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# Death by a Thousand Paper Cuts

## The Effect of Barriers to Competition on Canadian Productivity





Death by a Thousand Paper Cuts: The Effect of Barriers to Competition on Canadian Productivity  
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## Preface

There is evidence that competition-enhancing policies can foster higher productivity and economic growth. This report examines the extent of the barriers to competition in Canada and their impact on productivity. The report concludes that there is a legacy of international and internal protection that inhibits the development of competitive markets. Canadian productivity could be enhanced by eliminating barriers that impair the effective functioning of markets, especially in a core group of primary and manufacturing industries. The results are important in shaping policy approaches to closing the Canada–U.S. productivity gap.

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# Death by a Thousand Paper Cuts

## The Effect of Barriers to Competition on Canadian Productivity

### At a Glance

- While international tariffs have declined significantly over the past 15 years, non-tariff barriers (NTBs) continue to represent a formidable barrier to competition.
- A majority of the 198 Canadian firms surveyed by the Conference Board indicated that NTBs create compliance costs and raise costs associated with reduced innovative capacity and an inefficient size of operations.
- The results of an empirical analysis undertaken for this report indicate that barriers to competition have a negative effect on Canada–U.S. relative productivity for a core group of 16 industries in the primary and manufacturing sectors.
- However, for the services sector, which represents two-thirds of the Canadian economy, barriers to competition do not appear to explain Canada’s lower productivity performance vis-à-vis the United States.
- Given the economic importance of the services sector, policy-makers must look to other factors, in addition to barriers to competition, for a complete explanation of the Canada–U.S. productivity gap.
- Policy-makers should focus on promoting bilateral and multilateral provincial agreements to reduce interprovincial trade barriers and creating a binding dispute mechanism to settle conflicts regarding non-tariff barriers to competition.
- Policy-makers should also seek to reduce international tariff and non-tariff barriers, focusing in particular on unnecessary regulatory barriers between Canada and the United States.

The objective of this study is to assess the scope of existing tariff and non-tariff barriers (NTBs) to competition in Canada and to evaluate the extent to which they could be affecting overall productivity. The study also examines whether differences in these barriers between Canada and the United States are contributing to the Canada–U.S. productivity gap. Finally, the study makes a number of recommendations to policy-makers to help lower regulatory barriers.

International tariffs have declined to the point where almost 50 per cent of goods entering Canada are duty-free. Much of this decline has occurred over the past 15 years, thanks to Canada’s participation in the World Trade Organization (WTO) and regional free trade agreements, notably the North American Free Trade Agreement (NAFTA). However, certain sectors of the Canadian economy, such as agriculture, continue to have a high degree of international tariff protection.

While the tariff burden has declined, there has been less progress in reducing domestic and international NTBs, including domestic regulations. Canada has a bewildering array of such barriers, spanning all levels of government and often involving extremely complex regulatory frameworks. No complete list of all of the regulatory barriers to competition exists. However, the in-depth inventory presented in this report gives a good indication of the vast scope of existing NTBs.

The signing of the Agreement on Internal Trade (AIT) in 1995 allowed for significant progress in reducing NTBs in certain areas, especially those relating to the

sale of alcoholic beverages and government procurement restrictions. However, regional interests and the need for negotiation between the federal government and the provinces, as well as among the provinces, make it extremely difficult to achieve progress in lowering domestic barriers to competition.

In an attempt to re-energize the effort to lower NTBs, premiers agreed to address the problem of interprovincial barriers to competition by creating the Council of the Federation in 2003. The Council has attempted to breathe life back into the process of lowering internal barriers to competition by bringing together the ministers concerned to negotiate reductions in various NTBs. Despite some success, progress to date remains slow. NTBs thus continue to represent a significant barrier to competition in Canada.

In order to examine how internal NTBs affect the ability of Canadian firms to operate efficiently, The Conference Board of Canada surveyed Canadian businesses. The majority of the 198 firms that took part in the survey indicated that they faced problems arising from NTBs to competition in Canada. Although standards and regulations were, not surprisingly, the most common barrier cited, procurement policies and restrictions on labour mobility were also high on the list—despite the focus of the AIT and the Council of the Federation on reducing these latter two NTBs. The main impact of NTBs is to raise not only compliance costs but also costs associated with reduced innovative capacity and an inefficient size of operations.

Respondents identified a number of production, marketing and lobbying strategies that they have pursued to deal with NTBs, including abandoning certain markets altogether. The survey results suggest that NTBs are hurting the competitiveness of Canadian firms.

Although much work has been done on the impact on productivity of eliminating international tariffs, very little research has been carried out on the productivity effects of eliminating or lowering the burden created by NTBs. This study breaks new ground by including both tariff and non-tariff barriers in its analysis of the productivity gap between Canada and the United States. The

empirical results indicate that barriers to competition have a negative effect on productivity for a core group of 16 industries in the primary and manufacturing sectors of the Canadian economy. Thus, Canada could narrow the productivity gap with the United States by lowering barriers to competition in the tradable goods sector. However, these 16 industries represent only 20.5 per cent of the economy. For the services sector as a whole, which represents two-thirds of the Canadian economy, barriers to competition do not appear to explain Canada's lower productivity performance vis-à-vis the United States. Given the economic importance of the services sector, policy-makers must look to other factors, in addition to barriers to competition, for a complete explanation of the Canada–U.S. productivity gap.

The research results also point to the strategy and tactics that Canadian policy-makers should adopt to foster competitive markets. The emphasis must be on further reducing domestic NTBs to competition, especially as they relate to the primary and manufacturing sectors.

Specific policy recommendations that will help to facilitate the process of reducing internal NTBs are as follows:

1. Free trade should be established as the standard for interprovincial trade agreements, and a strong evidence-based case should be required for specific barriers to be permitted. The current practice tends to create loopholes for regional interests.
2. The existing dispute settlement mechanism of the AIT needs to be made binding. Currently, dispute panel recommendations can be ignored, or circumvented through offsetting local legislation, due to the absence of an enforcement mechanism.
3. Agreements among and between provinces should be encouraged as a way to make progress on reducing internal NTBs. Bilateral or multi-provincial agreements could circumvent roadblocks created by one or more other provinces, and could serve as positive models for Canada-wide action.

Policy-makers should also seek to reduce international tariff and non-tariff barriers, focusing in particular on unnecessary regulatory barriers between Canada and the United States.

# The Link Between Openness to Competition and Productivity

### Chapter Summary

- Improving Canada's productivity performance on a sustained basis is a key national challenge; previous Conference Board of Canada research concluded that lower productivity in Canada is the single most important reason for our lower standard of living relative to the United States.
- Empirical work has provided evidence that competition-enhancing policies can foster higher productivity and economic growth.
- There is a legacy of international and internal protection that inhibits the development of competitive markets in Canada.
- While some regulation is necessary, for example legislation that protects health and safety, the concern is with regulations that go beyond what is required to meet public policy goals and thus become unnecessary barriers to competition.
- Canadian productivity could be enhanced by eliminating barriers that impair the effective functioning of markets, especially in a core group of primary and manufacturing industries.

The Organisation for Economic Co-operation and Development (OECD) Growth Study and other empirical work have provided evidence that competition-enhancing policies can foster higher productivity and economic growth by improving resource allocation, encouraging managerial efficiency and effectiveness, increasing innovation and technological diffusion, boosting employment and spurring capital investment.<sup>1</sup>

This report builds upon this evidence by examining the relationship between open, competitive markets and productivity in Canada. It concludes that there is a legacy of international and internal protection that inhibits the development of competitive markets. Canadian productivity could be enhanced by eliminating barriers that impair the effective functioning of markets, especially in a core group of primary and manufacturing industries. Such a move would lead to more efficient allocation of resources, higher overall economic activity and improved living standards for Canadians.

Some degree of regulation is clearly necessary, including regulations that protect the health and safety of citizens or anti-monopoly provisions that enhance the functioning of markets. The concern is with regulations that go beyond what is required to meet public policy goals and thus become unnecessary barriers to competition. In addition there are tradeoffs associated with regulations in terms of how they affect competing societal goals. For example, certain environmental regulations may impede economic development. Canadians need to feel comfortable that they have struck the right balance in implementing such regulations. Incompatibilities in regulatory systems across jurisdictions—between our provinces and territories, and between Canada and our principal trading partners—also create unnecessary barriers to competition. While regulatory impediments to competition have recently declined in all OECD countries, a “hard core” of regulations that impede competition still persist in virtually all countries.<sup>2</sup> This

report strongly suggests that policy-makers in Canada should work hard to rationalize, harmonize and streamline the regulatory framework in a number of key sectors.

## CANADA'S PRODUCTIVITY RECORD

Improving Canada's productivity performance on a sustained basis is a key national challenge. Previous Conference Board of Canada research on the productivity gap between Canada and the United States concluded that lower productivity in Canada is the single most important reason for our lower standard of living.<sup>3</sup> On a per capita basis, nominal gross domestic product (GDP) in Canada was 85 per cent of that of the United States in 2005, due principally to our lower labour productivity levels.<sup>4</sup> Chart 1 shows that Canada-U.S. productivity growth differentials between 1981 and 2004 were sizable, particularly in the 2000-04 period. The OECD argues that stronger competitive forces in the United States contributed to this difference.<sup>5</sup>

Detailed analysis at the industry level reveals that productivity levels and growth for particular industries vary widely from country to country—of the 29 industries that make up the business sector, 19 have lower labour productivity levels in Canada than in the United States, while 10 have higher levels.<sup>6</sup> (See Chart 2.) The 19 lower-productivity industries accounted for 73 per cent of Canada's GDP in the business sector in 2001; the 10 higher-productivity industries accounted for only 27 per cent. An in-depth study of seven industries, carried out by the Conference Board and the Centre for the Study of Living Standards, concluded that decision-

makers need to focus on achieving more openness to competition when considering ways to improve productivity performance.<sup>7</sup>

The determinants of productivity are complex and multi-faceted. (See Exhibit 1.) While no one factor alone explains the Canada-U.S. productivity gap, it is clear that the environment in which businesses operate is critical. Canada's productivity performance is influenced by broad trends in the global business environment—such as the rise of China—that are largely beyond our control, although we can exercise some influence over the international trade and investment policy environment. Productivity is also influenced by thousands of decisions made by individual firms, including the type and amount of physical capital and human resources in the production process and the rate of adoption of technological change. Between these two spheres lie the business environment and policy framework within which individual firms operate. Taken together, the openness of the economy to trade and investment, the degree of competition and the regulatory regime help set the context for productivity performance. Creating the appropriate framework within which business can prosper is increasingly seen as a critical role for governments.

While regulation serves a number of important public policy goals (see box, "Are All Barriers to Competition Bad?"), policy-makers in many countries have become increasingly concerned about the potential for regulation to be so intrusive as to stifle market mechanisms and productivity. Consequently, most OECD governments, including Canada's, have been reviewing and updating their regulatory systems. The ultimate goal is "smart regulation," or regulatory environments that serve the public interest while maximizing economic openness and competitiveness.



## STUDY OBJECTIVE

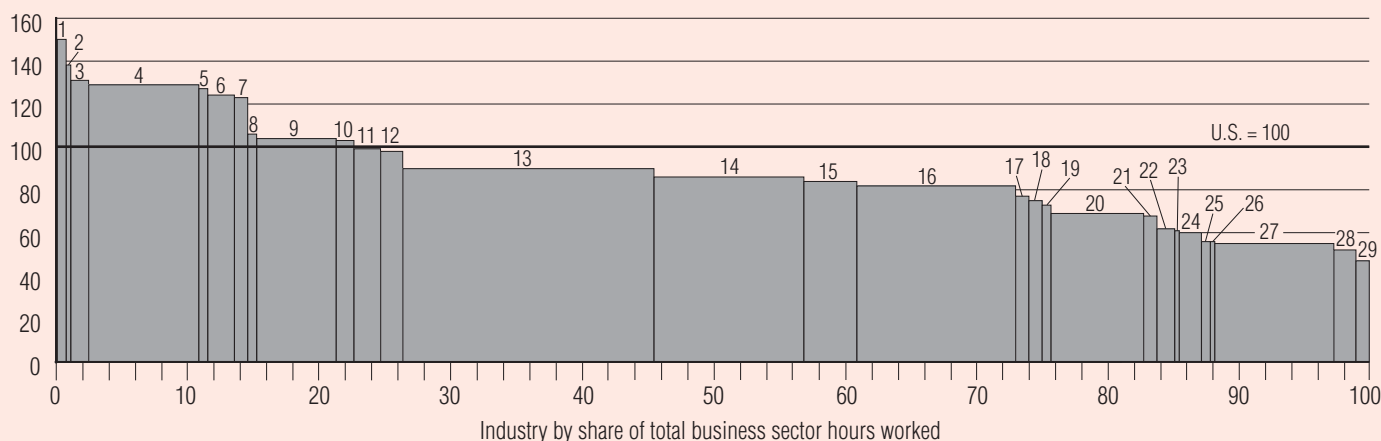
The objective of this study is to assess the scope of existing tariff and non-tariff barriers (NTBs) in Canada and to evaluate the extent to which they could be affecting overall productivity in Canada. The study also examines whether differences in these barriers between Canada and the United States are contributing to the Canada-U.S. productivity gap.



**Chart 2**

Relative Labour Productivity Levels in Canadian Industries by Share of Total Business Sector Hours Worked, 2001  
(per cent; share of U.S. level)

- |                                   |                                |   |  |
|-----------------------------------|--------------------------------|---|--|
| 1. Primary metals                 | 9. Transportation              | 17. Plastic and rubber products         | 25. Electrical equipment               |
| 2. Non-metallic mineral products  | 10. Motor vehicles             | 18. Utilities                           | 26. Miscellaneous manufacturing        |
| 3. Wood products                  | 11. Food, beverage and tobacco | 19. Furniture and related products      | 27. Finance, insurance and real estate |
| 4. Construction                   | 12. Mining                     | 20. Wholesale trade                     | 28. Fabricated metal products          |
| 5. Other transportation equipment | 13. Other services             | 21. Machinery                           | 29. Computer and electronics           |
| 6. Printing and publishing        | 14. Business services          | 22. Textile and clothing                |  |
| 7. Paper                          | 15. Agriculture                | 23. Petroleum and coal products         |  |
| 8. Chemicals                      | 16. Retail trade               | 24. Information and cultural industries |  |

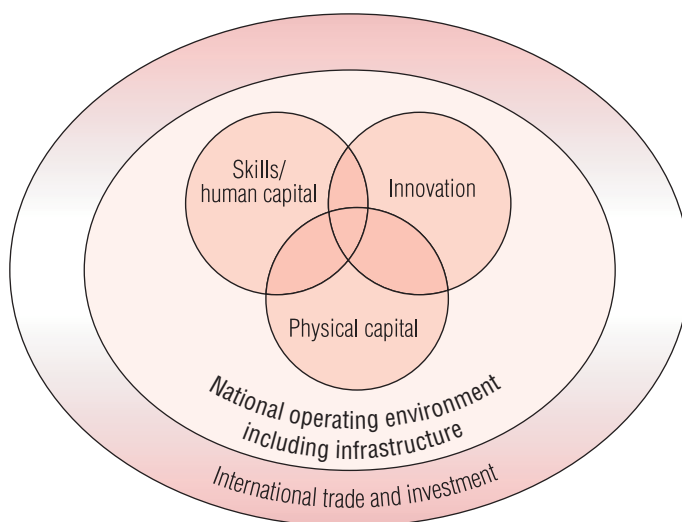


Source: Relative productivity data from Someshwar Rao, Jianmin Tang, and Weimin Wang, "Measuring the Canada-U.S. Productivity Gap: Industry Dimensions," *International Productivity Monitor* 9 (Fall 2004), p. 10. Unpublished data from authors.

Past research strongly suggests that eliminating barriers to competition has an important effect on productivity growth. For example, one study concluded that between 1988 and 1996, the Canada-U.S. Free Trade Agreement (FTA) raised labour productivity by 3.3 per cent per year in the industries most affected by tariff reductions.<sup>8</sup>

Although much work has been done on the impact on productivity of eliminating international tariffs, very little research has been carried out on the productivity effects of eliminating or lowering NTBs, which have become relatively more important as the tariff burden has decreased. This study breaks new ground by including both tariff and NTBs in the analysis of the productivity gap between Canada and the United States. The effect of barriers to competition on Canada-U.S. relative productivity performance is analyzed by looking at the relationship between industry price differentials between Canada and the United States, and differences in productivity for those same industries. Price differentials are adjusted to exclude wholesale and retail margins, indirect taxes and transportation costs, and also take into account the Canada-U.S. exchange rate. This

**Exhibit 1**  
National Productivity: A Conceptual Framework



Source: The Conference Board of Canada.

## Are All Barriers to Competition Bad?

Regulation is perhaps the most pervasive form of intervention in economic activity. While the current focus on “openness” may seem to have emerged with globalization, the debate about the role of regulation has deep historical roots. Some of these roots are ideological—such as the 18th-century liberalism of Adam Smith and David Hume, which influenced the insertion of Section 121 in the *British North American Act*<sup>1</sup>—and some can be traced to specific events—such as the inability of free markets to provide an adequate social safety net for those in distress during the Great Depression of the 1930s.

An appropriate policy framework must take into account both economic performance and other matters that concern the public interest. Arguments in favour of open, competitive markets are very persuasive. Competition encourages firms to be nimble, adapting to changing circumstances through innovation. It provides consumers with the widest possible choice at the lowest possible cost. Moreover, competition encourages both transparency and liquidity in markets, while making it extremely difficult for participants to achieve super-normal returns known as economic “rent.”

However, there are important and legitimate non-economic goals of public policy for which regulation is frequently the tool of choice. Among these are the protection of public health and safety, and of the environment. Other goals include fostering a nation's unique identity and culture, which has traditionally been a high priority in Canada, and achieving balance in regional economic and social development. But regulation has its drawbacks. For instance, safety standards can go beyond what would be scientifically mandated to protect human health and become a thinly disguised form of protection. Similarly, discrimination in favour of local producers in the name of preserving cultural identity or fostering regional development may not achieve the desired goal and could certainly raise costs and generate market inefficiencies. Thus good regulatory policy requires a judicious balancing of both economic and non-economic goals and of local and national interests.

1 Section 121 *BNA*: “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.”

adjusted price differential thus should reflect tariff or non-tariff barriers to competition; without such barriers, competition would act to equalize these industry prices. By using adjusted industry price differentials, the report is able to examine the link between all barriers to competition and relative Canada–U.S. productivity performance by industry.

## LAYOUT OF THE REPORT

The remainder of this report proceeds as follows:

- Chapter 2 outlines current tariff and non-tariff barriers to Canadian international and interprovincial trade. Such an inventory of barriers to competition has not previously been compiled, and the chapter findings help to set the stage for the empirical work undertaken in later chapters of the report.
- Chapter 3 summarizes the results of a survey that asked Canadian businesses to identify the trade barriers—both international and domestic—that they face.
- Chapter 4 provides a literature review of some key studies on topics such as how to measure the presence of barriers to competition in different economies, the impact of the North America Free Trade Agreement (NAFTA) on Canadian productivity, and how to measure the productivity gap between industries in Canada and the United States. The literature review was used to determine the best methodology for measuring the impact of tariff and non-tariff barriers on Canada–U.S. relative productivity performance.
- Chapter 5 examines whether barriers to competition affect Canada–U.S. relative productivity performance using a methodology that captures the impact of tariff and non-tariff barriers. The analysis provides a unique window into how non-tariff barriers can affect Canada–U.S. relative productivity performance.
- Chapter 6 summarizes the main findings of this report and describes the policy implications of the research.

1 See the summary in Paul Conway, Véronique Janod and Giuseppe Nicoletti, *Product Market Regulation in OECD Countries: 1998–2003*, Economics Department Working Paper 419 (Paris: OECD, February 2005), p. 4.

2 *Ibid.*, p. 2.

