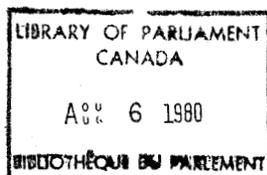


POWERS OVER THE ECONOMY:
SECURING THE CANADIAN ECONOMIC UNION IN THE CONSTITUTION

DISCUSSION PAPER SUBMITTED BY
THE GOVERNMENT OF CANADA



July 9, 1980

POWERS OVER THE ECONOMY:

SECURING THE CANADIAN ECONOMIC UNION IN THE CONSTITUTION

TABLE OF CONTENTS

	Page
1. Introduction	1
2. Arrangements Between States	5
2.1 The International Trading System (GATT)	6
2.2 An Economic Community of Sovereign States (EEC)	8
3. Other Federations	10
3.1 United States	10
3.2 Australia	11
3.3 The Federal Republic of Germany	13
3.4 Switzerland	13
3.5 India	14
4. The Canadian Federation	15
4.1 Ambit of Section 121	16
4.2 Federal and Provincial Legislative Jurisdiction	17
4.3 Implications for the Operation of the Economic Union	18
4.4 An Institutional Perspective	21
4.5 Constitutional Proposals Related to the Canadian Economic Union	23
5. General Approach	24
6. Conclusion	27

ANNEXES

A. Illustrative Survey of Actual or Potential Restrictions on the Interprovincial Mobility of Goods, Services, Labour and Capital within Canada	28
B. Summary of Constitutional Proposals Directly Related to Economic Mobility within Canada	43

POWERS OVER THE ECONOMY:

SECURING THE CANADIAN ECONOMIC UNION IN THE CONSTITUTION

1. Introduction

The purpose of this document is to consider the means whereby the Canadian economic union could be better secured in the Constitution.

An economic union is an entity within which goods, services, labour, capital and enterprise can move freely, that is, without being subject to fiscal and other institutional barriers, and which is endowed with institutions capable of harmonizing the broad internal policies which affect economic development and of implementing common policies with regard to the entity's external economic relations. Moreover, the form which the political institutions of our economic union should take is determined since Canada is, and is destined to remain, a federal state. Accordingly, new constitutional provisions to safeguard and strengthen the Canadian market must take into account the other goals of the Federation, such as the preservation of its linguistic and cultural diversity, and the sharing of income and wealth among citizens and regions.

Canada has achieved a high degree of economic integration over the past century, but the existence and operation of a common market within its territory is not adequately safeguarded in its basic law. The two orders of government have the constitutional authority to restrict in numerous ways the free movement of persons, goods, services, capital and enterprise within the country.

Although the B.N.A. Act does not contain an explicit economic definition of the federation, the following description can be drawn from a number of provisions, as interpreted so far by the courts:

- a customs union, since provincial legislatures are prohibited from levying internal border taxes and Parliament is empowered to establish a common external tariff;
- an imperfect common market for goods — imperfect because Section 121 probably does not prohibit non-tariff barriers to interprovincial trade, and because judicial interpretation has limited the federal trade and commerce power;
- an imperfectly safeguarded common market for capital and enterprise, since provinces can impede the movement of some financial assets and business establishments across interprovincial borders;
- distinct and "protectable" provincial markets for labour and most other services, except in federally regulated industries;

- a highly integrated economic union nonetheless, by virtue of federal jurisdiction over taxation, money and banking, interprovincial trade, commerce and transportation, agriculture, communications, weights and measures, etc.

The Government of Canada is of the view that, of the five broad functional categories suggested in Powers over The Economy: A Framework for Discussion, the securing of the economic union should receive priority attention in the process of constitutional renewal. This view is founded on two basic realities.

The first reality is political. To be a citizen of Canada must be dynamic reality rather than a static abstraction, a reality that extends beyond the realm of political and legal institutions to the vital aspects of one's material existence. As the Government of Quebec argued twelve years ago in a proposal on the general aims of the Constitution, "all Canadians must be full citizens, having in principle the same rights, the same responsibilities and the same opportunities for self-fulfillment". To the extent compatible with federalism, this basic equality of all citizens must apply to economic affairs, under provincial law as well as under federal law. Wherever they may have been born or have chosen to reside in the country, Canadians should be free to take up residence, to acquire and hold property, to gain a livelihood, to invest their savings, to sell their products and purchase their supplies in any province or territory of Canada, provided they abide by the laws of general application of that province or territory.

