run Gains: Estimates do not account for the sometimes long and costly process of adjustment.
- Aggregate Gains: Estimates abstract from distribution of costs and benefits across individuals.
- Legitimate Policy Objectives: Regulatory variation may serve valid purposes and may yield efficiency benefits despite inhibiting trade.
- Federalism: Potentially unavoidable consequence of a decentralized federation

A New Flexible Approximation of Gains

Policy makers could benefit from a simple rule-of-thumb to allocate effort across products, sectors, etc.

A New Flexible Approximation of Gains

Example of MCPF In Action!

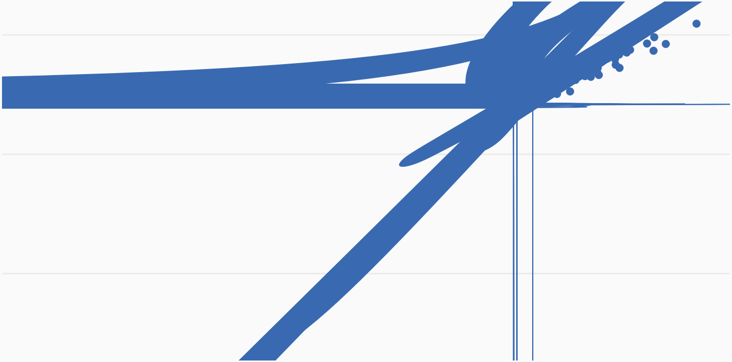
Bemrose et al. (2020) estimate internal trade costs of 4% for food and non-alcoholic beverages

The network centrality of this sector (calculated easily from Statistics Canada's input-output tables) is 0.0643

Total

Comparing the MCTF Estimates with a Full CGE Model

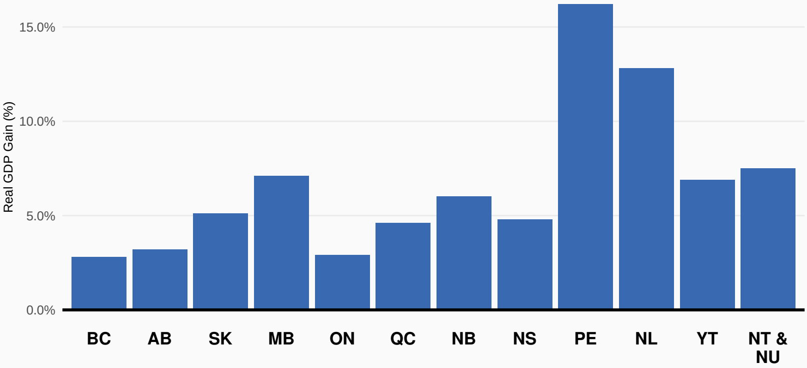
Figure 5: Real GDP Gains from Lowering Sectoral Internal Trade Costs by 1%



Source: own calculations from Tombe (2021?), not yet publicly available. Soon! ... hopefully

Potential Gains from Internal Trade Liberalization

Figure 6: Gains from Eliminating Non-Geographic Trade Costs on Goods



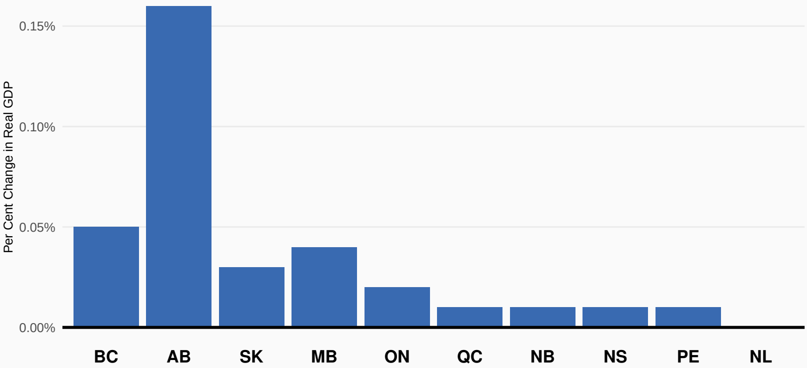
Source: Alvarez, Krznar, and Tombe (2019), Table 7. IMF Working Paper No. 19/158.

Gains from Unilateral Internal Trade Liberalization

Figure 7: Real GDP Gain to Alberta, Unilateral vs Multilateral Liberalization

Gains from Unilateral Liberalization

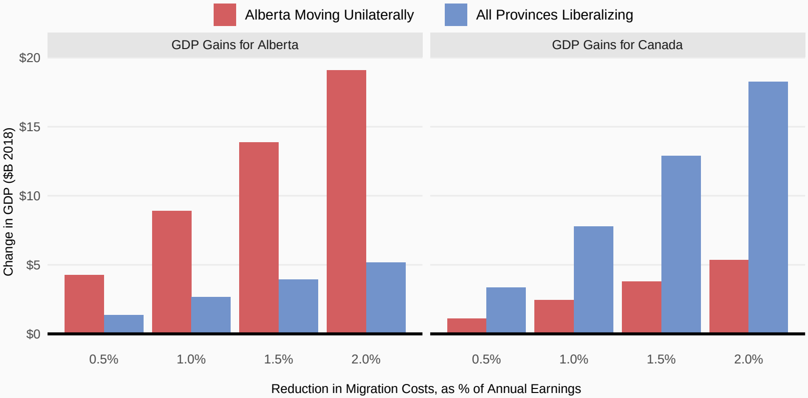
Figure 8: Real GDP Gains from a 1% Reduction of Alberta Import Costs



Displays the gains in real GDP from Alberta unilaterally lowering the cost of imports from other provinces by 1 per cent. Source: own

A Related Issue: Interprovincial Labour Mobility

Figure 9: Real GDP Gains from Easier Labour Mobility



Source: Tombe and Schwanen (2020), Alberta's Opportunity: The Ins, Outs and Benefits of Greater Job Mobility, C.D. Howe Institute Commentary No. 580, Figure 3.

Concluding Thoughts

Significant progress on internal trade policy in Canada

Accelerating progress through the CFTA to enhance Canada's post-COVID recovery requires a careful allocation of effort

- The RCT capacity is limited
- Direct effort towards highest-return products/sectors

Provincial governments can achieve a majority of available economic gains from internal liberalization by moving unilaterally

- Has both political advantages and disadvantages
- Alberta started, but appears to have completely stalled
- Post-COVID, watch Alberta for more