3 Brenda Lafleur, “Explaining the Canada–U.S. Income Gap: What It Is and Why It Matters.” In *Performance and Potential 2003–04: Defining the Canadian Advantage* (Ottawa: The Conference Board of Canada, 2003), pp. 54–79.

4 Canadian GDP is converted into U.S. dollars using purchasing power parity exchange rates.

5 Hannes Suppanz, Michael Wise and Michael Kiley, *Product Market Competition and Economic Performance in the United States*, Economics Department Working Paper 398 (Paris: OECD, July 2004), p. 2.

6 Someshwar Rao, Jianmin Tang and Weimin Wang, “Measuring the Canada–U.S. Productivity Gap: Industry Dimensions,” *International Productivity Monitor* 9 (Fall 2004), pp. 3–14.

7 Brenda Lafleur and Andrew Sharpe, “The Canada–U.S. Productivity Gap: Deepening Our Understanding.” In *Performance and Potential 2004–05: How Can Canada Prosper in Tomorrow's World?* (Ottawa: The Conference Board of Canada, 2004), pp. 75–77.

8 Gary Sawchuk and Daniel Treffer, “A Time to Sow, A Time to Reap: The FTA and Its Impact on Productivity and Employment.” In Someshwar Rao and Andrew Sharpe, eds., *Productivity Issues in Canada* (Calgary: University of Calgary Press, 2002), p. 560.

# Current Barriers to Competition in Canada

### Chapter Summary

- Tariffs on imports have declined to the point where almost 50 per cent of goods entering Canada are duty-free. However, certain sectors of the Canadian economy, such as agriculture, continue to have a high degree of protection.
- While the tariff burden has decreased, there has been less progress in reducing domestic and international non-tariff barriers.
- While Canada has been forced to adjust a few non-tariff barriers due to challenges from our trading partners, regional interests and the need for negotiation among the federal and provincial governments have made it extremely difficult to achieve progress in lowering non-tariff barriers to competition.

Canadian companies have become more open to both international and domestic competition in the last 15 years through NAFTA and the Agreement on Internal Trade (AIT). The latter, which was signed by first ministers in mid-1994 and came into effect one year later, aims to reduce barriers to the movement of persons, goods, services and investments between provinces. Despite NAFTA and the AIT, high tariffs and quotas continue to protect certain industries in Canada. And, where tariffs and quotas have been eliminated, NTBs have become more prominent in managing trading relationships with other countries.

This chapter examines the array of tariff and non-tariff barriers in Canada today.<sup>1</sup> The section on tariff barriers includes the actual level of protection in many sectors of the Canadian economy as well as the interaction between tariffs and quotas, notably in the agriculture sector. The section on NTBs looks at both international and domestic barriers.

## INTERNATIONAL TARIFFS AND QUOTAS

### TARIFFS

After several years of progressive tariff reductions, Canada's tariff rates on industrial goods are quite low. About 50 per cent of Canada's current tariff schedule is duty-free due to the ongoing Most Favoured Nation (MFN) tariff reductions following the Uruguay Round of multilateral trade negotiations. The average MFN tariff rate was 6.8 per cent in 2002, down from 7.2 per cent in 2000. Despite the drop, the Canadian rate is the highest in the "quad" regions—Canada, the European Union, Japan and the United States. Canadian tariff rates that are greater than 0 per cent (i.e., non-zero rates) averaged 13.1 per cent in 2002, compared with 13.4 per cent in 2000. Canada grants MFN status to all its trading partners except North Korea and Libya, which are subject to the General Tariff (set at 35 per cent for most imported products).

The most significant factors explaining Canada's overall drop in tariffs are duty reductions of 50 to 100 per cent on a number of iron and steel products as well as paper products, and reductions of 15 to 25 per cent on several plastic products and some inorganic chemicals.

Table 1 presents a list of average applied tariff rates for a number of important imported commodities. As the table indicates, despite ongoing reductions in overall tariff rates, tariffs on agricultural products, such as live animals and dairy products, and tariffs on textiles and footwear are significantly higher than those on most other products.

### PREFERENTIAL TARIFFS

Canada also has many preferential tariffs under free trade agreements with different countries. NAFTA, for instance, enables close to 100 per cent of imports from the United States and 94 per cent of imports from Mexico to enter Canada duty-free. The average tariff on goods entering Canada from Mexico has decreased since 2000 mainly as a result of reductions in tariff rates for textiles, clothing, footwear and plastic products. In January 2002, the three NAFTA partners agreed to accelerate the elimination of NAFTA tariffs on a number of different products. For Canada, this measure applied mainly to imports of certain types of motor vehicles from Mexico.

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### Almost 100 per cent of U.S. imports and 94 per cent of Mexican imports now enter Canada duty-free.

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However, poultry and dairy products remain highly protected under NAFTA. Tariffs on some of these products are greater than 200 per cent, mainly because out-of-quota tariffs on poultry and dairy products are exempt from the regular tariff-reduction commitments under NAFTA (see following section.)

Table 2 shows the tariff schedules under Canada's various trade agreements with different countries. Imports from Chile have benefited significantly from tariff reductions stemming from the signing of the Canada-Chile Free Trade Agreement in July 1997. Under the agreement, the share of duty-free lines from that country increased from 88 per cent in 2000 to 94.2 per cent in 2002.

The General Preferential Tariff (GPT) also provides reductions from the 35 per cent General Tariff for many developing countries. In 2002, the average GPT tariff

**Table 1**  
Canada's Import Tariffs, 2002  
(per cent)

	Average applied tariff
Dairy products	237.3
Live animals	52.7
Prepared foods	18.3
Footwear	11.6
Textiles	9.8
Fats and oils	9.3
Beverages and spirits	8.3
Transportation equipment	5.2
Misc. manufacturing	5.2
Vegetable products	4.5
Plastics	4.2
Chemicals	3.2
Wood	2.6
Base metals	2.2
Machinery	2.0
Minerals	1.1
Pulp and paper	0.6

Source: World Trade Organization.

was 5.4 per cent, down from 5.8 per cent in 2000. The extension of the GPT to other goods and services is at the discretion of the Minister of Finance. Products ineligible for the GPT include textiles, clothing, refined sugar and certain agricultural products.

Canada's Least Developed Country Tariff (LDCT) provides duty-free access for approximately 90 per cent of all tariff items. Eligible countries include those the United Nations defines as being least developed (with the exception of Myanmar); to be eligible for duty-free entry, goods and services from least-developed countries (LDCs) must first be eligible for the GPT. The average duty for LDCs is 4.1 per cent. Most exports from LDCs to Canada are clothing products. In June 2002, Canada extended duty-free and quota-free access to imports from 48 of the world's LDCs. Products exempt from this extension include out-of-quota imports on supply-managed products such as dairy, eggs and poultry products.

### TARIFF QUOTAS

The production of dairy, eggs and poultry products continues to be supply-managed in Canada. Federal and provincial marketing boards, as well as producer associations, try to match total supply with total demand in these markets, and producers must purchase quotas to participate in the domestic market. An effective quota system imposes significant penalties for exceeding the quota. In general, a low duty is applied on imports up to a certain quantity, while imports beyond the quota are

**Table 2**  
Canadian Import Duties by Tariff Regime, 2000  
(per cent)

	Most Favoured Nation tariff	U.S. tariffs under NAFTA	Mexican tariffs under NAFTA	Chilean tariffs under the Canada–Chile Free Trade Agreement	Israeli tariffs under the Canada–Israel Free Trade Agreement	Least-Developed Country tariff	Generalized Preferential Tariff
<b>Average tariff</b>	6.8	2.6	2.7	2.7	3.1	4.1	5.4
<b>By selected products</b>							
Agriculture and livestock	7.7	4.4	4.9	5	6.7	5.2	6.9
Food products	24.2	20.1	20.3	20.4	23.1	21.0	23.5
Textiles	9.2	0	0.2	0.2	0	6.5	8.2
Clothing	15.1	0	1.5	1.5	0	12.5	14.2
Furniture	6.3	0	0.1	0	0	0	4.1
Fabricated metal	4.1	0	0	0	0	0	2.2

Source: World Trade Organization.

often subject to very high tariffs. (See Table 3.) Under the terms of Canada's Uruguay Round commitments, 21 tariff quotas restrict imports of mainly dairy products, chicken, turkey and eggs and, to a lesser extent, beef, margarine, wheat and barley. While, since 2000, out-of-quota MFN tariffs have been lowered on roughly 60 tariff lines (mostly cereal preparations) by an average of 3 per cent, tariffs remain in the 200 to 300 per cent range for most dairy products.

Some Canadian trading partners receive unilateral preferential tariff treatment benefits that exempt them from the quota system. For instance, free trade partners such as Chile, Mexico and the United States can ship unlimited quantities of wheat and barley to Canada duty-free, subject to origin requirements. Similarly, imports of bovine meat from Chile, Commonwealth Caribbean countries, Costa Rica, Mexico and the United States can enter Canada duty-free, as can imports of margarine from

Chile and Mexico. In contrast, the MFN tariff for bovine meat from MFN countries is 27 per cent, while the MFN tariff for margarine is 218 per cent.

#### TARIFF REMISSIONS AND DRAWBACKS

Canada has tariff drawback and remission measures that can negate, to an extent, the effect of certain tariffs on costs. Most of these measures were related to the Canada–U.S. Auto Pact. The Big Three automakers were permitted under the Auto Pact to import vehicles duty-free from any MFN source, subject to certain performance requirements, with the result that the MFN tariff of 6 per cent on certain motor vehicles was not applied. However, Canada eliminated the duty-free treatment in February 2001, following a ruling by the World Trade Organization (WTO). As a result, vehicles imported by Auto Pact companies now face the same tariff as other MFN imports. In other words, this WTO ruling has essentially eliminated the Auto Pact.

**Table 3**  
Selected In- and Out-of-Quota Tariff Rates, 2002  
(per cent except where noted)

	Out-of-quota tariff	In-quota tariff
Cream	292.5	7.5
Ice cream	277.0	6.5
Beef and veal	26.5	0
Other dairy	250.5	6.5
Fluid milk	241.0	7.5
Yoghurt	237.5	6.5
Margarine	218.0	7.5
Wheat flour	\$139.83/tonne	\$2.42/tonne

Source: World Trade Organization.

#### Vehicles imported by Auto Pact companies now face the same tariff as most favoured nation imports.

A relatively new tariff remission measure applies to eligible Canadian fashion designers, who can have duty-free access to fabrics priced at \$14 or more per square metre for use in the production of apparel. This provision is designed to benefit fashion designers who produce unique apparel that they sell to the market under their own label.

The textiles and clothing industry has faced increased international competitive pressures as Canada has dismantled trade barriers applied to this sector. Under the 1994 General Agreement on Tariffs and Trade, Canada agreed to gradually reduce tariffs on textiles and clothing over a 10-year period ending in January 2004. (See Table 4.)

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**In 2002, the government announced a strategic framework to help the textiles/clothing industry become more competitive internationally, focusing on productivity, efficiency, costs and new markets.**

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Quotas, too, have protected domestic producers of clothing and textiles since the 1960s. These quotas have been gradually eliminated over a 10-year period and, as part of the WTO Agreement on Textiles and Clothing (ATC), disappeared on January 1, 2005. With the end of the ATC, the Canadian textiles and clothing industry must contend with intense global competition.<sup>2</sup> In preparation for this, in June 2002, the federal government announced a strategic framework to help the textiles and clothing industry become more competitive internationally by enhancing its productivity, lowering costs, improving efficiency and identifying new markets. Further initiatives were announced in December 2004.

**Table 4**  
Average Tariff Rates for Textiles and Clothing  
(per cent)

	Most favoured nation	United States	Mexico	Least developed country
<b>Textiles</b>				
1998	11.1	0	5.7	8.5
2000	10.0	0	2.2	7.0
2002	9.2	0	0.2	6.5
2004	8.5*	0	0	0
<b>Clothing</b>				
1998	17.2	0	8.9	14.5
2000	16.1	0	5.3	13.3
2002	15.1	0	1.5	12.5
2004	14.0	0	n.a.	0

\* estimated  
Source: World Trade Organization.

## INTERNATIONAL NON-TARIFF BARRIERS

Foreign businesses face more than tariff barriers when selling their exports to the Canadian market; they must also deal with numerous NTBs in the form of rules and regulations that apply specifically to them. This section looks at the issue of NTBs in an effort to identify the most common—and possibly the most criticized—NTBs to international trade in Canada.

NTBs can be defined as all the obstacles to the entry of merchandise or services into or within Canada, with the exception of customs duties and tariffs. These barriers may take the form of specific sanitary standards, technical specifications or complex administrative requirements that are sufficiently expensive to discourage imports of certain goods and services.

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**NTBs can be defined as all obstacles to the entry of merchandise or services into or within Canada, with the exception of customs duties and tariffs.**

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The literature identifies four main categories of NTBs: (1) investment restrictions and controls; (2) quantitative restrictions and controls; (3) technical, sanitary or phytosanitary regulations; and (4) all other NTBs to trade.

### INVESTMENT RESTRICTIONS AND CONTROLS

Investment restrictions and controls were introduced in Canada for reasons of national security and to protect Canadians' economic, social and cultural well-being. These restrictions help control a number of important aspects of our economy that are deemed essential to affirm our sovereignty, cultural identity and security. Table 5 presents several examples of investment controls and restrictions in Canada and provides an overview of the target sectors and the types of constraints imposed.

### QUANTITATIVE RESTRICTIONS AND CONTROLS

Most quantitative restrictions and controls on imports are introduced to protect national security, human health, social morality, animal or vegetable life, or the environment. Import volumes are generally controlled through a system of import licences. Quantitative restrictions and controls apply mainly to prescription drugs and other medication, weapons, various animal and vegetable species, and hazardous products. Quantitative restrictions are often set at high levels to protect the health

**Table 5**  
Selected Investment Restrictions and Controls, by Sector

Sector	Level of Government	Limitation
<b>Notification and review provisions</b>		
All sectors	Federal ( <i>Investment Canada Act</i> [ICA])	An investment is reviewable if there is an acquisition of a Canadian business and the asset value of the Canadian business being acquired equals or exceeds the following thresholds: <ul style="list-style-type: none"> <li>• For WTO member investors or where a Canadian business is ultimately controlled by a WTO member (other than a Canadian), the threshold is \$250 million (for 2005).</li> <li>• For non-WTO investors, the threshold is \$5 million for a direct acquisition and \$50 million for an indirect acquisition; the \$5 million threshold applies for an indirect acquisition if the asset value of the Canadian business being acquired exceeds 50 per cent of the asset value of the global transaction.</li> </ul>
Uranium production Transportation services Financial services Cultural industries	Federal (ICA)	An investment is reviewable if there is an acquisition of a Canadian business and the asset value of the Canadian business being acquired equals or exceeds the following thresholds: \$5 million for a direct acquisition and \$50 million for an indirect acquisition; the \$5 million threshold applies for an indirect acquisition if the assets in Canada are 50 per cent or more of the assets of the targeted company. All other investments in cultural industries must be notified and may be subject to review (with the exception of broadcasting).
<b>Ownership limitations</b>		
Fishing	Federal ( <i>Fisheries Act</i> )	Only Canadians or Canadian-controlled corporations are permitted to obtain fishing licences. Canadian fish-processing companies that have more than 49 per cent foreign ownership are not permitted to hold commercial fishing licences.
Air transportation	Federal ( <i>Canada Transportation Act</i> )	Foreign ownership of an airline is limited to 25 per cent.
Book publishing and distribution	Federal (ICA and supplementary policy guidelines)	Foreign investment in new businesses is limited to Canadian-controlled joint ventures. Foreign acquisition of existing Canadian-controlled businesses is allowed only if: <ul style="list-style-type: none"> <li>• the business is in clear financial distress; and</li> <li>• Canadians have had full and fair opportunity to purchase.</li> </ul>
Periodical publishing	Federal (ICA and supplementary policy guidelines)	Foreign acquisitions of Canadian-owned and Canadian-controlled periodical publishing businesses are not permitted. Foreign investments in the periodical publishing sector, including investments to establish or, directly or indirectly, acquire foreign businesses to produce and sell periodicals in Canada and to access the Canadian advertising services market are allowed provided there is a commitment to the production of majority Canadian editorial content. Foreign investments with respect to the publication, distribution and sale of periodicals are subject to review for net benefit to Canada.
Broadcasting	Federal ( <i>Broadcasting Act</i> )	Foreign ownership of a broadcasting, programming and distribution undertaking is limited to 20 per cent of voting shares (maximum 33.3 per cent in the case of a parent corporation).

(cont'd)

**Table 5 (cont'd)**  
Selected Investment Restrictions and Controls, by Sector

Sector	Level of Government	Limitation
<b>Ownership limitations (cont'd)</b>		
Film distribution	Federal (ICA)	Foreign acquisition of a Canadian-controlled distributor is not allowed. Foreign investment in new film distribution businesses is permissible only for the importation and distribution of proprietary products (the importer owns world rights or is a major investor). Direct or indirect acquisition of foreign distribution businesses in Canada by foreign-owned companies is permissible only if the investor undertakes to reinvest a portion of its Canadian earnings in accordance with national cultural policies.
Financial services	Federal ( <i>Bank Act</i> )	No individual investor may hold more than 10 per cent of the shares of a bank listed in Schedule 1, and the aggregate holdings of non-residents and their associates may not exceed 25 per cent of all shares. A similar rule applies to federally incorporated trust companies and loan companies under the <i>Trust and Loan Companies Act</i> .
	Federal ( <i>Insurance Companies Act</i> )	Foreign ownership in an existing Canadian-owned life insurance company is limited to 25 per cent in the aggregate and 10 per cent for any individual non-resident. Provincial legislation also places restrictions on foreign investment in the insurance industry.
	Provincial laws	Foreign ownership is limited to 10 per cent individually and 25 per cent collectively of provincially regulated trust and loan companies and securities firms in several provinces.
Insurance agents	Prince Edward Island	Only residents or corporations established in the province may obtain licences.
Insurance services and other services auxiliary to insurance	Quebec ( <i>Loi sur les assurances</i> )	Non-residents may not acquire more than 30 per cent of the voting shares of a Quebec-chartered insurance company without ministerial approval.
	British Columbia ( <i>Financial Institutions Act</i> )	Incorporation, share acquisition or application for business authorization, where any person controls or will control 10 per cent or more of the votes of the company, is subject to ministerial approval.
	Quebec, Saskatchewan, British Columbia	Mandatory motor vehicle insurance is provided by public monopoly.
Telecommunications	Federal	Foreign ownership of Canadian common carriers is limited to 20 per cent direct and 33.3 per cent indirect (46.7 per cent combined direct and indirect). There are no restrictions on foreign ownership of non-voting shares.

Source: WTO, *Trade Policy Review Canada*, 2003. Updated by The Conference Board of Canada.



and safety of Canadians, but in some cases the restrictions are so prohibitive that Canada's trading partners view them as a serious impediment to trade. It is often difficult to determine whether a quantitative restriction is designed to protect the health and safety of Canadians or simply to protect a domestic industry from foreign competition.

Table 6 provides a partial list of the licences and permits required to import certain goods to Canada. There are others—for instance, used automobiles and aircraft manufactured in the previous 15 years cannot be imported into Canada unless they were made in the United States.

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**It is often difficult to determine the underlying purpose of a quantitative restriction.**

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## **TECHNICAL, SANITARY AND PHYTOSANITARY REGULATIONS**

Canada imposes technical, sanitary and phytosanitary regulations that serve as constraints on activity in a range of economic areas. Examples of regulated areas include construction, chemical products and pharmaceuticals, energy, food, transportation equipment, telecommunications and the environment. These technical standards or requirements could be seen as constraints to the trade of goods and services. For example, the *Food and Drugs Act* makes nutrition labelling mandatory on most food labels. Since one standard may apply to a number of products, there is no list of rules or standards by product, making it hard for businesses to determine which standards apply to their products. Moreover, the list of agencies responsible for setting and monitoring these standards and for certifying products included in the World Trade Organization's *Trade Policy Review* clearly signals the potential difficulties facing foreign businesses interested in trading with Canada. (See Table 7.) Finally, these businesses would also have to comply with product technical requirements. A system of technical standards and requirements would be most effective if it imposed the same standards in all countries for all products and services. At present, however, technical standards vary not only between countries but also between Canadian provinces.