There may be circumstances, of course when the pursuit of other political, social, economic and cultural goals justifies some restriction of the economic freedom of Canadians. But the freest possible access to the national market should be inherent to Canadian citizenship, and therefore secured in the Constitution. Any provincial authority should bear in mind that whenever it discriminates against the residents of other provinces, it exposes its own residents to retaliatory discrimination by the governments of these other provinces; and whenever it seeks to retain the ability to restrict the mobility of other provinces' residents, it simultaneously argues that the freedom of its own residents should be subject to curtailment by nine other governments. As for the federal authority, while it would be imprudent to limit its ability to meet the varying needs and aspirations of different parts of the country in a differentiated way, it should always be aware that such use of its powers can be quite contentious since it inevitably raises difficult problems of interpersonal and interregional equity.

The second reality is economic. It was admirably expressed in A Future Together, the main report of the Task Force on Canadian Unity:

"Our analysis indicates that greater economic benefits should result from increasing levels of integration. Some of these benefits are associated specifically with the integration of regional economic activities into a larger market. For example, larger markets provide a greater scope for the diversification of sectors and specialization, resulting in a better allocation of the factors of production. Competition is enhanced; industries can take advantage of economies of scale; and a larger and more efficient financial sector may be created. Moreover, the availability of a more diversified and broader natural resource base is an important benefit - when the market for one commodity is low it may be counter-

balanced by the more favourable position of other commodities.

"Other benefits related to size come into play, particularly when integration takes the form of federal union. We have in mind a variety of aspects related to the efficiency and effectiveness of the larger public sector, such as the economies of scale in the delivery of public goods (for example in national defence), and a greater scope for interregional policy coordination which would take into account programs whose impact could not be restricted to a single region. Also significant is the enhanced capacity of the public sector to raise funds through external borrowings.

"In a federal union the regions can expect their economies to perform better as a result of the movement of labour, capital, goods and services. Other advantages are the greater chance of restraining undue competition among the regions for development projects and the improved leverage of the regions in securing international trade advantages. Finally, as we have noted, a federation allows for interregional transfers of funds through income support measures and adjustment assistance to the regions.

"While such benefits may be difficult to measure precisely, they are nevertheless very real, and they are reflected in the standard of living Canadians have long enjoyed. In a nutshell, integration creates a surplus, because the whole is greater than its parts. And the surplus, using the central government as an instrument can be redistributed so that the strong parts help the weak to the benefit of the whole."

The Task Force also points out that Canada, given its geography, linguistic duality and cultural diversity, cannot be single-minded in its pursuit of economic integration — indeed, no country can afford to be. But it argues that there is still ample scope to increase the "surplus" or benefits arising from the Canadian economic union while keeping attendant costs at a reasonable and acceptable level.

The Federal Government not only shares that view, but considers that there is some urgency in safeguarding and strengthening our economic union, given prevailing trends in the world economy. Technological developments, the internationalization of factors of production, the need to get the benefits of greater economies of scale and specialization of production facilities, have generated considerable pressure for larger markets. There has been continuing liberalization of market access among the main industrialized countries through major tariff reductions. A number of countries have combined their market power through the creation of free trade areas or common markets. These and other developments in the world market place, including the constant emergence of new exporters, have made unavoidable structural adjustments of numerous individual sectors and lines of production within the Canadian economy. These adjustments run the risk

of being less effective and costlier if we are unable to exploit fully the potential strength of our national market.

Of particular concern, in this respect, are signs of economic segmentation within Canada which run counter to observed trends in other economic entities. Protectionism among provinces, and weakening of the federal government's ability to promote balanced economic development, can involve significant efficiency losses for Canada as a whole, and hence for each and every one of its parts:

- higher supply costs, fragmentation and stunted growth for firms, and diseconomies of scale which enhance import penetration and reduce the international competitiveness of domestic production;
- diversion of trade to foreign suppliers, when fragmentation results in neither in-province nor out-of-province suppliers being able to service provincial markets on a competitive basis;
- lower incomes and lesser employment opportunities for residents of all provinces;
- higher burdens upon national and provincial taxpayers, due to higher cost of public procurement and lower tax yields.

The converse, of course, applies. The competitiveness of Canadian industry and hence the incomes and employment opportunities of Canadians will be significantly enhanced if we succeed, not only in resisting trends towards segmentation of our domestic market, but in devising new constitutional arrangements which would make closer economic integration possible and compatible with the preservation of our federal system. It should be noted that any increase in the economic surplus generated by the Canadian economic union could only improve our ability to reduce regional economic disparities, provided adequate mechanisms to do so are in place.