Several studies have argued that regulatory convergence between Canada and the United States, in particular, would benefit the Canadian economy by reducing regulatory compliance costs for Canadian exporters to the United States, while also increasing the competitiveness of the North American economy as a whole.<sup>3</sup> To this end, in 2005 the federal government entered into the Security and Prosperity Partnership of North America, which included a commitment to develop a "regulatory cooperation framework" for Canada, the United States and Mexico by 2007. This agreement offers important opportunities for reducing unnecessary regulatory burdens and barriers, but it remains to be seen whether it will produce substantial results.

## **OTHER NON-TARIFF BARRIERS TO TRADE**

There are many other NTBs that can impede international trade with Canada. Some, such as local-content requirements, anti-dumping duties, state-owned enterprises, NAFTA rules of origin, government procurement and border security measures, do not readily fit into any of the previous three categories. This section briefly reviews the scope and content of a few of these NTBs.

**Local-content requirements.** These are rules establishing a minimum proportion (by value or volume) of a product that must be domestically or locally produced in order to obtain a benefit for the producer (e.g., the ability to sell the product within the specified region). A number of local-content requirements are currently in place at the provincial level in Canada.

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**Other NTBs can impede international trade: local-content requirements, anti-dumping duties, NAFTA rules of origin and border security measures.**

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In the Canadian wine and spirits sector, for instance, market distortion persists through local-content requirements at the provincial level and through monopoly sales by provincially owned market enterprises. As an example, Ontario requires that wine sold in private retail outlets contain a minimum of 30 per cent per bottle produced from Ontario grapes. If this minimum local-content requirement is not met, the wine must be sold by the Ontario Liquor Control Board—the provincially owned liquor marketing agency. In Nova Scotia, the local-content requirement was increased to 75 per

**Table 6**  
Controlled or Licensed Imports, June 2002

Legislation	Products	Purpose
<i>Controlled Drugs and Substances Act</i> <i>Food and Drugs Act</i>	Controlled drugs, narcotics and restricted drugs	Ensuring that the quantity of drugs imported does not exceed medical needs
<i>Controlled Drugs and Substances Act</i> <i>Food and Drugs Act</i>	Industrial hemp	Permitting the legal production and processing of hemp for commercial purposes while providing compliance and enforcement mechanisms to prevent diversion of cannabis to the illicit drug market
<i>Controlled Drugs and Substances Act</i> <i>Food and Drugs Act</i>	Medical devices	Safety and effectiveness
<i>Explosives Act</i>	Blasting explosives, detonators, propellants, cartridges and all types of fireworks and pyrotechnic devices	Safety
<i>Nuclear Safety and Control Act</i>	Nuclear equipment and information, radioactive devices, nuclear substances	Safety, security, health, environment
<i>Plant Protection Act</i>	Plants and products	Protection against pests
<i>Canadian Environmental Protection Act</i>	Hazardous waste, ozone-depleting substances	Environment, health
<i>Wild Animal and Plant Protection and Regulation of International and Interprovincial Trade Act</i>	Endangered species	Conservation, environment
<i>Firearms Act</i>	Firearms, weapons and devices	Security, safety
<i>Health of Animals Act</i>	Animals, birds and products	Protection against foreign animal diseases
<i>National Energy Board Act</i>	Natural gas	Equitable distribution of natural gas
<i>Export and Import Permits Act</i>	Broiler hatching eggs and chicks; eggs and egg products; turkey and turkey products; chicken and chicken products; beef and veal; margarine; wheat and barley and their products; cheese, yoghurt, butter, milk and cream, buttermilk, ice cream and other dairy products	Implementation of tariff quotas maintained under the WTO Agreement on Agriculture
<i>Export and Import Permits Act</i>	Cut roses and rose buds from Israel	Implementation of the Canada–Israel Free Trade Agreement

(cont'd)

cent this year. In Quebec, only wines bottled in the province may be distributed through Quebec grocery stores. And in Newfoundland and Labrador, out-of-province beer and beer products may be denied access to brewers' agents (convenience stores).

In the energy sector, petroleum and gas projects in Newfoundland and Labrador can be approved only if they result in sufficient local employment and purchases of goods and services produced by the province. Petroleum exploration rights in Nova Scotia are conditional

on an attempt to use local labour, goods and services. Under the *Mining Act* in New Brunswick, the minister may require an economic impact analysis from companies regarding the feasibility of in-province processing. And to preserve local employment opportunities in Quebec, a variety of fish (including cod and mackerel) and seafood (including shrimp and crab) must be processed by companies located in the province.

These local-content requirements constitute barriers to competition to both interprovincial and international trade.

**Table 6 (cont'd)**

Controlled or Licensed Imports, June 2002

Legislation	Products	Purpose
<i>Export and Import Permits Act</i>	<p>Yarns (polyester, acrylic and nylon yarns)</p> <p>Fabrics (polyester or polyester-cotton, cotton, wool, nylon, cellulose acetate broadwoven fabrics)</p> <p>Made-up (cotton terry towels and washcloths, work gloves, bed sheets and pillowcases, handbags)</p> <p>Apparel (winter outerwear; hosiery; pants, slacks, jeans, overalls, coveralls and outer shirts; blouses and shirts, t-shirts and sweatshirts; sleepwear and bathrobes; rainwear; sportswear, dresses, skirts, coordinates or matching sets; foundation garments; swimwear; underwear, jackets, overcoats, topcoats, professional coats and shop coats; fine suits, sports coats and blazers; shirts with tailored collars; sweaters, pullovers and cardigans)</p>	Implementation of restraints under the WTO Agreement on Textiles and Clothing
<i>Export and Import Permits Act</i>	Carbon and specialty steel	Import monitoring
<i>Motor Vehicle Safety Act</i>	Motor vehicles and tires	Compliance with safety regulations and emission standards

Source: WTO, *Trade Policy Review Canada*, 2003.

**Anti-dumping duties.** Dumping takes place when goods are sold to importers in Canada at prices that are below the selling price of comparable goods in the country of export. In such cases, the import price may be increased by an anti-dumping duty. In determining the degree to which a Canadian industry has been hurt by dumping, the Canadian International Trade Tribunal (CITT) looks at factors such as lost sales, lost market share, reduced prices and decreased profits. If the CITT concludes that the harm is significant, a duty can be imposed on the imported goods to enable the domestic industry to compete on a more level playing field with the imported product.

As of June 2005, 58 Canadian anti-dumping measures were in effect, some of which are outlined in Table 8. This number represents a decrease from the 85 measures in effect at the time of Canada's last WTO trade policy review in 2003. The vast majority of anti-dumping duties cover steel products, such as stainless steel round bars and hot-rolled carbon steel sheet.

In order to illustrate the pressures that give rise to anti-dumping measures, it is worth examining the case of the steel industry in greater detail. During the 1990s, due

to growing steel imports from countries such as Brazil and China, the Canadian steel industry underwent significant restructuring. The result was a 15 per cent reduction in employment and the closure of a number of inefficient or unprofitable steel manufacturing facilities. The domestic industry reacted to the increased competition from rising imports by using, or threatening to use, trade remedy measures for protection. For instance, anti-dumping investigations concerning steel products increased substantially. Between 2000 and 2001, 37 of the 46 new anti-dumping investigations launched in Canada were associated with steel industry products and involved a total of 23 countries. In all cases, individual market shares were quite small—between 0.1 per cent and 4.4 per cent of total consumption. In 2005, 36 of the 58 anti-dumping measures in effect concerned steel products and, once again, involved 23 countries.

According to the CITT, anti-dumping initiatives have an impact on less than 1 per cent of Canada's imports. Moreover, in some instances, duties are applied to imports that account for a relatively minor share of the total domestic market in Canada. The CITT also notes that the *volume* of dumped imports is only one of the factors looked at when determining the impact on the domestic industry

**Table 7**  
Main Agencies Responsible for Technical, Sanitary or Phytosanitary Regulations

Area	Main responsible agency	Main legislation
Chemicals	Health Canada (Product Safety Bureau, Health Protection Branch), Environment Canada, Pest Management Regulatory Agency (relating to pesticides)	<i>Hazardous Products Act</i> unless covered by the <i>Explosives Act</i> , <i>Food and Drugs Act</i> , <i>Pest Control Products Act</i> , <i>Atomic Energy Control Act</i> , <i>Canadian Environmental Protection Act</i>
Building	Provincial/territorial agencies	Provincial/territorial legislation based on national codes (National Building Code, National Fire Code, National Plumbing Code, National Energy codes)
Consumer products other than food	Industry Canada, Health Canada	<i>Consumer Packaging and Labelling Act and Regulations</i> , <i>Hazardous Products Act</i> , <i>Precious Metals Marking Act and Regulations</i> , <i>Textile Labelling Act</i> and <i>Textile Labelling and Advertising Regulations</i>
Energy	Natural Resources Canada (Office of Energy Efficiency), provincial agencies	<i>Energy Efficiency Act and Regulations</i> , provincial regulations based on national standards
Environment	Environment Canada, Health Canada, Canadian Food Inspection Agency, provincial/territorial agencies	Federal and provincial acts and regulations dealing with environmental protection, pollution, preservation of wildlife and environmental assessment
Food	Canadian Food Inspection Agency, Health Canada	<i>Food and Drugs Act</i> and regulations and other statutes (e.g., <i>Canada Agricultural Products Act</i> , <i>Consumer Packaging and Labelling Act</i> , <i>Feeds Act</i> , <i>Fertilizers Act</i> , <i>Fish Inspection Act</i> , <i>Meat Inspection Act</i> , <i>Seeds Act</i> ), complemented by provincial legislation
Measuring devices	Industry Canada	<i>Electricity and Gas Inspection Act</i> , <i>Weights and Measures Act</i>
Medical devices	Health Canada	<i>Food and Drugs Act</i> , <i>Medical Devices Regulations</i>
Pharmaceuticals	Health Canada	<i>Food and Drugs Act and Regulations</i> , <i>Narcotics Control Act and Regulations</i>
Telecommunications equipment	Industry Canada (Director General, Spectrum Engineering Branch)	<i>Telecommunications Act</i> , <i>Radiocommunication Act</i> and interference-causing equipment regulations
Transportation equipment	Transport Canada, provincial/territorial agencies	<i>Motor Vehicle Safety Act and Regulations</i> , complemented by provincial legislation

Source: WTO, *Trade Policy Review Canada*, 2003.

in Canada. In the belief that small volumes of very low-priced imports can have a major impact, the dumping investigators also consider the prices of dumped imports and their impact on the domestic market.

**NAFTA rules of origin.** Rules of origin are used to evaluate the amount of North American content in specific goods in order to determine whether those goods are eligible for duty-free movement between NAFTA countries. North American importers, exporters, producers and governments incur compliance costs to meet rules-of-origin requirements. These costs include filling out

forms to satisfy customs requirements, and business costs associated with determining, meeting and proving origin.<sup>4</sup> According to one study, NAFTA has the most restrictive and costly rules-of-origin arrangements of any major trade agreement in the world.<sup>5</sup>

Canada, the United States and Mexico have been working to liberalize NAFTA rules of origin for many years, and most recently committed in the 2005 Security and Prosperity Partnership of North America to complete negotiation of a new round of changes by May 2006.

**State-owned enterprises.** Canada's state-trading industries are the Canadian Dairy Commission, the Canadian Wheat Board, the 12 provincial and territorial liquor boards, the Canadian Fish Marketing Corporation and the Ontario Bean Producers Marketing Board.

The Canadian Dairy Commission has the power to purchase any dairy product and to package, process, store, ship, insure, import, export, sell or otherwise dispose of any dairy product that it purchases. It has a de facto monopoly on the import of butter under the tariff quota system, but no exclusive authority for the export of any product. Conversely, the Canadian Wheat Board has exclusive authority to export Western Canadian wheat, durum wheat and barley, but no authority over the import of grains.

Under the 1928 *Importation of Intoxicating Liquors Act*, each province and two territories have monopolies on the introduction of all alcoholic beverages into their jurisdictions both from abroad and from other provinces. Only a board, commission, officer or governmental agency legally authorized to sell intoxicating liquor may import liquor (including wine) considered intoxicating by provincial law. Distribution and warehousing services for importers are generally also reserved for the provincial liquor board. The new *Excise Act, 2001* did not affect market access conditions for foreign suppliers, and maintained the existing import restrictions and trade-related exemptions on bulk spirits. It is also noteworthy that 8 of the 12 provincial liquor jurisdictions in Canada apply a higher service charge on imported products to reflect, according to the authorities, higher carrying costs as well as higher operational costs associated with imported products.

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**Canada's state-trading industries involve these products: dairy, wheat, liquor, fish and beans.**

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A good illustration of the possible effects of deregulation in the alcoholic beverage sector can be found in Alberta, which privatized both warehousing and retail distribution in 1993. The WTO's *Trade Policy Review for Canada* reported that, in 2001, there were more than 18,800 liquor products registered for potential importation in Alberta, compared with approximately 3,300 prior to privatization. The retail network expanded significantly.

**Table 8**  
Examples of Anti-dumping Investigations

Country	Product	Dumping margin* %	Trade volume
China	Garlic	68.1	7,533,369 kg
China	Waterproof footwear	33.0	4,108,000 pairs
China	Hot-rolled steel sheet	25.4	137,224 metric tonnes
Bulgaria	Hot-rolled steel sheet	49.0	22,178 metric tonnes
Latvia	Steel bar	3.9	27,228 metric tonnes
South Africa	Hot-rolled steel sheet	26.4	37,631 metric tonnes
Ukraine	Hot-rolled steel sheet	49.0	22,111 metric tonnes
Vietnam	Garlic	55.7	389,291 kg

\* The dumping margin is the difference between the price charged in the exporting country's domestic market and the price charged to the importing country.  
Source: World Trade Organization.

**Government procurement.** As a party to the WTO Agreement on Government Procurement (GPA), Canada opens its federal government procurement market to other signatories to the GPA. Provisions in national and international arrangements such as the AIT and NAFTA also affect government procurement in Canada. Most federal procurement notices for goods and services valued at more than \$25,000 are posted on MERX (the government's electronic tendering service).

Canada grants national treatment to foreign suppliers in respect of procurement covered by the GPA and other international agreements. As required by the GPA, the threshold dollar amounts for government contracts (i.e., open bidding is required above these amounts) are revised and provided to the WTO every two years. In July 2004, the relevant thresholds were set at \$261,300 for supplies of goods and services and \$10 million for construction contracts. NAFTA grants national treatment to Canadian, Mexican and U.S. goods and services. Since 2004, the thresholds for federal departments and agencies have been as follows: for goods, \$38,000 between Canada and the United States and \$89,000 between Canada and Mexico; for services, \$89,000; and for construction for all NAFTA signatories, \$11.5 million. The thresholds for Crown corporations are \$445,000 for goods and services and \$14.2 million for construction. The Agreement exempts certain departments or agencies, such as the National Film Board and the Canadian Space Agency.

The procurement chapter of the AIT covers procurement by the federal government, 10 provincial governments and two territories. It also covers procurement by municipalities, municipal organizations, publicly funded academic institutions, and health and social service agencies. The AIT applies to all government procurement of goods valued at \$25,000 or more, and services and construction valued at \$100,000 and up. For MASH (municipalities, the academic community, school boards, health and social services) entities, the thresholds are \$100,000 for goods and services, and \$250,000 for construction. The AIT does not cover MASH entities in Yukon and pertains to only 7 of the 43 Crown corporations.

Some Canadian provinces maintain price preferences and other discriminatory procurement policies that favour Canadian or their own provincial suppliers. For example, under its *Purchasing Commission Act*, British Columbia can give preference to goods and services produced, manufactured or sold in that province. Saskatchewan gives priority to companies from the province—in practice, a 10 per cent premium is awarded to local manufacturers. And Ontario gives a 10 per cent price preference in favour of Canadian steel producers. The preference is applied by deducting 10 per cent of the value of products identified as Canadian structural steel products in a construction bid of \$100,000 or more.

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**Some Canadian provinces maintain price preferences and other discriminatory procurement policies that favour Canadian or their own provincial suppliers.**

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The discriminatory practices in provincial government procurement regulations represent substantial barriers to competition. Other WTO members have asked Canada to include the sub-federal government procurement activities in Canada's WTO commitments. However, the Canadian negotiators have indicated that no coverage at sub-federal levels will be considered at this time unless other WTO members are prepared to include sectors of priority interest to Canadian suppliers, such as steel and transportation, in their government procurement packages.

**Border security measures.** Canada and the United States enjoy the largest economic partnership in the world. The Canada–U.S. relationship is based on cooperation to ensure security, the sharing and sustainability of natural resources, and trade for economic prosperity. After the 9/11 terrorist attacks on the United States, many Canadian industry associations raised concerns about impediments to the free and rapid movement of goods across the Canada–U.S. border. As free movement of goods across the border is key to the economic success of Canadian manufacturing industries, Canadian industry associations have a vested interest in eliminating border constraints between the two countries.

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**After the 9/11 terrorist attacks on the United States, many Canadian industry associations raised concerns about impediments to the free and rapid movement of goods across the border.**

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The Canadian and U.S. federal governments are currently examining several options to improve the speed and efficiency of the movement of goods and people between the two countries. Canadian industry associations favour reverse inspection, whereby each country would have a secure zone for processing vehicles before they cross the border. Another approach to border management is Free and Secure Trade (FAST), a joint Canada–U.S. program intended to accelerate the movement of pre-approved, low-risk trucks, drivers and goods across the Canada–U.S. border at 20 major points. The Canadian industry associations involved would like to ensure that the FAST program is fully implemented and extended to other border crossings. Although the situation is gradually improving, Canadian companies continue to identify border security–related delays as a barrier to competition in the integrated North American marketplace.

**DOMESTIC NON-TARIFF BARRIERS**

Barriers to internal trade exist in Canada due to its federal constitution, under which economic and regulatory powers are assigned to federal, provincial and territorial jurisdictions. This enables provincial and territorial governments to intervene, through regulations, to protect their economies from outside competition. Governments have put in place policies to protect the environment, establish

workforce standards and achieve other consumer protection goals. However, some regulations go beyond what is required to meet their stated goals and thus become unnecessary barriers to competition.

There has been little research to date on the many interprovincial barriers to competition in Canada. These barriers are found in all sectors of the economy and affect trade in both goods and services. No comprehensive listing of these barriers seems to exist—indeed, their sheer numbers present a daunting obstacle to any attempt to compile a full list or estimate the cost of each barrier to the Canadian consumer.

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**Numerous interprovincial barriers to competition in Canada are found in all sectors of the economy and affect trade in both goods and services.**

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During the summer of 2004, the Canadian Chamber of Commerce surveyed its members to gather examples of existing barriers to competition. Based on the comments received, the Chamber concluded that barriers to trade in Canada are not unique to any industry or to any particular province, territory or region of Canada. The most common barriers cited were overlapping regulations among and between jurisdictions, multiple licensing requirements, and local preferences in awarding government contracts. In some cases, an estimate of the cost of the barrier on a yearly basis was provided.<sup>6</sup>

#### **AGREEMENT ON INTERNAL TRADE**

Interprovincial barriers have been justified as a means of protecting local jobs, income, public health and other local interests. But, with the increasing liberalization of international trade, the lowering of internal barriers to competition has become a more pressing priority. Thus, in 1994, Canadian first ministers signed the AIT. The purpose of the AIT, which entered into force on July 1, 1995, was to improve competitiveness and increase interprovincial trade by reducing barriers to the movement of people, goods, services and investments within Canada. (See box, “Guiding Principles of the Agreement on Internal Trade.”)

Guided by six general principles, the Agreement on Internal Trade focuses on reducing interprovincial barriers to competition within the 11 areas outlined below.<sup>7</sup> Note that neither financial services nor cultural industries fall under AIT jurisdiction.

#### **Guiding Principles of the Agreement on Internal Trade<sup>1</sup>**

Parties to the AIT agreed to six general rules, designed to prevent governments from establishing new barriers to competition and to reduce existing barriers.

- 1. Non-discrimination**  
Provinces agree to treat residents, goods, services and investments of any other province no less favourably than they treat their own. The federal government agrees not to favour one part of the country over another part.
- 2. Right of entry and exit**  
Governments may not impose import or export controls.
- 3. No obstacles**  
Any measure adopted or maintained must not operate so as to create an obstacle to trade.
- 4. Legitimate objectives**  
A measure may be inconsistent with rules 1, 2 and 3 if the objective is to protect health, safety, the environment or consumers, and the measure is carried out in the least trade-restrictive way.
- 5. Reconciliation**  
Standards will be reconciled through harmonization, mutual recognition or other means.
- 6. Transparency**  
Measures must be visible and made readily accessible.

<sup>1</sup> See “Overview of the Agreement on Internal Trade” on the Internal Trade Secretariat website at [www.intrasec.mb.ca](http://www.intrasec.mb.ca).

- 1. Procurement**—Eliminating local price preferences, biased technical specifications, unfair registration requirements and other discriminatory practices for non-resident suppliers to ensure equal access to procurement for all interested Canadian suppliers.
- 2. Investment**—Preventing discriminatory treatment of Canadian business according to head-office location, limiting local residency requirements, prohibiting local content and purchasing conditions and standardizing corporate registration and reporting requirements to ensure Canadian firms are free to make business decisions based on market conditions.
- 3. Labour mobility**—Eliminating the current barriers of residency, certification and professional standards within individual provinces to enable qualified workers—such as accountants, lawyers, construction workers and tradespeople—to practise their occupation anywhere in Canada.
- 4. Consumer-related measures and standards**—Reconciling the varying consumer protection requirements of different provinces and territories that act as NTBs to allow Canadian firms to capitalize on economies of scale by servicing larger markets with the same products.

5. **Agricultural and food products**—Examining supply management systems for dairy, poultry and eggs; removing technical barriers between provinces, such as differing product and grade standards, and plant and animal health regulations.
6. **Alcoholic beverages**—Prohibiting discriminatory practices in areas such as product listing, pricing, distribution and merchandising between the liquor control boards and retail outlets of the provinces and territories.
7. **Natural resources processing**—Prohibiting the introduction of new barriers relating to the processing of forestry, fisheries and mineral resource products.
8. **Energy**—Harmonizing the treatment of energy goods and energy services.
9. **Communications**—Ensuring equal access to public telecommunications networks and use of public telecommunications services.
10. **Transportation**—Harmonizing the regulations applicable to commercial vehicles, such as safety standards, weights and dimension rules, bills of lading, tax administration and operating authority requirements.
11. **Environmental protection**—Ensuring that federal, provincial or territorial environmental protection measures do not become NTBs.

The Internal Trade Secretariat's website shows that the provinces and the federal government have been pursuing discussions and negotiations in most sectors since early 2004.<sup>8</sup> The site documentation also illustrates that NTBs are numerous and often include minute legislative detail—factors that impede preparation of an exhaustive list of NTBs and add to the complexity of addressing the problem.

A good example of progress can be seen in Chapter 10 (alcoholic beverages) of the AIT. When the Agreement came into effect, it:

- prohibited, with certain exceptions, discriminatory treatment in listing, pricing, access and distribution of alcoholic beverages from other parties;
- prohibited obstacles to trade through administrative procedures, labelling and packaging requirements, oenological measures and advertising regulations;
- limited fees and charges to the cost of the necessary service;
- committed parties to reconciling standards-related measures; and
- established procedures ensuring transparency when measures are adopted or amended.

Given the diversity of existing barriers to competition in each province in areas such as pricing, administrative procedures, packaging and advertising for alcoholic beverages, the AIT clearly entered into force with ambitious objectives.

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**While reviews and actions have begun to liberalize the movement of alcoholic beverages between the provinces, there is still much to do to further open this market.**

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The work accomplished and the actions taken on Chapter 10 since July 1, 1995, reinforce the view that interprovincial barriers can be highly diverse, detailed and specialized. For instance, since the AIT came into effect, the parties have:

- reviewed and reconciled the definition of “wine and wine products” with the Canadian Wine Standards (the Standards Committee on Wine of the Canadian General Standards Board);
- reviewed Nova Scotia's differential floor pricing for beer and beer products, which has been eliminated;
- reviewed the reservation of New Brunswick and Quebec's right to apply differential costs of service to beer and beer products for other parties, and facilitated initial discussions between Ontario, Quebec and New Brunswick on removing this reservation;
- reviewed Ontario's Canadian grape content requirement, which resulted in the province opening its borders to out-of-province wine and agreeing to accept 100 per cent imported wine products from other countries, whether bottled from imports or Canadian produced;
- agreed to eliminate reservations on markup differentials for wine; and
- continued to develop a National Wine Standard.

While these reviews and actions have begun to liberalize the movement of alcoholic beverages between the provinces, there is still much to do to further open this market. The AIT considers the completion of a National Wine Standard to be its most pressing piece of unfinished business, while the Canadian Vintners Association continues to work closely with federal, provincial and industry authorities to obtain higher quality standards for wine that would benefit the Canadian consumer.



However, the AIT has generated significant progress in other sectors. In the procurement sector, \$15 billion in government purchasing was subject to procurement rules based on fairness, openness, accessibility and transparency. Thirty billion dollars in MASH procurement has been added since the Agreement was signed, and \$20 billion in Crown corporation procurement came into effect in January 2005. In the investment sector, provincial governments agreed to adhere to prohibitions ensuring no discriminatory treatment of Canadian investors and businesses based on residency or place of incorporation or head-office location, as well as no imposition of local content or purchasing and sourcing requirements on investors or businesses from other jurisdictions. They also agreed to a Code of Conduct on Incentives prohibiting job poaching (enticing existing businesses from one jurisdiction to another). In labour mobility (Chapter 6 of the AIT), residency requirements were eliminated as a condition of employment or of eligibility for licensing, certification or registration; regulators representing 48 of 51 regulated occupations now recognize at least some of the accredited occupational qualifications of workers from other jurisdictions.

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**Progress can be slow and arduous because discussions involve 13 governments with sometimes very different visions of what constitutes a trade barrier.**

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On the other hand, progress can be slow and arduous because the discussions involve 13 governments with sometimes very different visions of what constitutes a trade barrier. Two cases provide useful illustrations of the complexity of interprovincial barriers to competition and the reluctance of certain provinces to eliminate them.

The first concerns the sale of margarine in Quebec. Since 1987, Quebec has prohibited margarine from having the same colour as butter. Recently Alberta filed a complaint against this regulation on the grounds that it was not in accordance with the AIT. Quebec has responded that it does not prohibit the sale of margarine, and that Quebec manufacturers are subject to the same standards and requirements with respect to margarine colouring as manufacturers from outside the province. The fact that an internal barrier to trade can be based solely on a product's colour underlies the complexity of Canada's NTB structure.

The other often-cited case of an ongoing NTB concern relates to Ontario's *1990 Edible Oil Products Act* (EOPA). The Act made it illegal to manufacture and sell products that resemble a dairy product if those products combine edible oils, such as soybean oil and canola oil, with any quantity of dairy product. In effect, the Act was a trade-restrictive measure that prevented the manufacture and sale of vegetable oil-based alternatives to dairy products in Ontario. After a series of delays, the Act was finally repealed on January 1, 2005. However, on December 23, 2004, the Ontario Farm Products Marketing Commission approved changes to Ontario's *Milk Act* regulations to prohibit filled milks and dairy edible oil spreads that contain less than 50 per cent milk fat by weight of the total fats and oils—some of the same restrictions that were in force under the EOPA. These continued restrictions go against the findings of an AIT panel report that any replacement measures that Ontario may attempt to introduce through other legislation, such as the *Milk Act*, would be barriers to competition and inconsistent with Ontario's AIT obligations. In addition, the panel advised that the Government of Ontario "make it clear it will not use the *Milk Act* to implement limitations on the sale of Dairy Analogs and Dairy Blends in a manner similar to the limitations imposed by the EOPA."<sup>9</sup>

The Marketing Commission's decision also ignored statements made by the Ontario Ministry of Agriculture, Food and Rural Affairs in a letter dated June 30, 2004: ". . . I nevertheless want to reiterate this government's intention to not erect any new barriers to interprovincial trade, particularly with respect to any new regulations that would act as a substitute for EOPA once repealed."

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**Two cases illustrate the reluctance to eliminate interprovincial barriers to competition: one concerns the sale of margarine in Quebec, the other relates to Ontario's 1990 Edible Oil Products Act.**

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The Ontario and Quebec cases discussed above clearly show the degree to which NTBs can take on forms that are difficult to imagine, or even to locate in the legislation. They also highlight the limits on the enforcement power of the AIT. Despite the fact that all provinces signed the AIT in 1994, full commitment to interprovincial free trade is sporadic and uneven.

## THE COUNCIL OF THE FEDERATION

In line with a decision to more directly attack the problem of domestic NTBs, the provincial premiers met in Charlottetown, Prince Edward Island, on December 5, 2003, to set up the Council of the Federation. As a priority for concerted intergovernmental action, they singled out the need to reinforce the economic union and especially to revitalize internal trade. In February 2004, the provinces and territories followed through with a work plan on internal trade to cover the period until mid-2005. The plan contains a number of matters for immediate action, as well as short- and long-term objectives. The full description of the work plan can be viewed on the Council of the Federation's website.<sup>10</sup>

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**With a concrete action plan and more frequent meetings scheduled within the Council of the Federation, the political will toward eliminating interprovincial barriers to competition may be materializing.**

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In the "immediate action" category, the premiers moved quickly on two matters: they agreed to re-establish annual meetings of the Committee on Internal Trade, and they agreed to comply with the guiding principles and general rules of the Agreement on Internal Trade. The work plan also asks the provinces and territories to undertake, individually or in groups, research and analysis on particular internal trade challenges and any other current issues.

With a concrete action plan in place and more frequent meetings scheduled within the Council of the Federation, the political will to work toward eliminating interprovincial barriers to competition may be materializing. Examples of recent commitments or actions are described below.

### Financial Services

Although financial services are not included in the 11 sectors covered by the AIT, several provincial ministers responsible for securities industry regulation in their respective provinces signed an agreement on September 30, 2004, to implement a securities passport system by August 2005. This new system, which came into effect in September 2005, enables issuers and registrants to interact with only one regulator in their principal jurisdiction and exempts them from some legal requirements in other provinces and territories. Provinces and

territories are also working together to simplify and harmonize securities laws across Canada to an even greater degree.

Although Ontario did not sign the agreement, the signatories indicated that they were ready to work with that province to find ways of improving the securities regulatory framework in Canada. Ontario would prefer to set up a single securities regulatory agency for the country.

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**Provinces and territories are working together to simplify and harmonize securities laws.**

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### Procurement

In April 2004, provincial and territorial ministers responsible for internal trade agreed on how to include procurement by provincial/territorial Crown corporations under the procurement chapter of the Agreement on Internal Trade, effective January 1, 2005. In general, preferences based on local content must be reduced, calls for tender must be publicized electronically, and MASH entities must now be subject to AIT provisions. As this was the last outstanding procurement item to be negotiated since the AIT came into effect, provincial-territorial negotiations have indeed made significant progress on liberalizing the procurement process.

Improvements are still called for in other areas, notably in reducing thresholds, expanding coverage to include professional services and opening up access to tender calls by way of a unique gateway—points that are to be brought back to the table at upcoming meetings.

For instance, Quebec government departments and agencies open advertising and public relations contracts worth \$100,000 or more only to companies from Quebec and the State of New York.<sup>11</sup> In other words, there are still constraints in the area of awarding procurement contracts.

### Labour Mobility

In labour mobility, real progress is evident in provincial recognition of credentials from other provinces (although this is less true when it comes to recognizing the credentials of specialists trained in other countries). According to the AIT Secretariat, as of September 2005, 33 of the 51 occupations regulated in more than one jurisdiction have mutual recognition agreements (MRAs) signed by

all regulating jurisdictions, 15 have partial MRAs that have not been signed by all regulating jurisdictions, and 3 have yet to negotiate an MRA. Nonetheless, much work remains to be done in this area.

### **Agriculture**

In this sector, the agriculture ministers have indicated that their key challenges lie at the international level and that obstacles to internal trade are thus a lower priority.

### **Energy**

In the energy area, the ministers responsible agreed in 1998 on all but two points: the provisions on hydraulic rights and the exemptions related to regional development measures for oil and gas activities, both inshore and offshore. Since 1998, ministers have reached an agreement on hydraulic rights, but there is no consensus on how to deal with regional development exemptions for oil and gas activities. At the August 2005 meeting, premiers agreed to establish a Council Committee on Energy. They also reviewed progress made by internal trade ministers toward the conclusion of an energy chapter under the AIT. Negotiations on regional development exemptions will continue to take place at future meetings, but no resolution to this problem is imminent.

### **Recent Developments**

In August 2005, premiers approved a report, submitted by premiers Doer and Lord, on the progress made by internal trade ministers in addressing internal trade barriers. Premiers noted the recent developments, including improvements to the dispute resolution mechanism of the AIT, and the agreement to conclude a review of the scope and coverage of the agriculture and food goods chapter by December 2005. They also endorsed the efforts of internal trade ministers to move the energy chapter negotiations toward a successful conclusion. As a next step, the premiers requested the Forum of Labour Market Ministers to develop an action plan on labour mobility that addresses specific targets and timelines for completion. Premiers agreed that internal trade ministers should meet in the late fall of 2005 to discuss further steps on internal trade. They also instructed internal trade ministers to meet regularly and to provide regular progress reports on the work plan to the Council of the Federation.

In January 2006, the Council of the Federation announced further improvements to the AIT's dispute settlement mechanism. Among other things, they recommended exploring the enhancement of retaliatory measures against non-compliant provinces, including the potential imposition of monetary consequences and/or enforcement in the courts. Moving in this direction is essential. Currently, dispute panel recommendations can be ignored, or circumvented through offsetting local legislation, due to the absence of an enforcement mechanism.<sup>12</sup>

The Council of the Federation thus appears to have re-energized the ministers concerned to seriously attack the problems caused by interprovincial barriers to competition in Canada.

## **SUMMARY**

Tariffs have declined to the point where almost 50 per cent of goods entering Canada are duty-free. Much of this decline occurred in the past decade, thanks to Canada's participation in the WTO and regional free trade agreements, notably NAFTA. However, certain sectors of the Canadian economy, such as agriculture, continue to have a high degree of protection.

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**Tariffs have declined to the point where almost 50 per cent of goods entering Canada are duty-free. Much of this decline occurred in the past decade.**

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While the tariff burden has decreased, there has been less progress in reducing domestic and international NTBs. Canada has a bewildering array of such barriers, spanning all levels of government and often involving extremely complex regulatory frameworks. No complete list of all of the regulatory barriers to competition exists. However, the inventory presented in this chapter gives a good indication of the scope of existing NTBs.

In some instances, Canada has been forced to adjust NTBs due to challenges from our trading partners through the WTO, as was the case with dairy products. However, absent such challenges, regional interests and the need for negotiation between the federal government

and the provinces, as well as among the provinces, make it extremely difficult to achieve progress in lowering barriers to competition.

The signing of the AIT in 1995 allowed for significant progress in reducing NTBs in certain areas, especially those relating to the sale of alcoholic beverages and government procurement restrictions. However, much work remains to be done even in these areas. In an attempt to re-energize the effort to lower NTBs, premiers agreed to address the problem of interprovincial barriers to competition by creating the Council of the Federation in 2003. The Council has succeeded in breathing life back into the process of lowering internal barriers to competition by bringing together the ministers concerned to negotiate reductions in various NTBs. Despite some success, progress to date remains slow. NTBs thus continue to represent a significant barrier to competition in Canada, as we shall see in Chapter 5. The

Security and Prosperity Partnership of North America also offers the promise of reducing unnecessary regulatory differences between Canada, the United States and Mexico—although much more work remains to be done in this area as well.

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**The Council of the Federation has succeeded in breathing life back into the process of lowering internal barriers to competition, but progress to date has been slow.**

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To gauge the degree of progress in the elimination of unnecessary or burdensome regulations, the Conference Board felt it was important to survey businesses on their sense of the costs imposed by the existing regulatory framework. The results of this survey are presented in the next chapter of this report.

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1 Much of the information in this chapter comes from the *Trade Policy Review for Canada*, published by the World Trade Organization Secretariat in March 2003.

2 Charles A. Barrett and Roland Paris, *Fighting Over Fabrics: The Textile Wars and the Politics of Free Trade* (Ottawa: The Conference Board of Canada, November 2005).

3 Michael Hart and William Dymond, *Common Borders, Shared Destinies: Canada, the United States and Deepening Integration* (Ottawa: Centre for Trade Policy and Law, Carleton University, 2001); Fidèle Ndayisenga, "Economic Impacts of Regulatory Convergence Between Canada and the United States," *Horizons* (June 2004), pp. 9–16.

4 Robert Kunimoto and Gary Sawchuk, "Moving Toward a Customs Union: A Review of the Evidence," *Horizons* (June 2004), pp. 23–31.

5 Antoni Esteveadoral, "Negotiating Preferential Market Access: The Case of the North American Free Trade Agreement," *Journal of World Trade* 34, 1 (2000), pp. 141–166.

6 Canadian Chamber of Commerce, *Obstacles to Free Trade in Canada: A Study on Internal Trade Barriers* (Ottawa: The Canadian Chamber of Commerce, November 2004).

7 See "Overview of the Agreement on Internal Trade" on the Internal Trade Secretariat website at [www.intrasec.mb.ca](http://www.intrasec.mb.ca).

8 See "Progress to Date" on the Internal Trade Secretariat website at [www.intrasec.mb.ca](http://www.intrasec.mb.ca).

9 Agreement on Internal Trade, *Report of the Article 1704 Panel Concerning a Dispute Brought Forward by Alberta and British Columbia Against Ontario Regarding Ontario's Measures Relating to Dairy Analogs and Dairy Blends*, November 10, 2004, p. 40.

10 See the Council of the Federation website at [www.councilofthefederation.ca](http://www.councilofthefederation.ca).

11 Treasury Board Secretariat, Government of Quebec, *Summary of Procurement Liberalization Agreements. Quebec Government Departments and Agencies* (Québec: Government of Quebec, July 2004).

12 The Council of the Federation, *Internal Trade Workplan Progress Report*, January 2006, on the Council of the Federation website at [www.councilofthefederation.ca](http://www.councilofthefederation.ca).

# Business Leaders' Views on Barriers to Competition

### Chapter Summary

- The majority of firms that took part in the Conference Board's survey dealing with the impact of inter-provincial trade barriers faced problems arising from non-tariff barriers to competition in Canada.
- Respondents cited standards and regulations as well as procurement policies and restrictions on labour mobility as the most prohibitive barriers to trade.
- Specific laws covering insurance, securities, trucking, book publishing, credit unions, fertilizers and the transportation of dangerous goods were also mentioned by some respondents as sources of barriers to competition.
- According to the respondents, the main impact of non-tariff barriers was loss of business.
- The increased costs stemmed from not only compliance costs but also costs associated with reduced innovative capacity and an inefficient size of operations.

### INTRODUCTION

As the previous chapter illustrated, there is an extensive array of non-tariff barriers (NTBs) across Canadian provinces and territories. These NTBs are supported in law by the Canadian constitution, which gives provincial governments the right to impose regulations and standards in areas where they have jurisdiction. Often, the regulations and standards are ingrained in the values, traditions and economic conditions of the local economy. Provinces and territories have used NTBs to increase employment and promote economic growth locally—a practice that is difficult to abandon, particularly given the positive political feedback it can engender.