The course of Canada's economic development as well as international experience, particularly in the past three decades, should give governments the confidence and the foresight to proceed in this direction, with due care of course, but also with boldness and imagination. Canadians owe much of their current prosperity to the economic union, however imperfect, established 113 years ago by the Fathers of Confederation. Also, the general post-war movement towards freer trade, which is now enshrined in international law, has resulted in enormous productivity and income gains for Canada, regional markets like the European Economic Community, and the world economy as a whole. Economic history and theory points to the benefits that would flow from strengthening and better safeguarding of the Canadian economic union.

In this regard, a survey of relevant provisions of the General Agreement of Tariffs and Trade (GATT), the Treaty of Rome, the constitutions of other federal states and that of Canada may help to bring out some of the deficiencies in the main operating rules of the Canadian economic union. There are, of course, basic differences between the nature, aims and institutions of the Canadian federation and that of a multilateral trade agreement like the GATT, which is based on reciprocity of benefits and a mutual balance of international rights and obligations, or a common market like the EEC, established by a treaty creating a community of sovereign states, and even other federations

like the United States, Australia, the Federal Republic of Germany, Switzerland and India, which have their own particular history, geography, social make-up and political traditions. Nevertheless, such comparisons may provide us with useful background and a broad perspective.

2. Arrangements Between States

The aspects of multilateral and regional economic arrangements of greatest interest for Canadian constitutional renewal are their fundamental principles and objectives. In addition, it is useful to review how major issues are dealt with, such as government aids and incentives, government procurement, technical regulations, public enterprises, commodity trade and the mobility of labour, capital and enterprise.

Government assistance, either through the fiscal system or direct or indirect subsidies, is widely used for the promotion of social and economic policy objectives such as regional development, sectoral adaptation, enhancement of industrial innovation and revenue stabilization. The legitimacy of such programs is recognized in international economic agreements, but concern about costly competitive subsidization between national treasuries and the effects which government subsidies may have on the trade interests of other countries have led to the negotiation of international rules to deal with them.

Government contracting for goods and services now represents a substantial portion of the markets available to many industrial sectors, particularly high technology industries, and this market power is considerably increased if agencies and entities directly or indirectly controlled by governments are included. Concerns about restrictive government purchasing practices and their impact on the efficiency of world trade and production patterns have led to the development of disciplinary provisions in international law.

In modern society, technical regulations are essential to protect human and animal life and health; to ensure that products offered to the consumer meet the necessary levels of quality, purity, technical efficiency and performance; to protect the environment; and for reasons connected with safety, national security, and the prevention of deceptive practices. Technical regulations are adopted by governments at all levels: central, provincial and municipal. However, such regulations can create significant distortions or obstacles to trade.

Governments often choose to engage directly through various institutions, in production and trade, including the retail level. A technique often used to regulate directly or indirectly imports or exports and the purchase and sale of certain goods and services is the establishment of public enterprises, with or without monopoly control. As yet, governments have shown little inclination to bring these governmental activities under common international discipline, but they do receive some specific attention in both the GATT and the EEC.

International commodity trade has become important for most national economies and for international development. Indeed, commodity trade issues have come to play a substantial role in the management of the international economy and have contributed to a heightened awareness of the degree of economic interdependence in the international community.

Finally, some international economic arrangements, notably common markets, attempt to go beyond the benefits of increased trade in products to capture efficiency gains arising from free movement of factors of production — labour, capital and enterprise. Accordingly, the EEC is a useful reference for this more advanced form of economic integration.

In reviewing international arrangements, one must keep in mind that these systems experience many operational problems which examination of their legal foundations does not necessarily reveal. The GATT, for example, does not require adherence of member countries to its more than one hundred subsidiary agreements, and its effectiveness in stemming the recent resurgence of protectionism is open to question. Similarly, there are many weaknesses in the actual operation of the European Economic Community, notably its continuing inability to develop efficient agricultural policies, remove non-tariff barriers to the mobility of factors of production, and harmonize broad economic policies. Many of these weaknesses may be attributed to the limited effectiveness of institutions established to implement such international arrangements. Notable, in the case of the EEC, are the delays, lengthy consultations and protracted negotiations resulting from the quasi-confederal nature of its decision-making (e.g., legislative and regulatory) processes and the very limited authority of its executive organs. Nevertheless, the overall effect of these arrangements has unquestionably been to facilitate the expansion and to enhance the efficiency of trade and production, both at world level and within the broad areas more immediately affected by the GATT and Western Europe in the case of the Treaty of Rome.