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**Non-tariff barriers can lower the competitiveness of Canadian companies nationally and internationally, simply because they impose excess costs.**

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The OECD Growth Study and other empirical work have provided evidence that competition-enhancing policies can foster higher productivity and economic growth by improving resource allocation, encouraging managerial efficiency and effectiveness, increasing innovation and technological diffusion, boosting employment and spurring capital investment. Thus, provincial and territorial NTBs—those that, broadly speaking, affect the movement of goods and services, the mobility of workers and the free flow of capital—potentially have a negative impact on companies doing business outside their own province or territory. As well, these NTBs can lower the competitiveness of Canadian companies nationally and internationally, simply because they impose excess costs. As part of The Conference Board of Canada's work on strategies for raising Canadian productivity, it is therefore crucial to examine how internal NTBs affect the ability of Canadian firms to operate efficiently.

In 1992, the Conference Board undertook a survey-based study on the perceived impact of interprovincial tariff and non-tariff trade barriers. The study concluded that many companies in Canada operated under interprovincial barriers that increased their costs and hurt Canada's overall competitiveness.<sup>1</sup>

To better understand the current impact of NTBs, the Conference Board conducted a new survey of firms in June 2005. This latest survey sought to identify the impact of NTBs on Canadian companies and the strategies these companies are using to mitigate potential business losses. A follow-up telephone survey enabled respondents from the June survey to further elaborate on how specific federal and provincial laws affect their business operations. (See box, "A Note on the Survey Methodology.")

## TYPES OF BARRIERS TO COMPETITION

The survey results suggest that the majority of respondents felt that NTBs negatively affect them and that regulations constrain their ability to enter other markets. Ninety-four per cent of respondents (186 respondents) said that NTBs have some form of impact on their business.

Companies were asked to identify the barriers to competition in Canada that affected their ability to do business. (See Table 9.) The most common barrier was standards and regulations, identified by 41 per cent of respondents (81 respondents). This was followed by procurement policies at 26 per cent (52 respondents), licensing requirements at 20 per cent (39 respondents), impediments to labour mobility at 13 per cent (25 respondents) and privacy legislation at 12 per cent (24 respondents).

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### Survey respondents cited the most common barriers to competition in Canada as standards and regulations.

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Companies were also asked to indicate whether the NTBs that affect them fall within federal or provincial jurisdiction. (See Table 9.) Out of a total of 282 responses that identified level of government, 22 per cent (62 respondents) indicated that the barriers are solely federal, 44 per cent (123 respondents) said solely provincial, while 34 per cent (97 respondents) indicated that the barriers are both federal and provincial.

#### A Note on the Survey Methodology

The survey questionnaire was sent to a cross-section of small, medium-sized and large Canadian companies, located in all regions across Canada. The survey questions focused on four main areas:

- What are the federal or provincial barriers to competition that hamper the company's ability to do business?
- What impacts have the barriers had on trade and business operations in general?
- How have federal or provincial regulations affected the company's ability to do business in that province, another province or other countries? In other words, does a regulation make the company less competitive in markets outside its home province?
- What strategies has the company developed to alleviate the burden of federal or provincial barriers to competition?

A total of 198 surveys were completed. Of these, 152 (77 per cent) were from companies with fewer than 50 employees; 16 (8 per cent) from companies with 50 to 100 employees; 14 (7 per cent) from companies with 100 to 500 employees; and 16 (8 per cent) from companies with more than 500 employees. The corresponding distribution of all Canadian companies is as follows: 94.5 per cent of companies have fewer than 50 employees, 3.1 per cent of companies have 50 to 100 employees, 2.2 per cent of companies have 100 to 500 employees and 0.3 per cent of companies have more than 500 employees. While our sample over-represents large firms, the degree of bias is not considered high enough to invalidate the survey results.

In revenue size, 137 responding companies (69 per cent) had less than \$5 million in revenues; 32 (16 per cent) had revenues between \$5 million and \$25 million; 12 (6 per cent) had revenues between \$25 million and \$100 million; 14 (7 per cent) had revenues between \$100 million and \$1 billion; and 6 (3 per cent) had revenues of more than \$1 billion.

For the follow-up telephone survey, researchers called the 86 respondents from the survey who had indicated a willingness to be contacted to elaborate on their responses. A total of 54 respondents agreed to take part in the follow-up survey. These respondents were then asked to identify specific federal and provincial legislation that acted as NTBs. Many respondents were unable to identify specific laws that negatively affected their businesses, and some simply reiterated comments made in the original survey. However, 13 respondents provided either specific or general comments on government legislation; these comments appear in this report.

**Table 9**  
**Categories of Barriers to Competition in Canada**  
 (based on responses to a Conference Board survey, June 2005)

Barrier	Responses (%)	Total number of responses	Jurisdiction			No response
			Federal (number of responses)	Provincial (number of responses)	Both (number of responses)	
Standards and regulations	41	81	21	28	32	0
Procurement policies	26	52	10	17	25	0
Licensing requirements	20	39	7	24	8	0
Labour mobility	13	25	0	18	6	1
Privacy legislation	12	24	5	5	14	0
Transport trucking regulations	11	21	5	11	5	0
Distribution restrictions	10	19	5	12	2	0
Marketing boards	6	12	4	4	3	1
Securities regulation	6	11	5	4	2	0
<b>Total</b>		<b>284</b>	<b>62</b>	<b>123</b>	<b>97</b>	<b>2</b>

Source: The Conference Board of Canada.

Standards and regulations were the barriers identified most times (53 responses) as being federal in nature. However, roughly 40 per cent of the responses (61 responses) also pointed to federal involvement in marketing boards, privacy legislation and procurement policies. The barrier viewed as being strictly provincial in nature was restrictions on labour mobility. The three most commonly identified barriers at the provincial level were standards and regulations (60 responses), procurement policies (42 responses) and licensing (32 responses). Together, these three categories account for just over 60 per cent of the barriers identified as originating with the provinces.<sup>2</sup>

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**The three most commonly identified barriers at the provincial level were standards and regulations, procurement policies and licensing requirements.**

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When asked to comment on the specific impact of these NTBs, some respondents expressed particular concern about non-standardized regulations for professional credentials and qualifications that reduce labour mobility and thwart product approvals. They indicated that the resulting lack of labour market flexibility makes it difficult to do business across provinces. One respondent noted that in the construction industry, the inability to use out-of-province labour in Quebec reduces efficiency, virtually locking competition from other provinces out of that market.

In the follow-up telephone survey, three respondents mentioned specific federal laws that are barriers to competition (specific provincial laws are discussed in a later section). A company that manufactured fertilizer stated that the *Fertilizers Act*, which controls the content of fertilizers in Canada, has a stringent regulatory requirement and is resulting in diverting business to the United States where there is a more accessible regulatory body. Another company in the wholesale trade sector noted that the *Transportation of Dangerous Goods Act* favoured Quebec and discriminated against other provinces. The Act enables companies in Quebec to ship goods to other countries without using UN packaging. Companies in other provinces must use UN-approved packaging before they can deliver their products to foreign markets. The third company, an organization in the financial sector, stated that federal securities regulations have a negative impact on equity markets in Canada.

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**Some respondents are concerned about non-standard regulations for professional credentials.**

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An additional three respondents in the follow-up survey, while unable to mention specific federal laws that are barriers to competition, provided interesting detail. A company in the wholesale trade sector mentioned that its business has been negatively affected by Health Canada's requirement that organizations reveal the formula used in their products before they can be

distributed. The respondent said that this requirement, while not a problem for large organizations, was a major impediment for small business. A company in the professional, scientific and technical sector noted that privacy legislation at the federal level made it difficult for it to obtain lists of people and organizations in Canada that it could potentially use for marketing purposes. Another organization in the electrical equipment sector mentioned that the federal government has not given enough priority to helping companies obtain licensing for new products.

## IMPACT OF BARRIERS TO COMPETITION

Survey results indicated that barriers to competition have negatively affected their ability to do business. (See Table 10.) The most significant impact was loss of business, identified by 51 respondents. This was followed by increased administration costs (48 respondents); reduced competitiveness, either nationally or internationally (25 respondents); and a higher cost structure (22 respondents). Some respondents (20 in total) also mentioned the higher costs associated with fighting or avoiding barriers, higher input prices, reduced innovation and product improvement capacity, and inefficient size of operation. Loss of business generally represents the cumulative impact of all the barriers to competition, as regulatory restrictions or higher cost structures render companies non-competitive.

Respondents had the opportunity to elaborate on the impact of the additional burden imposed by barriers to competition. One firm indicated that the regulatory bur-

den has reduced product speed to market and thus generated a higher cost structure. Another company stated that it is losing potential customers in the United States because the barriers to competition in Canada have stopped company growth, resulting in an inefficient size of operation. Three firms in the services sector were especially critical of provincial government procurement policies, which they felt were biased toward in-province suppliers, either explicitly through office residency terms or implicitly in the bidder selection process. These firms felt shut out of many important business opportunities. As one company noted, “The result is that small companies cannot establish cross-provincial practices.”

## IMPACT OF PROVINCIAL NTBs ON COMPETITIVENESS

Given the focus of this report on competitiveness and a perception that NTBs are especially prevalent at the provincial level, a specific survey question asked respondents to indicate whether provincial regulations hurt their competitiveness. Approximately one-third of the respondents said that provincial regulations were hindering their competitiveness in their home province (57 respondents) and in other provinces (59 respondents). Close to one-quarter (36 respondents) said that provincial regulations hindered their competitiveness internationally. (See Table 11.)

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**About one-third of respondents said that regulations in their home province hindered their competitiveness as did those in other provinces or territories.**

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Asked to elaborate, firms said that provincial legislation impeded competitiveness through excessive, unclear, inflexible regulations (22 respondents); inconsistent regulations across provinces, territories and other countries (18 respondents); taxes and duties (10 respondents); licensing and certification (6 respondents); and language laws (4 respondents). Some of the issues identified—such as tax laws—would not normally be categorized as regulatory barriers to competition, since all firms face the same tax legislation. Rather they simply add to the cost of doing business, according to the respondents.

**Table 10**  
Impacts of Barriers to Competition

Impact	Percentage of responses	Actual number of responses
Loss of business	26	51
Increased administrative cost	24	48
Reduced competitiveness nationally and/or internationally	13	25
Higher cost structure	11	22
Higher costs fighting or avoiding barriers	5	9
Higher input prices	3	5
Reduced innovation and product improvement capacity	2	3
Inefficient size of operations	2	3

Source: The Conference Board of Canada.



Some respondents felt that regulatory inflexibility has hampered their efforts to become more efficient and that excessive, complex regulations increase their administrative costs and diminish their ability to compete effectively in their home province, in other provinces and/or internationally. One respondent said, for example, that “regulations that apply in B.C. do not have to be met by out-of-province companies shipping their products to B.C.,” while another noted that “transport regulations reduce our competitiveness and/or willingness to travel to provinces such as B.C. and Ontario.” Complying with the regulations imposes constraints on timelines. This puts a strain on the company’s personnel and adds costs, which in turn affect a company’s competitiveness.

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**Respondents identified high taxes as a problem when trying to compete in world markets against countries such as China, which can produce products at very low prices.**

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As noted above, the inconsistency of regulatory barriers across provincial and territorial jurisdictions is seen as another factor hurting competitiveness. Respondents pointed to the burden on administrative resources caused by stricter regulations in some jurisdictions, particularly regarding packaging and labelling requirements and safety standards. As one respondent remarked, “Fire marshal regulations are stricter, and they are constantly monitored in Ontario. We don’t believe this is the case in Quebec, and this presents an uneven playing field.” Such regulations restrict a company’s ability to sell in target markets.

Some respondents indicated that the tax regime in different provinces has impeded their ability to compete—conflicting and opposing regulation of provincial taxes puts a cost burden on a company competing in other jurisdictions. In addition, respondents identified high taxes as a problem when trying to compete in world markets against countries such as China, which can produce products at very low prices.

Finally, a few respondents considered licensing and professional certification an impediment to a company’s ability to be competitive in other provinces. Certification

**Table 11**  
Provincial Regulations Impeding a Company’s Competitiveness

	Yes (%)	Number	No (%)	Number	Total number of responses
In their home province	32.6	57	67.4	118	175
In other provinces	34.9	59	65.1	110	169
In other countries	23.7	36	76.3	116	152

Source: The Conference Board of Canada.

is not always recognized across jurisdictions, which prevents businesses from using qualified personnel on projects or assignments.

In the follow-up survey, seven respondents mentioned a number of specific provincial laws that are barriers to competition for their organizations. One respondent in the health-care sector noted that Ontario’s Bill 198, which expanded liability coverage for auto accidents and other claims, has had a negative impact on business. While Bill 198 expanded liability coverage, it also placed a ceiling on the amount of money that individuals could claim after being injured in a car accident. This cap on claims for individuals has reduced business at that respondent’s physiotherapy centre.

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**A few respondents considered licensing and professional certification an impediment to a company’s ability to be competitive in other provinces.**

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An organization in the professional, scientific and technical sector felt that Alberta’s *Occupational Health and Safety Act* placed undue financial pressure on the company. The respondent was also concerned about the province’s proposed “ticketing” act which would discriminate against employers in the province. If an employer decided to fire a worker without two weeks’ notice, the employer would still be required to compensate that employee for two weeks of pay. However, the proposed act would not have any repercussions for an employee who decided to quit without giving two weeks’ notice.

A respondent involved in the insurance business contended that British Columbia's captive insurance legislation, which in essence allows companies to own insurance firms in order to manage their own insurance needs, is a hindrance for their business. British Columbia is the only province that has this type of legislation, and no other provinces in Canada will accept captive insurance papers as licensed documents. A respondent from the educational services sector complained about Ontario's *Private Career Colleges Act*, which requires the organization's programs to be approved at the provincial level. According to the respondent, this process takes too long (years), and by the time a program is approved it is no longer required. The respondent also stated that the people responsible for this process are often inexperienced.

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**A respondent from the insurance business contended that B.C.'s captive insurance legislation is a hindrance, and no other provinces will accept captive insurance papers as licensed documents.**

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Two respondents had difficulties with different aspects of trucking and transportation legislation. Ontario's regulation 555-92, part of the *Truck Transportation Act*, discriminates against Ontario-based trucking companies, according to one respondent. Unlike Quebec-based freight companies, Ontario companies must deposit revenues from sales into a trust account. This creates an unlevel playing field in the industry in Canada. While another respondent in the transportation sector could not name a specific law, he noted that provincial and federal regulations restricting the amount of overtime that truck drivers could work created difficulties for the business. This was compounded by problems in hiring new drivers—something that was made even more difficult by the provincial government's lack of financial support for apprentice programs.

A book publisher in Western Canada felt strongly that Ontario's Book Publisher Tax Credit, which is designed to assist first-time authors, is a barrier to trade that has a negative impact on his business. Quebec has a similar tax credit, and both it and the Ontario tax credit create an unlevel playing field for book publishers in other provinces, according to the respondent. Finally, one respondent noted that "buy Quebec" policies limited access to the Quebec market, while another indicated

that the differences in provincial legislation governing electricity pricing make it difficult to conduct business in the different regions in Canada.

## **STRATEGIES TO ALLEVIATE BARRIERS TO COMPETITION**

How are companies dealing with non-tariff barriers to competition? The six main strategies are as follows:

1. **Change production techniques, product lines or marketing strategy (22 respondents)**—Companies are factoring compliance with the barriers to competition into their business practices and production runs. Compliance strategies mentioned include revamping marketing strategies; improving efficiencies and automating systems to reduce overhead and time to market; focusing on diversification and service differentiation; and redesigning business forms.
2. **Avoid selling in certain provinces (16 respondents)**—Many respondents simply avoid doing business in certain provinces because of regulations and procurement programs. Instead, they focus on their core business in their home province or in provinces with limited barriers to entry in their sector.
3. **Lobby government for changes to regulations (12 respondents)**—In an effort to effect change, companies have also been actively lobbying federal, provincial and territorial governments on issues affecting their competitiveness. Many respondents who indicated that they were pursuing this strategy also indicated frustration at their lack of success.
4. **Seek business opportunities outside Canada (12 respondents)**—Some respondents have given up trying to do business in Canada because of NTBs. Companies indicated that they are seeking business opportunities in more hospitable international jurisdictions, where there is more open competition with fewer restrictions and regulations. Some companies are redirecting investments; others are moving their operations out of Canada to these other countries.
5. **Form partnerships with associations or subcontractors (12 respondents)**—Certain respondents actively pursue partnerships with organizations that are based in target provincial markets with high barriers to competition. Companies seek out partnerships either by subcontracting work to local suppliers or by working closely with their professional and trade associations.

6. **Staffing changes (10 respondents)**—Finally, a few respondents have developed special strategies to manage human resources when faced with competition barriers in Canada. Some companies have staffed up to deal with the added administrative burden imposed by NTBs. Others have increased staff training and licensing to enable them to work in other provinces or territories, while others are downsizing and reducing their workforce in order to remain competitive in a higher-cost environment.

## SUMMARY

The majority of firms that took part in the Board's survey face problems arising from NTBs to competition in Canada. Although standards and regulations are, not surprisingly, the most common barrier cited, procurement policies and restrictions on labour mobility are also high on the list—despite the focus of the AIT and the Council of the Federation on these latter two NTBs. Respondents indicated that the provincial/territorial governments bore more responsibility than the federal government for creating the NTBs. The follow-up survey identified laws covering insurance, securities,

trucking, book publishing, credit unions, fertilizers and the transportation of dangerous goods as sources of barriers to competition. Responses from both surveys (June and follow-up) suggest that much work remains to be done before NTBs cease to be a problem in Canada.

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### **Respondents identified strategies to deal with NTBs, including abandoning the Canadian market.**

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As might be expected, the main impact of NTBs is to raise the cost structure of respondents' businesses. The increased costs include not only compliance costs but also, less obviously, costs associated with reduced innovative capacity and an inefficient size of operations. Respondents identified a number of production, marketing and lobbying strategies that they have pursued to deal with NTBs, including—most worryingly—abandoning certain provincial markets or the Canadian market altogether. Almost all of these strategies come with a higher cost of doing business. According to the survey respondents, NTBs are hurting the competitiveness of Canadian firms.

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1 Stelios Loizides and Michael Grant, *Barriers to Interprovincial Trade: Implications for Business* (Ottawa: The Conference Board of Canada, 1992).

2 Note that all of these figures include instances where the respondent indicated that the barrier was both federal and provincial.

# The Economic Literature on the Effect of Barriers to Competition on Productivity

### Chapter Summary

- The literature on measuring openness to trade provides a number of different methodologies for measuring the extent of barriers to competition.
- From the Conference Board's perspective, the best approach uses international price differentials for tradable goods to estimate the size of tariff and non-tariff barriers to competition.
- There has been little research on the relationship between non-tariff barriers and the Canada–U.S. productivity gap.

Chapter 2 examined the current state of both tariff and non-tariff barriers in Canada and concluded that, while tariff barriers have declined significantly in both absolute and relative terms, NTBs remain pervasive. Chapter 3 indicated that NTBs to competition raise business costs and prevent businesses from operating in certain markets.

The research results reported in chapters 2 and 3 suggest that it would be important to investigate the extent to which barriers to competition contribute to the Canada–U.S. relative productivity gap. This chapter presents the results of a literature review aimed at deriving a methodology for exploring this research question.

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**A lot of research exists on the effect on productivity of removing international tariff barriers, but little on non-tariff barriers.**

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Little has been written on the precise relationship between NTBs and the productivity gap between industries in Canada and the United States. However, a significant amount of research exists on the effect on productivity of removing international tariff barriers—and this information is important for guiding empirical work on the relationship between barriers to competition and Canada–U.S. relative productivity.

Given the dearth of literature on the impact of NTBs on productivity, it was necessary to examine methods for measuring the degree of trade protection present in an economy as a result of tariffs and NTBs. When the degree of protectionism is combined with existing work on measuring the size of the productivity gap between

industries in Canada and the United States, the stage is set for an empirical analysis of the relationship between barriers to competition and Canada–U.S. relative productivity.

## MEASURING PROTECTION

The fact that countries protect their industries in a number of different ways complicates attempts to measure protection. The proliferation of bilateral and multilateral free trade agreements has fostered significant reductions in tariff barriers, but governments in both industrialized and developing countries continue to protect markets with non-tariff barriers. In many cases, it is difficult to know if a government is using regulation appropriately to protect the population or achieve policy goals in a legitimate fashion or if it is simply trying to protect a domestic market from competition.

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### **Countries protect their industries in different ways, complicating attempts to measure protection.**

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The attempt to measure the impact of all possible barriers to competition for all tradable goods and services on the flow of international trade represents a significant challenge. Fortunately, the literature describes a number of different methods of measuring barriers to competition between different countries.

## ECONOMETRIC MODELS

Several economists have built econometric models to estimate the trade that would have taken place in the absence of existing trade barriers. These results are then compared with the trade that actually occurred. Two different types of empirical models have been used to estimate trade in a “no trade barrier” scenario. The Heckscher-Ohlin model, originally developed in the 1920s, stresses differences in factor endowments as the primary determinants of trade; the Helpman-Krugman model makes product differentiation and scale economies the central forces determining trade. In both these approaches, the difference between the international trade actually observed and the predictions of the models is attributed to trade barriers. Leamer (1987) used the Heckscher-Ohlin model to explain cross-national net trade flows between 1958 and 1975 for 60 countries

with 10 aggregate sectors and found that patterns of trade among different countries cannot necessarily be explained by a country’s factor endowments.<sup>1</sup>

The use of trade models to measure the presence of barriers to competition has one drawback that is often noted by economists using this approach: it is difficult to determine the degree to which the differences between the predicted and actual trade flows reflect the effect of barriers to competition or whether the differences are simply a result of model misspecification and/or data mismeasurement.

## UNIT VALUES

Another approach to measuring the impact of barriers to competition compares the unit values of domestic and imported goods. Unit values are derived from detailed trade data and are calculated by dividing the declared value of imports by the appropriate physical unit of measure (e.g., dollars per tonne of wheat). If the unit value of an imported good is lower than the unit value of its domestic counterpart, the difference should be due to the existence of tariff and/or non-tariff barriers. For example, if the unit value of an imported good is 100 and the unit value of its domestic counterpart is 150, the implication is that the domestic industry garners tariff-equivalent protection of 50 per cent of the imported unit value. If the tariff on this product is 5 per cent, the remaining gap (45 per cent) should, in theory, be attributable to NTBs.

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### **We can measure the impact of barriers by comparing the unit values of domestic and imported goods.**

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Sazanami (1995) compared the unit values of domestically produced goods and imported goods in Japan. He found that, since unit value differentials for Japanese imports far exceeded Japanese tariff rates, it was likely that non-tariff barriers were a more substantial cause of protection than tariff barriers. For instance, the unit values of televisions and radios produced in Japan were six times higher than the unit values of similar products imported into Japan. Common NTBs in Japan included import quotas, government procurement policies limited to domestically produced goods, price support programs and various restrictions resulting from the Japanese system of industrial organization.

While unit values can be used to analyze a wider range of commodities than is possible with price surveys (which are discussed below)—because unit values are available for more products—the system has serious methodological issues. Other explanations, such as quality, could explain the gap between domestic and imported unit values. Sazanami would have overestimated the actual level of protection for Japanese radios and televisions if these products were generally of higher quality than those of other countries.

### INVENTORY APPROACH

The United Nations uses an inventory approach to measure non-tariff barriers.<sup>2</sup> It has developed a database that includes a brief description of the nature of the barriers, the countries imposing them, the exporting countries affected by the barriers, and coverage ratios that compute the percentage of products within a sector in the different countries with NTBs. The database includes over 130 countries, and it is widely recognized as the most comprehensive international classification system available for NTBs.

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**The inventory approach is problematic in that the coverage ratios do not take into account the degree of restrictiveness of each NTB.**

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The database reveals that most consumer goods have a relatively low number of NTBs. The two sectors with the highest number of NTBs are textiles and clothing, and iron and steel. The European Union, Canada and India have relatively high NTB coverage for textiles and clothing, while the United States, Canada and the European Union have high coverage for iron and steel. On a country basis, India has a relatively high number of NTBs as do Canada and Taiwan. Australia, Peru and Singapore have relatively low numbers of NTBs.

The inventory approach is problematic in that the coverage ratios do not take into account the degree of restrictiveness of each NTB. One sector could have many products subject to minor NTBs, while another could have a few products subject to very restrictive NTBs. The sector with many products subject to minor NTBs would have a much higher coverage ratio than

the sector with the greater degree of protection. In addition, the coverage ratios could be distorted because they are not trade-weighted.

### PRICE DIFFERENTIALS

Due to the difficulties with the model-based, unit value and inventory approaches to measuring tariff and non-tariff barriers to competition, other economists have used price differentials between goods and services produced in different countries to measure the degree of protection. Bradford (2003) examined the differences in final selling prices for tradable goods in eight OECD countries in order to assess the degree of protection in each country. The underlying rationale for this approach is one of arbitrage: if selling prices, adjusted for indirect taxes, exchange rates and transportation costs, differ between countries, then there is an arbitrage opportunity that should equate prices. Firms in the country with the lower price will be able to undercut their competitors in the country with the higher price and will thus increase their market sales in the high price country until prices (adjusted for indirect taxes, exchange rates and transportation costs) between the two countries are equalized.

Persistent adjusted price differentials between countries are thus held to indicate barriers to competition—the greater the price differential, the more important the tariff and non-tariff barriers. Bradford found that the adjusted price differences between Canada and the United States averaged 15.2 per cent for tradable goods in 1993.

The price differential approach to measuring barriers to competition enables researchers to capture the combined impacts of all barriers, both explicit and implicit. (Implicit barriers can include any number of regulations and bureaucratic procedures.) This methodology also takes into account market power that could potentially result in non-competitive pricing. If domestic producers' prices are greater than the world price, Bradford argues, there must be barriers to competition supporting the gap even if prices have been established in non-competitive markets. Import-competing businesses, while they may be able to influence prices, cannot maintain a price above the prevailing world price without a trade barrier. Differences in demand also do not compromise Bradford's approach. A difference in demand for certain products

between two countries—especially two highly integrated countries such as Canada and the United States—can persist only if there is a trade barrier that enables differences in demand to emerge and be sustained.

Also of interest is the research by Baldwin and Yan (2004) dealing with price differences between similar products in Canada and the United States. While not directly comparable to the Bradford approach (because the authors did not adjust the price differentials for transportation costs and indirect taxes), their work does provide a starting point for comparing prices between the two countries. Baldwin and Yan used data from Statistics Canada's purchasing power parity (PPP) database, which contains more than 160 bilateral commodity prices over five benchmark years (168 goods and services for 1985, 1990, 1993 and 1996, and 165 goods and services for 1999). They compared prices for goods and services classified into three groups: homogeneous tradables, differentiated tradables and non-tradables. Non-tradables included services that could not be easily shipped across the border, such as hair cutting, other personal services and certain utilities. Products that crossed the border with ease were classified as tradable. Within the tradable category, standardized goods such as flour were grouped together as homogeneous tradables, while more heterogeneous products such as machinery and equipment were classified as differentiated tradables.

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**Comparisons of U.S. and Canadian prices to measure competition barriers must consider the slow reaction of Canadian prices to exchange rate adjustments.**

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Baldwin and Yan concluded that, for products that can flow relatively easily across the border, prices were about 3 per cent higher in Canada than in the United States. For non-tradable activities such as personal services, prices were on average 8 per cent less in Canada, likely because Canadian wages are lower than those in the United States. Shifts in comparative price levels between the two countries generally reflected changes in the exchange rate. In the long run, Canadian prices mirrored U.S. prices but generally reacted slowly to exchange rate movements. This suggests that comparisons of U.S. and Canadian prices to measure barriers to competition must carefully consider the time frame of the analysis due to the slow reaction of Canadian prices to exchange rate adjustments.

## **MEASURING THE PRODUCTIVITY GAP BETWEEN CANADA AND THE UNITED STATES**

A number of economists have attempted to measure the productivity gap between industries in Canada and the United States. Rao, Tang and Wang (2004) provide the most up-to-date method of analyzing this issue. The authors note that reliable estimates of Canada–U.S. productivity gaps are important for two reasons. First, an assessment of Canada's ability to compete effectively in international markets depends on Canada's productivity relative to that of the United States, the country's major trading partner. Second, Canada's ability to attract and retain physical and human capital depends on its ability to pay competitive returns to factors of production. These payments are determined by Canada's relative productivity—widening productivity gaps will erode Canada's future economic performance and generate an unwellcome cycle of poor economic growth, resulting in even wider gaps in both productivity and income between Canada and the United States.

### **THE INPUT–OUTPUT APPROACH**

The major challenge in measuring productivity gaps between industries in Canada and the United States is to develop bilateral purchasing power parity exchange rates by industry, because the use of market exchange rates can produce unreliable estimates of the productivity gap. Temporary factors such as cyclical movements in commodity prices or interest rates can result in market exchange rates that diverge sharply from the underlying structural level based upon relative rates of inflation. Rao, Tang and Wang used the methodology developed by Lee and Tang (2000) to measure purchasing power parity exchange rate estimates by industry and the 1999 benchmark data on expenditure-based bilateral PPPs for gross output, intermediate inputs, capital structure and value added for 31 industries. These estimates were then used to derive estimates of labour productivity and total factor productivity (TFP) gaps for the 31 industries for the period 1997–2001.

Their estimates revealed that the business sector Canada–U.S. labour productivity gap in 1999 was 18 per cent and the TFP gap was 14 per cent. In the manufacturing sector, the labour productivity gap was 18 per cent and the TFP gap was 9 per cent. The results also showed that Canada was less productive in terms of labour productivity than the United States in 17 of the industries, including machinery and computers, electronic and electrical

equipment, information and cultural industries, petroleum and coal products, fabricated metal, and textiles and clothing. On the other hand, Canada was more productive in resource-based industries such as primary metals, paper and non-metallic mineral products. According to Rao, Tang and Wang, differences in capital intensity explained about 25 per cent of the economy-wide labour productivity gap and about 50 per cent of the productivity gap in the manufacturing sector.

They note that their estimates of the productivity gap are generally lower than some previous estimates, mainly because of differences in the estimates for PPP exchange rates for some of the industries. The new PPP exchange rates are smaller than some of the previous estimates and, as a result, the labour productivity gaps are also lower.

The main drawback of the research by Rao, Tang and Wang is that the level of aggregation to 31 industries may hide some important productivity differences among industries that would have appeared with a greater level of disaggregation. However, the challenge of deriving PPPs by industry makes it extremely difficult to measure the productivity gap at a greater level of disaggregation.

### **THE PRODUCTION FRONTIER APPROACH**

Harchaoui and Dachraoui (2003) used a different approach to measure the productivity gap between industries in Canada and the United States. They measured multi-factor productivity growth based on the production frontier, a method that benchmarks industries against an estimated best-practice production frontier. The optimal frontier reveals the maximum possible output that can be generated from different combinations of inputs. The authors constructed a North American frontier for the business and manufacturing sectors based on data from the two countries. They then compared each industry with the ideal frontier.

The authors concluded that multi-factor productivity growth in the aggregate business sector in Canada lagged behind that of the United States for the 1981–2000 period. The main factor accounting for the difference was an ongoing deterioration in technical efficiency because of a slower rate of diffusion of best-practice technology in

Canada. The Canadian manufacturing sector had lower multi-factor productivity than its U.S. counterpart because of weaker technical efficiency.

The authors found that using a production frontier approach to measuring the productivity gap produced results similar to those of the more traditional standard growth accounting approach. The standard growth accounting approach determines multi-factor productivity as a residual difference between the growth in output and the growth in labour and capital inputs. Both approaches indicated that productivity is higher in the U.S. manufacturing sector. However, the gap was larger when using the benchmarking frontier approach (0.7 percentage points versus 0.3 points). The main limitation of the study with respect to its usefulness for our study is that the analysis does not include the services sector of the economy.

### **REMOVING THE REMAINING TARIFFS: WHAT IS THE EFFECT ON THE ECONOMY?**

Several studies have examined the impact of the Canada–U.S. Free Trade Agreement (FTA) on indicators such as employment and productivity in Canada. The most up-to-date research on issues surrounding the Agreement originates from Trefler (2004) and Baggs (2004). The advantage of Trefler’s approach is that his methodology considers both industry- and plant-level data, and he uses more disaggregated tariff data to analyze trade liberalization between Canada and the United States than does the earlier research by Levinsohn (1993), Harrison (1994), Tybout (1995) and Beaulieu (2000). Baggs’ approach is of interest because she looked at the impact of the FTA resulting from the decline in both Canadian and U.S. tariffs.

Trefler argues that the FTA provides a unique window into the effects of freer trade—the FTA, he notes, was a relatively clean policy experiment due to the absence of serious macro shocks or financial crises. From the analysts’ perspective, the agreement was between two industrialized countries and was a reciprocal agreement affecting both importers and exporters. Most of the previous studies on trade liberalization dealt with the unilateral trade actions taken by developing countries, which are less mature economies and more subject to shocks or crises.



Trefler's trade regression model looks at the impact on employment and productivity of tariff reductions for more than 200 industries. He regresses the change in economic variables such as productivity on changes in tariffs in both Canada and the United States. His point of comparison is a pre-FTA period from 1980 to 1986 and an FTA period from 1989 to 1996. Trefler arrives at the following conclusions:

- The FTA was associated with substantial employment losses: 12 per cent for industries that faced the greatest degree of competition from U.S. imports, such as the brewery, clothing and shipbuilding industries, and 5 per cent for Canadian manufacturing industries as a whole.
- The FTA resulted in significant gains in productivity. Labour productivity increased by 14 per cent at the plant level for the most export-oriented group of industries, such as chemicals. Productivity also improved by 15 per cent for the most import-competing group of industries. At least half of the productivity gains for the import-competing group of industries resulted from the exit or contraction of low-productivity plants.
- Labour productivity increased by 6 per cent for the entire manufacturing sector, which Trefler considers remarkable given that most pre-FTA manufacturing activity was duty-free. This result could be attributable to the fact that the low average duty on manufactured goods masked the high tariffs that still existed on certain goods. Thus there was still room for productivity improvements in certain manufacturing sectors after the FTA was implemented.
- The FTA created more trade than it diverted, and it reduced import prices.

Trefler also makes an important point about data aggregation. He notes that past studies of the effect of trade liberalization on different countries generally used more aggregated tariff data and, as a result, missed some important impacts on the economy resulting from lower tariffs. Had his analysis included a three-digit Standard Industrial Classification aggregation of 105 industries rather than the 213 industries that he did include, only a few industries would have had tariffs in excess of 10 per cent. This illustrates the importance of using disaggregated data—important details are lost when using higher levels of aggregation.

Baggs argues that most studies of the FTA have been deficient, since they omit both how falling U.S. tariffs affect Canadian firms and how a firm's structure influences its response to changes in tariffs. To model the reaction of firms to changing tariffs, she used the segmented markets Cournot model. In this model, firms make separate decisions for every market in which they compete, making choices for one market independently of the choices made in others. While costs vary across firms, each firm's marginal costs are held to be constant, which enables the assumption of independence.

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**One study concludes that the Free Trade Agreement resulted in significant gains in productivity.**

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Baggs concludes that the success or failure of Canadian companies following a reduction in tariffs often depends on the efficiency of the company. Larger, more productive firms have a higher chance of survival than less productive firms. The chance of survival for less productive firms improves if they operate in an industry with disproportionately large declines in U.S. tariffs, because of the relatively larger increase in demand that results for the industry's products. Debt levels also play a role in determining success or failure in a more competitive business environment. Highly leveraged firms have a much lower chance of survival than those with low debt levels.

The OECD (2005) recently completed a study that examined the impact of reducing barriers to competition on member countries' exports and real GDP growth. The barriers that were relaxed included competition-restraining product market regulations, such as barriers associated with state control of companies and state involvement in business operations. Obstacles that countries put in place to restrict foreign direct investment were included as were traditional tariff barriers.

The OECD calculated an overall product market regulation (PMR) index that measured the regulatory burdens imposed by inward-oriented economic policies. A high PMR score indicates that a country has implemented relatively restrictive product market regulations. Canada's PMR indicator of slightly more than 1 was

relatively low compared with those of other OECD countries (Poland's ranking was highest at close to 3). Canada's ranking in terms of foreign direct investment (FDI) restrictions was not as positive. In fact, Canada was ranked third worst, ahead of only Turkey and Iceland. Canada's Most Favoured Nation tariff levels were below the OECD average.

### **INTERNAL TRADE BARRIERS: WHAT IS THE COST?**

Little research has been done in Canada on non-tariff barriers to competition. The aim of the few studies found was to estimate the additional costs that Canadian companies or consumers are forced to absorb because of these NTBs to interprovincial trade.

In a 1994 report, the Fraser Institute noted that non-tariff barriers cost Canadians at least \$6.5 billion per year in lost income. The figure came from Rutley (1991) of the Canadian Manufacturers Association, who stated that between 10 and 15 per cent of Canada's GDP was affected by goods and services barriers to competition that undermined Canadian industrial productivity. Rutley criticized the fact that governments had no list of interprovincial trade barriers, which by his calculations numbered over 500, and referred to a report written by Smith Gunther and Associates Ltd. for the federal Department of Industry, Science and Technology that listed over a thousand pages of interprovincial barriers to competition in Canada.

Rutley postulated that government departments and agencies were buying goods and services at prices at least 5 per cent higher than the lowest price possible solely because they were buying locally. Since the government's purchase of goods and services in 1990 totalled \$100 billion, it thus cost the government (i.e., Canadians) \$5 billion more to buy locally. To this \$5 billion cost, Rutley added another \$1.5 billion, which he estimated represented the additional provincial margin charged to consumers on alcoholic beverages (\$500 million) and agricultural products (\$1 billion). However, the author did not provide a clear methodology as to

how he arrived at these figures. For instance, he referred to two other studies, one on the beer market, which has changed considerably since 1990, and another by the Economic Council of Canada, published in 1981. The cost estimates are therefore questionable. Nevertheless, his study is the only one that attempts specifically to calculate the cost associated with interprovincial barriers to competition in Canada.

### **SUMMARY**

The literature on measuring the extent of barriers to competition, as well as the challenges involved in measuring productivity by industry across countries, contains critical information for the next chapter, which undertakes an empirical examination of whether barriers to competition affect relative Canadian-U.S. productivity. The literature on measuring openness to trade provides a number of different methodologies for tackling this issue.

In our judgment, the best approach is the one taken by Bradford, who used price differentials between tradable goods to measure the presence of barriers to competition. This methodology is particularly applicable to analyzing barriers to competition between Canada and the United States because of the vast amount of price information that is available for a wide range of commodities.

The research completed by Baldwin and Yan dealing with price differences between the two countries is also useful in this regard. The criticisms of Bradford's analysis (concerning the influence of non-competitive markets and differences in demand conditions between the two countries), while valid, are less of a concern when comparing prices between Canada and the United States due to the high degree of economic integration.

Finally, the research by Rao, Tang and Wang is invaluable when assessing the productivity gap between industries in Canada and the United States. The work is current, includes the latest data on PPP and provides much of the data required to perform the analysis outlined in the next chapter.

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1 For an in-depth discussion of the impact that factor endowments can have on trade patterns for industrial economies, including Canada, see the 1996 edition of The Conference Board of Canada's *Performance and Potential* report.

2 UNCTAD Database on Trade Control Measures.

# Empirical Results Regarding the Link Between Barriers to Competition and Canada–U.S. Relative Productivity

### Chapter Summary

- The empirical results suggest that barriers to competition have a negative effect on productivity for a core group of 16 industries in the primary and manufacturing sectors of the Canadian economy.
- Canada could thus narrow the productivity gap with the United States by lowering barriers to competition in this core group of industries.
- The empirical results also suggest that for the services sector, which represents two-thirds of the Canadian economy, barriers to competition do not explain Canada's lower productivity performance compared with that of the United States.
- Given the importance of the services sector as a share of economic activity, the results indicate that policy-makers must look to other factors, in addition to barriers to competition, for a complete explanation of the Canada–U.S. productivity gap.