2.1 The International Trading System (GATT)

The GATT is the key multilateral instrument that lays down agreed rules for international trade. As such, it is the primary international safeguard for the maintenance of an open global trading system. Although the GATT is now a complex set of agreements incorporating rights, obligations and trade concessions, the fundamental principles and aims of the Agreement are comparatively few, namely the reduction of tariffs and other barriers to trade and the elimination of discriminatory treatment in international commerce. The two key operating rules are the unconditional non-discriminatory treatment of like products originating in or destined for the countries of all other contracting parties (Article I) and the national treatment on internal taxation and regulations, including the principle that these should not be applied to imported or domestic products so as to afford protection to domestic production (Article III).

There is a GATT Agreement on Subsidies/Countervailing Measures aimed at reducing or eliminating trade restrictions or distortions arising from government subsidies and of countervailing measures, and establishing a framework of rights and obligations to deal with these effects. Under it, any form of subsidies (e.g., government financing of commercial enterprises, government support services and facilities, R & D fiscal incentives, government participation in or provision of equity capital, etc.) granted by any government or any public body within the territory of a signatory is subject to international rules. Except for export subsidies on non-agricultural products, which are prohibited, it is not subsidies per se but their effects which are objectionable, whether the effects are of an import substituting or of an export stimulating nature.

Concerning public procurement, there is an agreement based on the principles of non-discrimination and national treatment to be accorded to products and suppliers of signatory countries. The scope and coverage of the agreement on government procurement extends to any law, regulations, procedure and practice regarding the procurement of products and services incidental to the supply of these products. It applies to a negotiated list of purchasing agencies and entities of central governments and to contracts of a value of about \$220,000 and more. Further negotiations are envisaged to broaden the agreement so that it might include service contracts and products such as power generating, telecommunications and transportation equipment.

The GATT Agreement on Technical Barriers to Trade prohibits the adoption or application of technical regulations and related activities with the purpose of creating "obstacles to international trade" and accords non-discriminatory and national treatment in this regard to imports of like products. Recognizing that technical regulations introduced for legitimate domestic purposes may nevertheless adversely affect imports, the agreement obligates signatories to ensure that technical regulations and related activities do not have the "effect of creating unnecessary obstacles to international trade".

State trading enterprises are subject to the GATT rules (Article XVII) which require that public enterprises act in a manner consistent with the principles of non-discrimination and make purchases or sales solely in accordance with commercial considerations and afford the enterprises of other countries adequate opportunity, in accordance with customary business practice, to compete for participation for such purchases or sales.

Existing GATT rules with respect to commodity trade limit, in the main import restrictions on agricultural or fishery products to what is "necessary" for enforcement of governmental measures which operate an effective domestic supply management program (Article XI) and to measures undertaken in pursuance of obligations under bona fide intergovernmental commodity agreements (Article XX). As to export controls, existing GATT rules are relatively loose and permissive.

2.2 An Economic Community of Sovereign States (EEC)

The Treaty of Rome establishing the EEC contains a clear statement of principles and objectives, including (Article 3):

- elimination as between Member States of customs duties and of quantitative restrictions in regard to the importation and exportation of goods as well as "all other measures with equivalent effect";
- the establishment of a common customs tariff and commercial policy towards third countries;
- the abolition, as between Member States, of impediments to the free movement of goods, persons, services and capital;
- the establishment of common agricultural and transport policies;
- the establishment of a system ensuring that competition shall not be distorted in the common market;
- the implementation of procedures allowing co-ordination of the economic policies of Member States and resolution of payments imbalance among them; and,
- the approximation of their respective laws to the extent necessary for the functioning of the common market.

In addition, the principle of national treatment is clearly spelled out in the rules related to fiscal measures (Article 95) and the principle of non-discrimination is specifically reiterated in numerous sections.

These principles are carried through explicitly in many of the specific provisions dealing with the classes of activity brought under the discipline of the Treaty. For example, government aids which distort or threaten to distort competition by favouring certain enterprises or certain productions are regarded as incompatible with the development and functioning of the common market if they adversely affect trade between member states. Even certain aids which are specifically allowed for, such as consumer subsidies and regional development grants, must be extended without discrimination by origin of goods and not be contrary to the common interest.

Although the Treaty of Rome did not contain any explicit reference to the question of government contracting of goods and services, the Community had concluded, by 1976, an agreement based on the principle that restrictions to the free flow of goods contracted by public authorities, whether national, regional or local, are contrary to the provisions of the treaty prohibiting quantitative import restrictions and "all measures with equivalent effect" (Article 30). The scope and coverage of this agreement is still, however, incomplete as it does not apply to certain sectors such as defence, transportation, energy and telecommunications, nor to contracts below approximately \$220,000.