Chapter 2 described the vast array of international and interprovincial barriers to competition in Canada. The many forms that international and interprovincial barriers to competition can take makes the task of determining the link between tariff or non-tariff barriers and the productivity of Canadian industry difficult and demanding. The difficulty arises in part because the costs associated with these barriers can have an impact at different stages in the production and marketing of any given good or service—barriers to competition may increase input prices or transportation costs, or may simply maintain final selling prices at levels higher than would be the case under increased competition. Almost certainly, however, the impact from maintaining these barriers to competition will be felt in higher final selling prices.

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**Higher barriers to competition could explain the lower level of productivity in Canada.**

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The information contained in market prices thus reveals the scale of existing tariff and non-tariff trade barriers, especially when making price comparisons between countries—in this case, between Canada and the United States. Conference Board research on productivity differences at the industry level suggests that higher barriers to competition in Canada relative to the United States could be important in explaining the much lower level of Canadian productivity in certain industries.<sup>1</sup> The research described in this chapter tests this hypothesis by determining whether there is a

significant correlation between differences in selling prices by industry in each country (a proxy for the relative magnitude of trade barriers) and differences in productivity by industry in each country.

## METHODOLOGY

The methodology of this study is based upon the work of Bradford (2003), which is the most suitable approach to measuring the size of tariff and non-tariff barriers (see Chapter 4). Bradford measured the degree of protection in eight OECD countries by looking at the differences in producer prices adjusted for transportation costs for tradable goods in each country. His results indicated that the adjusted price wedge between Canada and the United States averaged 15.2 per cent for tradable goods in 1993.

Bradford's price information came from the OECD retail prices database. With the support of member governments, the OECD regularly gathers the retail prices of approximately 3,000 final goods to calculate purchasing power parity exchange rates between member countries. Although the prices are collected at a very detailed level, the data are aggregated at a level that is called "basic heading" (about 200 categories). Of these, Bradford used 124 basic headings representing goods traded on international markets.

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**To accurately measure the extent to which industries are isolated by trade barriers, international transportation costs must be factored in to the carefully calculated producer prices.**

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The prices in the OECD database are retail prices rather than the producer prices that are needed to measure the extent to which an industry is isolated from world competition by barriers to competition. In general, producer prices are not available for the services sector, and hence we need to adjust the retail prices to create proxies for producer prices. Thus Bradford first converted retail prices to producer prices by excluding wholesale and retail trade margins and transportation costs. The trade margins are found in the input-output commodity matrices for the various countries. With this information in hand, it is possible to determine which countries have the lowest commodity prices (adjusted for

exchange rates). However, an additional step is needed to measure the extent to which industries are isolated by trade barriers: international transportation costs must also be factored in.

To be sold abroad, a good or service must first travel from the production source to the border and then to the market in the foreign country. Only when these transportation costs have been added to the industry selling price can the price of the domestic good be compared with the competing foreign price to evaluate the existence of a relative trade barrier. To establish this international selling price, Bradford used data on export margins (markups by the exporter) and international transportation costs.

Export margins, which tend to be rather low and similar from one country to another, are available from national input-output tables; international transportation costs can be estimated from U.S. trade data. The United States publishes the import values for roughly 260 commodities on both a cost/insurance/freight (CIF) and free-on-board (fob) basis; the CIF/fob ratio is a good measure of the costs of shipping goods from abroad to the United States. To determine what he termed the "world reference price" of a good, Bradford used the following steps:

1. Convert retail prices to producer prices by subtracting retail and wholesale trade margins and transportation costs.
2. Calculate export prices by commodity for each country by adding the producer price derived in step 1 to the corresponding export margin and expressing each resulting price in U.S. dollars.
3. Derive a "world reference price" by adding international transportation costs only to the lowest country's price for any given commodity, under the assumption that this country's good would potentially be the one to exploit arbitrage opportunities through export.
4. Calculate tariff rates by commodity from input-output tables.
5. Calculate the final measurement of protection on a given commodity as the higher of either the price differential with respect to the world reference price or the tariff. Thus, if the price differential is lower than the tariff, the tariff becomes the measure of the trade barrier.

For the research that underpins this chapter, Bradford's approach had to be slightly modified. Bradford used basic heading price data from the 1993 OECD survey conducted in the spring of 1991 and fall of 1993. However, the major changes to barriers to competition that have occurred in Canada since then, including NAFTA in January 1994 and the Agreement on Internal Trade in July 1995, meant that the Canada–U.S. price comparison data needed to be updated.

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**Building upon previous studies, we were able to analyze a potential link between productivity and price differentials for 26 industries in Canada.**

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The confidential nature of price information in the database made it difficult to reproduce Bradford's (2003) methodology using results from a more recent OECD survey. However, the study conducted by Rao, Tang and Wang (2004) generated basically the same data using 1999 OECD prices to measure productivity differences by industry between Canada and the United States. The study served as a crucial foundation for the research in this chapter, as it presents the Canada–U.S. price differentials by industry rather than commodity. This made it possible to analyze a potential link between productivity and price differentials for 26 industries in Canada.

As noted in Chapter 4, Rao, Tang and Wang developed expenditure-based bilateral PPPs for gross output, intermediate inputs, capital structure and value added to derive estimates of Canada–U.S. relative productivity and total factor productivity gaps for 31 industries for 1997, 1999 and 2001.

Of most relevance to this research were the Canada–U.S. bilateral expenditure-based PPPs for gross output for 1999. A gross output PPP is defined as the amount of Canadian dollars received by a Canadian producer from selling the same quantity of goods and services that a U.S. producer sells for one U.S. dollar. To be converted to production-based commodity PPPs at producer prices, the expenditure-based commodity PPPs must be adjusted for margins (including indirect net commodity taxes, retail and wholesale trade margins, and transportation costs). All the margin rates for each commodity were estimated from input–output accounts in Canada and the United States.

Indeed, the only real difference between the adjusted industry selling prices in Bradford's work and those in the Rao, Tang and Wang study is Bradford's addition of international transportation costs to producer prices. Transportation costs obviously represent a barrier to trade. If, for example, producer prices in the United States are 2 per cent less than in Canada, but the cost of transporting the good in question between the two countries adds 3 per cent, the U.S. products will not be competitive in Canada, and Canadian producers will be able to charge a higher price.

An overview of statistics on international transportation costs between Canada and the United States (as measured by the CIF/fob ratios) shows that these costs accounted for an average of 1.65 per cent of the value of traded goods in 1999. In view of the generally very small overall importance of international transportation costs in the Canada–U.S. context, it was decided to ignore them in the current analysis, although it is possible that international transportation costs could be much higher for industries that generate products with low value-to-weight ratios.

The gross output PPPs by industry calculated by Rao, Tang and Wang represent the ratio of Canadian and U.S. producer prices for an identical product converted through the input–output matrices from commodity space to industry space. To determine the appropriate measure of the price gap by industry, these ratios (PPP<sub>s</sub>) must be converted into Canadian dollars by dividing them by the value of the Canadian dollar for an appropriate reference period.<sup>2</sup>

## **EVALUATION OF THE PRICE DIFFERENTIALS BETWEEN THE UNITED STATES AND CANADA**

Choosing the proper exchange rate for converting the prices into a common currency (in this case U.S. dollars) is complicated by the fact that it takes time for arbitrage to occur, as Baldwin and Yan (2004) found in their research. They concluded that comparative price variations between Canada and the United States over the short run generally reflect fluctuations in the exchange rate. Moreover, subsequent to these exchange rate movements Canadian prices are slow to react in re-establishing underlying differentials through arbitrage.

The Baldwin and Yan study dealt with price differences between similar products in Canada and the United States. Although not directly comparable to the Bradford approach (because the researchers did not adjust the price differentials for transportation costs and indirect taxes), the study sheds light on the movements in Canada–U.S. relative prices over time.

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**A good estimate of the time required for relative prices to adjust to arbitrage opportunities can be found in the literature on the “J-curve” effect.**

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Baldwin and Yan used data from Statistics Canada’s PPP database (which serves as input into the OECD retail prices database). This database contains more than 160 bilateral commodity prices over five benchmark years (1985, 1990, 1993, 1996 and 1999). They compared prices for close to 170 goods and services, classified into three groups: homogeneous tradables, differentiated tradables and non-tradables. They determined that the correlation between changes in price ratios and the exchange rate varies from product to product. For non-tradables, for example, the impact of exchange rate movements on price ratios tends to persist because of the lack of arbitrage opportunity. For homogeneous tradables, such as coffee or motor vehicles, variations in the U.S. dollar price ratio only partly reflect exchange rate variations.

A more precise estimate of the time required for relative prices to adjust to arbitrage opportunities can be gleaned from the literature on the “J-curve” effect. This literature examines the path of the nominal trade balance following an exchange rate shock. For example, under exchange rate depreciation, the initial effect is normally to worsen the nominal trade balance as import prices rise and export prices fall. Trade volumes take longer to adjust as contracts may apply and it takes time to find new suppliers. Eventually, however, trade volumes adjust to the new relative price regime. Normally the higher export volumes and lower import volumes that result overwhelm the price effects, leading to an improvement in the current account balance.

The speed of adjustment in trade volumes following an exchange rate shock is important for gauging the time required for arbitrage to equilibrate prices between Canada and the United States as exchange rates move. Similar

to the adjustment process following an exchange rate shock, the arbitrage process involves finding new suppliers at lower prices until measured prices are equilibrated. However, the time involved for arbitrage to equilibrate prices is longer than that required for nominal trade balances to improve following an exchange rate depreciation, because the volume changes must have time to feed back into prices until a new equilibrium is achieved.

The most recent research on the Canada–U.S. J-curve appears in a 1996 paper by Marwah and Klein. Their results for Canada suggest a mean lag of five quarters for the full adjustment in the current account balance to occur following an exchange rate shock. The longer time required for arbitrage to eliminate any price differentials suggests a period of adjustment of at least two years following an exchange rate shock before price differentials are eliminated.

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**The arbitrage process involves finding suppliers with lower prices until the prices are equilibrated.**

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In light of these findings, the exchange rate movements presented in Chart 3 help to identify the most appropriate exchange rate to use for Canada–U.S. industry selling price comparisons. The Canadian dollar depreciated sharply from US\$0.873 in 1991 to US\$0.732 in 1994, but then averaged close to the US\$0.73 level over the four years from 1994 to 1997. It could thus be argued that by 1999, prices between Canada and the United States would have had time to adjust to a US\$0.73 level, with arbitrage serving to bring prices closer to underlying equilibrium ratios, where these equilibrium price ratios included the impact of any trade barriers.

However, the further depreciation to about US\$0.67 in 1998 and 1999 would likely distort observed price differentials—there would not have been enough time for the arbitrage process to take place. The research suggests that a better exchange rate for comparing 1999 Canada–U.S. industry prices would be the average exchange rate that prevailed from 1994 to 1997, which was US\$0.73.

Column 2 in Table 12 gives the industry price comparisons using an exchange rate of US\$0.73. It indicates that Canadian prices are significantly higher (by at least 5 per cent) than U.S. prices in 11 industries.

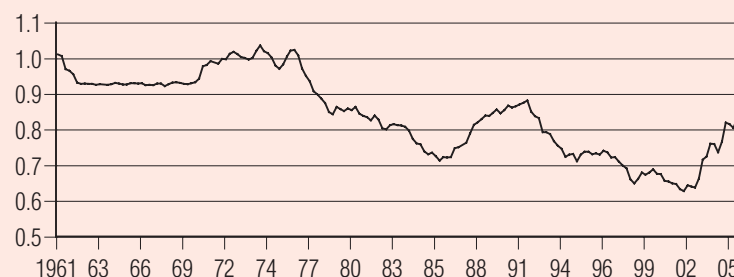
This suggests relatively higher barriers to competition on the Canadian side of the border in these industries, which include traditionally protected industries such as agriculture and textiles, and less obviously protected manufacturing industries such as fabricated metals and machinery. Canadian prices are at least 5 per cent lower than U.S. prices in 14 cases, suggesting higher relative U.S. barriers for these industries. On the manufacturing side, these include paper, printing and publishing, primary metals and non-metallic minerals. Yet the vast majority of the lower-priced industries are in the services sector or construction, which are, in most instances, non-tradable.

Much more work would be required to explain the existing price differentials in non-tradable industries. As Baldwin and Yan point out, the adjustment process for relative prices in the non-tradable sector is much longer than in the tradable goods sector. Perhaps these prices still reflect the even higher Canadian dollar that prevailed prior to 1994. Alternatively, Canadian services industries may be more productive than their U.S. counterparts and may operate in a more competitive environment. Or perhaps, as Baldwin and Yan suggest, the lower Canadian prices result from lower Canadian nominal input prices, especially labour. Finally, appropriately measuring services sector selling prices is difficult, and the generally lower Canadian prices in the services sector may simply reflect data measurement problems. However, analyzing the causes of the generally lower Canadian relative prices for non-tradable goods is beyond the scope of the current study.

## PRICE DIFFERENTIALS AND THE PRODUCTIVITY GAP

Do barriers to competition in Canada, whether tariff or non-tariff, allow Canadian businesses to maintain a lower level of productivity? The answer is generally independent of exchange rate movements, which in themselves simply move the price ratios up or down in lockstep; thus any correlation of price ratios for Canadian and U.S. industries and productivity ratios for the same industries is not altered by different exchange rates. It is important to note, however, that a high correlation between the price ratios and the productivity ratios does not mean that Canada has high trade barriers, but simply that the relative size of the Canada–U.S. barriers is related to the productivity differential.

**Chart 3**  
Exchange Rate  
(\$CDN/\$US)



Source: Statistics Canada.

A good starting point for the discussion is to plot the relative price ratio (column 2 of Table 12) against labour productivity (column 3 of Table 12), where the productivity data are derived from Rao, Tang and Wang. Building on the work of Baldwin and Yan, and to better assess the relationship between these two variables, we removed some industries from the list either because they are not readily traded internationally or because the price data are suspect. These industries are construction, retail trade, transportation, finance, insurance and real estate, and other services. For certain other industries, labour productivity figures were unavailable for 1999. Accordingly, only 22 points appear in Chart 4, whereas at the outset, PPPs were available for 31 industries.

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### The relative price data suggest higher barriers to competition in Canada in 11 industries, including agriculture, textiles, fabricated metals and machinery.

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Chart 4 is divided into four quadrants. Quadrants I and II include those Canadian industries that show higher producer prices than their U.S. counterparts; quadrants III and IV show Canadian industries that have lower producer prices than their U.S. equivalents (at an exchange rate of US\$0.73). At the same time, Canadian industries in quadrants II and III have higher labour productivity than their U.S. competitors, while Canadian industries in quadrants I and IV are relatively less labour-productive.

**Table 12**  
Gross Output PPPs\*, Relative Producer Prices and Productivity, by Industry, 1999

Industry	PPP gross output	Price ratio** (Canada/U.S.)	Labour productivity ratio (Canada/U.S.)	Multi-factor productivity (MFP)
<b>Primary Industries</b>	1.43	1.04	0.84	0.76
1 Agriculture	1.48	1.08	0.80	0.90
2 Mining	1.36	0.99	1.07	0.85
3 <b>Construction</b>	1.03	0.75	1.20	1.19
<b>Manufacturing Industries</b>	1.37	1.00	0.82	0.91
4 Food, beverage and tobacco	1.34	0.98	0.77	1.04
5 Textiles and clothing	1.52	1.11	0.68	0.80
6 Wood products	1.49	1.09	1.11	0.92
7 Paper	1.26	0.92	1.17	0.99
8 Printing and publishing	1.13	0.82	1.02	1.28
9 Petroleum and coal products	1.34	0.98	0.48	0.47
10 Chemicals	1.18	0.86	0.86	0.93
11 Plastic and rubber products	1.44	1.05	0.74	0.86
12 Non-metallic mineral products	1.18	0.86	1.14	1.22
13 Primary metal	1.30	0.95	1.34	1.31
14 Fabricated metal	1.67	1.22	0.51	0.66
15 Machinery and computer	1.55	1.13	0.70	0.87
Machinery	1.59	1.16	n.a.	n.a.
Computer	1.44	1.05	n.a.	n.a.
16 Electronic and electrical equipment	1.46	1.07	0.63	0.98
Communications equipment	1.47	1.07	n.a.	n.a.
Other electronic equipment	1.44	1.05	n.a.	n.a.
Electrical equipment	1.49	1.09	n.a.	n.a.
17 Motor vehicle	1.38	1.01	1.09	1.07
18 Other transportation equipment	1.37	1.00	1.13	1.36
19 Furniture and related products	1.46	1.07	0.71	0.86
20 Miscellaneous manufacturing	1.33	0.97	n.a.	n.a.
<b>Services Industries</b>	1.17	0.85	0.79	0.83
21 Utility	1.26	0.92	0.77	0.64
22 Wholesale trade	1.18	0.86	0.71	1.05
23 Retail trade	1.18	0.86	0.85	0.93
24 Transportation	1.18	0.86	0.98	0.97
25 Information and cultural	1.17	0.85	0.65	0.80
26 Fire	1.13	0.82	0.58	0.86
27 Business	1.20	0.88	0.79	0.96
28 Other services	1.00	0.73	0.83	n.a.
<b>Private Business Sector</b>	n.a.	n.a.	0.82	0.86

\* Purchasing power parity

\*\* This column is based on calculations by The Conference Board of Canada using a 73 cent Canada/U.S. exchange rate.

Sources: Rao, Tang and Wang (2004).



Quadrant I holds seven industries that exhibited lower productivity and higher output prices. Quadrant II holds only one Canadian industry—the wood products industry—that was more productive than its counterpart in the United States and had significantly higher prices. Another industry, motor vehicles, was more productive than its U.S. counterpart, but prices were only slightly above those in the United States. Quadrant III shows that labour was more productive in Canada than in the United States in five industries, while prices were relatively lower in Canada. Quadrant IV shows that seven industries have lower relative output prices in Canada as well as lower labour productivity. The sloped line on the graph represents a simple linear regression between the two variables.

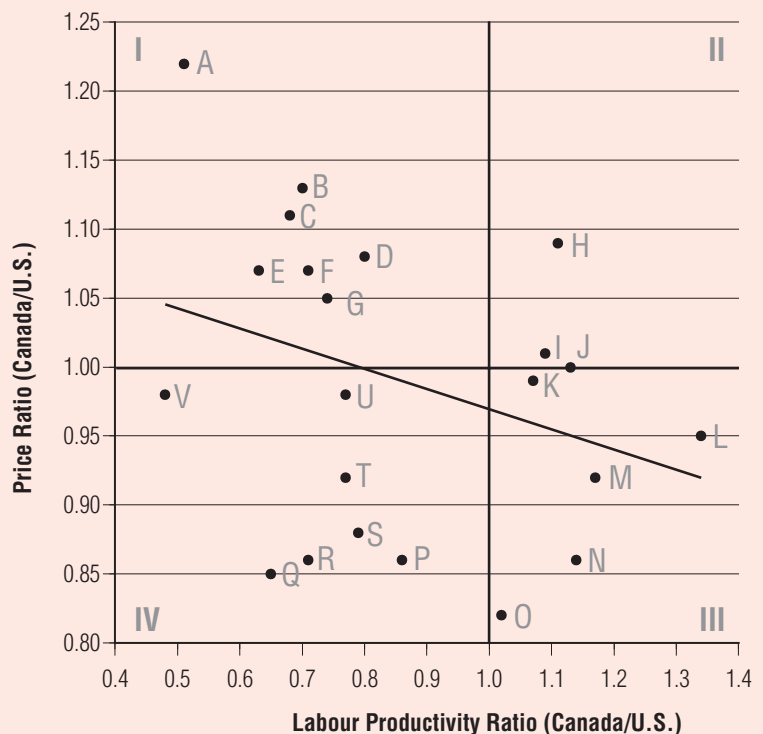
**Further elimination of barriers would pay dividends in closing the productivity gap with the U.S.**

The link between relative labour productivity and relative selling prices is weak, with a correlation coefficient of  $-0.32$  and a  $t$ -statistic of  $-1.51$ . It is therefore not possible to reject the hypothesis that the coefficient is equal to zero with a confidence level of 95 per cent. The minus sign is nonetheless consistent with the argument that barriers to competition are hurting relative Canadian–U.S. productivity. A negative correlation means that the higher relative prices are in Canada, the lower Canadian productivity is relative to that of the United States. Given the hypothesis that higher relative prices are the result of barriers to competition, the inference is that higher barriers to competition lead to lower productivity.

The relationship becomes much stronger if all the services industries are excluded. The correlation coefficient jumps to  $-0.55$  and the  $t$ -statistic to  $-2.63$ , which is significant. The relationship between relative productivity and relative prices is therefore much stronger for primary and manufactured goods than for services. The jump in the correlation coefficient when all services industries are excluded reflects both their non-tradable nature and difficulties in measuring relative prices in the services sector.

The results are important. They strongly suggest an inverse relationship between higher relative prices in Canada and productivity in the primary goods and manufacturing sectors. Because the higher relative

**Chart 4**  
Relative Producer Price Versus Relative Labour Productivity  
(Canada and U.S., 22 industries)



**Industries**

- |   |                                     |   |                                     |
|---|-------------------------------------|---|-------------------------------------|
| A | Fabricated metal                    | L | Primary metal                       |
| B | Machinery and computer              | M | Paper                               |
| C | Textile and clothing                | N | Non-metallic mineral products       |
| D | Agriculture                         | O | Printing and publishing             |
| E | Electronic and electrical equipment | P | Chemicals                           |
| F | Furniture and related products      | Q | Information and cultural industries |
| G | Plastic and rubber products         | R | Wholesale trade                     |
| H | Wood products                       | S | Business services                   |
| I | Motor vehicle                       | T | Utility                             |
| J | Other transportation equipment      | U | Food, beverage and tobacco          |
| K | Mining                              | V | Petroleum and coal products         |

Source: Rao, Tang and Wang (2004).

prices reflect barriers to competition, the research suggests that further elimination of barriers to competition in Canada would indeed pay dividends in closing the productivity gap with the United States.

In their analysis, Rao, Tang and Wang also calculated multi-factor productivity (MFP), generally considered to be a broader measure of productivity performance than labour productivity. The results by industry are set out in the last column of Table 12. On average, for all industries, Canada remains less productive than the United States on an MFP basis, although the gap is slightly smaller. According to Rao, Tang and Wang, the Canada–U.S. productivity gap is reduced to

14 per cent for MFP compared with 18 per cent for labour productivity. The difference lies primarily in the manufacturing sector, where Canada is 18 per cent less productive on a labour productivity basis but only 10 per cent less productive on an MFP basis. The better Canadian MFP performance is attributable mainly to Canada's lower capital intensity, particularly for machinery and equipment. The Rao, Tang and Wang study made it clear that differences in capital intensity accounted for 25 per cent of the labour productivity gap for the entire economy and 50 per cent of the gap in the manufacturing sector.

In general, the results obtained from comparing relative prices with multi-factor productivity are little changed from comparing them with labour productivity. The correlation between MFP and the relative price ratio for the set of 22 tradable industries is  $-0.36$ , only slightly higher than for labour productivity and also not statistically significant. If all services industries are excluded and only the 18 primary and manufacturing industries taken into account, the correlation coefficient becomes  $0.53$ , slightly below the corresponding results for labour productivity. In this case, the  $t$ -statistic becomes  $-2.50$ , indicating that the correlation coefficient is statistically significant. As was the case for labour productivity, the relationship between relative MFP and relative prices is much stronger for primary and manufactured goods than for services.

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**On average, for all industries, Canada is less productive than the United States on an MFP basis.**

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An analysis of the results for these 18 industries indicates that two industries—petroleum and coal products, and chemicals—have MFPs that are much lower than their relative price position would suggest. Excluding these two industries generates the picture presented by Chart 5, which clearly illustrates a much tighter relationship between relative output prices and multi-factor productivity than for the 22 industries shown in Chart 4. This is confirmed by a very strong correlation coefficient ( $-0.78$ ) between the output price and productivity ratios for the 16 industries represented in Chart 5. Clearly, for this set of core tradable manufacturing industries, a very strong negative relationship exists between relative prices and productivity performance vis-à-vis the United States.

## THE HIGH LEVEL OF AGGREGATION LIMITS THE ANALYSIS

The high level of aggregation in the analysis can complicate the effort to identify the relationship between productivity gaps and price differentials by industry. A high level of aggregation can hide the fact that large barriers to competition exist in relatively small subsectors of certain industries, particularly in the agriculture sector of the economy. The price ratio of  $1.08$  in this sector indicates that while barriers to competition exist, they are not overly large. However, as noted in Chapter 2, a number of sub-components of the agriculture industry are heavily regulated, such as the dairy industry and the egg and poultry industry. More disaggregated data would likely reveal much larger price differences between Canada and the United States for dairy products and poultry given the presence of significant barriers to competition.

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**A high level of aggregation can hide the fact that large barriers to competition exist in relatively small subsectors of certain industries, particularly in the agriculture sector.**

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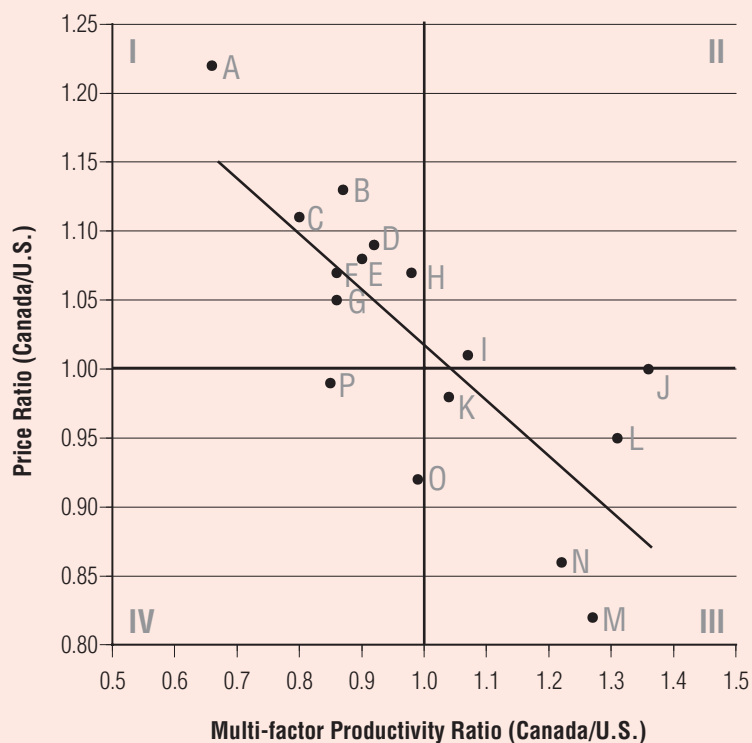
The high level of aggregation thus also has an impact on the correlation analysis. The results for all industries suggests a weak negative link between productivity and the ratio of prices between Canada and the United States. This could lead to the erroneous conclusion that barriers to competition in Canada are not a strong factor in explaining why Canada's productivity is lower than that of the United States. However, when the services sector is excluded from the correlation analysis, the results clearly reveal that barriers to competition play a role in explaining the difference in productivity between Canadian and U.S. manufacturers. Similarly, if it were possible to further disaggregate the agricultural sector, for example, the results would likely show a stronger link between barriers to competition and productivity. Future research in this area should pursue the relationship between price and productivity differentials at a more disaggregated level. Finally, further disaggregated data and a pooling of time-series with cross-sectional data would help dispel the possibility that for a significant number of industries, the observed price differences (again, adjusted for the exchange rate, wholesale and retail trade margins, indirect taxes and transportation costs) are the result of factors other than barriers to competition.

## SUMMARY

The results provided in this chapter show that barriers to competition have a negative effect on productivity for a core group of 16 industries in the primary and manufacturing sectors of the Canadian economy. Thus, Canada could narrow the productivity gap with the United States by lowering barriers to competition in the tradable goods sector. Furthermore, because international tariffs in most sectors of the Canadian economy have virtually been eliminated, the government must now focus on reducing non-tariff barriers to competition.

However, the 16 industries for which the relationship between barriers to competition and productivity is strongest represent only 20.5 per cent of the economy. For the Canadian services sector as a whole, which represents two-thirds of the Canadian economy, barriers to competition do not appear to explain Canada's lower productivity performance vis-à-vis the United States. Given the importance of the services sector as a share of economic activity, the results indicate that policy-makers must look to other factors, in addition to barriers to competition, for a complete explanation of the Canada–U.S. productivity gap.

**Chart 5**  
Relative Output Prices Versus Relative Multi-factor Productivity  
(Canada and U.S., 16 industries)



### Industries

A	Fabricated metal	I	Motor vehicle
B	Machinery and computer	J	Other transportation equipment
C	Textile and clothing	K	Food, beverage and tobacco
D	Wood products	L	Primary metal
E	Agriculture	M	Printing and publishing
F	Furniture and related products	N	Non-metallic mineral products
G	Plastic and rubber products	O	Paper
H	Electronic and electrical equipment	P	Mining

Source: Rao, Tang and Wang (2004).

1 For more information, see The Conference Board of Canada, *Performance and Potential 2004–05* (Ottawa: The Conference Board of Canada, 2004). Chapter 2 of this report compared average productivity levels for 29 industries in Canada and the United States. The industries in Canada that had lower productivity levels than their U.S. counterparts were: mining; other services; business services; agriculture; retail trade; plastic and rubber products; utilities; furniture and related products; wholesale trade; machinery; textile and clothing; petroleum and coal products; information and cultural industries; electrical equipment; miscellaneous manufacturing; finance, insurance and real estate; fabricated metal products; and computer and electronics.

2 The exchange rate in a very fundamental sense represents a universal tariff barrier—any U.S. shippers contemplating selling in Canada must convert the price of their products into Canadian dollars.

# Conclusion

### Chapter Summary

- Our research indicates that lowering barriers to competition in the tradable goods sector could narrow the Canada–U.S. productivity gap.
- For the services sector, however, differences between Canadian and U.S. regulatory frameworks do not appear to be related to relative productivity performance; thus, policy-makers must look to factors other than barriers to competition for a complete explanation of the Canada–U.S. productivity gap.
- Because tariffs are generally very low, the focus for improving productivity performance needs to be on lowering non-tariff barriers.
- A majority of the 198 Canadian businesses surveyed by the Conference Board indicated that they had experienced higher costs of doing business as a result of both federal and provincial non-tariff barriers.
- The reduction in domestic non-tariff barriers could be accelerated through negotiating agreements where free access is the rule rather than the exception, allowing bilateral and multilateral provincial agreements to serve as precedents for similar agreements between all provinces, and establishing binding dispute settlement mechanisms.

In its first *Performance and Potential* report 10 years ago, the Conference Board raised the issue of the large and growing income gap between Canada and the United States.<sup>1</sup> Subsequent research presented in succeeding editions of *Performance and Potential* pinpointed the differences in productivity performance between Canada and the United States as the main source of this income gap. Therefore, the Conference Board began the process of examining the various determinants of productivity growth.

As part of this research, the 2004–05 edition of *Performance and Potential* reported on the results of a joint study by the Conference Board and the Centre for the Study of Living Standards of the determinants of productivity in seven industries. The study pointed to more openness to competition as a direction decision-makers should follow when considering ways to improve productivity.<sup>2</sup> Moreover, the *OECD Growth Study* and other empirical work have provided evidence that lowering barriers to competition can foster higher productivity and economic growth.<sup>3</sup>

In this report, the Conference Board has taken this research program one step further, showing that barriers to competition, including non-tariff barriers (NTBs), have a negative effect on productivity for a core group of 16 industries in the primary and manufacturing sectors of the Canadian economy. In addition, the Board has compiled a detailed list of the important NTBs in Canada and has surveyed Canadian firms to understand how they view NTBs as a hindrance to their performance. All of this research has helped to determine the importance of barriers to competition in explaining Canada's productivity performance.

### KEY FINDINGS

#### CANADA HAS MADE PROGRESS IN LOWERING BARRIERS . . .

Tariffs have been declining to the point where almost 50 per cent of goods entering Canada are duty-free. Canada's participation in the WTO, as well as regional

free trade agreements—notably NAFTA—have led to a significant decline in tariffs over the past 15 years. Canada is also dismantling restrictions within some traditionally protected areas of the economy and opening them up to competition. For example, as part of commitments made during the Uruguay Round of multilateral trade negotiations, quotas on imports of some agri-food products (especially dairy products) have been converted into tariff quotas in Canada.

### **... BUT TARIFF BARRIERS REMAIN HIGH IN SOME INDUSTRIES ...**

Tariffs on industrial goods are quite low, the result of many years of progressive reductions. However, the degree of protection for some Canadian industries remains markedly high. Average tariffs for agricultural products, for instance, stand at the high level of 21.7 per cent, while those for dairy products are 238 per cent.

### **... AND NON-TARIFF BARRIERS CONTINUE TO RESTRICT COMPETITION**

As tariffs have gradually come down, non-tariff barriers have become relatively more important in managing trade relationships. NTBs include quotas, technical standards, procurement restrictions, licensing and certification requirements, and restrictions on foreign ownership.

The list of NTBs in Canada is daunting. Given the federal system of government, many of these barriers are internal rather than international, and their nature is often opaque. Protection of local interests and the complex negotiations required to lower internal NTBs make achieving an open economic union within Canada a serious challenge. The Agreement on Internal Trade was a good start in committing provinces to eliminate certain barriers to competition within this country, but little effort has been directed toward identifying further barriers or monitoring progress toward eliminating them.

### **BARRIERS RAISE THE COST OF DOING BUSINESS**

A majority of the 198 Canadian businesses surveyed by the Conference Board indicated that they had experienced problems arising from both federal and provincial NTBs. Although standards and regulations are, not surprisingly, the most common barrier cited, government procurement policies and restrictions on labour mobility are also high on the list of barriers identified. This is discouraging, given the focus of the AIT and the Council of the Federation on these latter two types

of NTBs. Respondents indicated that the federal and provincial/territorial governments were equally responsible for the creation of the NTBs, noting that the main impact of NTBs is to raise costs—which in this context means lower productivity. Costs include not only the costs of complying, but also, less obviously, the costs associated with reduced innovative capacity and an inefficient size of operations. Respondents also identified a number of production, marketing and lobbying strategies that they have pursued to deal with NTBs, including—most worryingly—abandoning certain markets altogether. Almost all of these strategies come with a higher cost of doing business.

### **CANADA COULD NARROW THE PRODUCTIVITY GAP WITH THE UNITED STATES BY LOWERING BARRIERS TO COMPETITION IN THE TRADABLE GOODS SECTORS**

Our empirical results show that barriers to competition affect relative Canada–U.S. productivity in the primary and manufacturing sectors. Thus, lowering barriers to competition in the tradable goods sector could narrow the Canada–U.S. productivity gap. However, the 16 industries for which the relationship between barriers to competition and productivity is strongest represent only 20.5 per cent of the economy. For the Canadian services sector as a whole, differences between the Canadian and U.S. regulatory frameworks did not appear to be related to relative productivity performance. Given the importance of the services sector to the economy, the results indicate that policy-makers must look to other factors in addition to barriers to competition for a complete explanation of the Canada–U.S. productivity gap.

### **POLICY IMPLICATIONS**

Canada would benefit from a fresh dose of competition by reducing domestic and international barriers to competition, including both tariff and non-tariff barriers.

With respect to reductions in international tariff rates, improving access to foreign markets has traditionally been the domain of trade policy, normally conducted through the negotiation of reciprocal concessions with our trading partners (multilaterally through the WTO or bilaterally or plurilaterally through regional trade agreements). Given the nature of the negotiating process, it probably does not make sense for Canada to liberalize

domestic markets (through further tariff reductions) unilaterally: doing so would forgo leverage for obtaining improved access to other countries' markets. Moreover, the scope for tariff reduction in non-agricultural markets is limited, precisely because tariffs are already very low. Nonetheless, Canada should not hesitate to open the few areas of its economy where tariff protection remains high (particularly in the agri-food sector), provided that it can obtain meaningful concessions from its trading partners through binding commitments to lower international tariff rates in their markets.

The most important gains in Canadian economic efficiency from reducing non-tariff barriers to competition in the *international* arena would come from an alignment of the Canadian and U.S. regulatory frameworks. This conclusion is obvious given the overwhelming importance of the United States in Canada's international trade flows and the host of existing regulations on both sides of the border. Policy-makers thus need to make this alignment a high priority activity. The recent agreement to enter into the Security and Prosperity Partnership of North America is a good start, but much work remains to be done.

The most important work, however, needs to be done at home: reducing internal non-tariff barriers that result from provincial regulations and practices. Completing this task is entirely within the purview of Canadians—albeit through many different players within the two senior orders of government. Based

upon our business survey results, there are important opportunities to improve domestic productivity by harmonizing internal regulations and eliminating barriers to competition within Canada. This reform should go beyond the current coverage of the AIT to include the resolution of long-standing internal regulatory issues such as securities regulation. Despite the difficulty of negotiating reductions in domestic NTBs, the payoffs in terms of enhanced productivity are potentially substantial, and the effort should be given a higher priority than it currently receives.

Specific policy recommendations that will help to facilitate the process of reducing internal NTBs are as follows:

1. Free trade should be established as the standard for interprovincial trade agreements, and a strong evidence-based case should be required for specific barriers to be permitted. The current practice tends to create loopholes for regional interests.
2. The existing dispute settlement mechanism of the AIT needs to be made binding. Currently, dispute panel recommendations can be ignored, or circumvented through offsetting local legislation, due to the absence of an enforcement mechanism.
3. Agreements among and between provinces should be encouraged as a way to make progress on reducing internal NTBs. Bilateral or multi-provincial agreements could circumvent roadblocks created by one or more other provinces, and could serve as positive models for Canada-wide action.

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1 The Conference Board of Canada, *Performance and Potential 1996: Assessing Canada's Social and Economic Performance* (Ottawa: The Conference Board of Canada, 1996), p. 16.

2 Brenda Lafleur and Andrew Sharpe, "The Canada–U.S. Productivity Gap: Deepening Our Understanding." In *Performance and Potential 2004–05: How Can Canada Prosper in Tomorrow's World?* (Ottawa: The Conference Board of Canada, 2004), pp. 75–77.

3 See the summary in Paul Conway, Véronique Janod and Giuseppe Nicoletti, *Product Market Regulation in OECD Countries: 1998–2003*, Economics Department Working Paper 419 (Paris: OECD, February 2005), p. 4.

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# Further Reading

- **Opportunity Begins at Home: Enhancing Canadian Commercial Services Exports**  
Report by Glen Hodgson, Ben Tomlin. April 2006, Source: The Conference Board of Canada, 44 pages  
*Global exports of commercial services are growing significantly, but Canada has not kept pace with other major countries. This study by The Conference Board of Canada proposes the elements of a national strategy for commercial services exports.*
- **The Benefits of Foreign Direct Investment: How Investment in Both Directions Drives Our Economy**  
Executive Action Report by Glen Hodgson, Roland Paris. March 2006, Source: The Conference Board of Canada, 7 pages  
*In this report, we examine the benefits of foreign direct investment (FDI)—both Canadian investment abroad (outward FDI) and foreign investment in Canada (inward FDI).*
- **Facing the Risks: Global Security Trends and Canada**  
Executive Action Report. February 2006, Source: The Conference Board of Canada, 6 pages  
*This report outlines potential risks in three major areas—conflict risks based on violence, social and health risks, and economic and technological risks—and suggests approaches for addressing them.*
- **Canada and the New World of Integrative Trade**  
Executive Action Report. December 2005, Source: The Conference Board of Canada, 8 pages  
*Based on Performance and Potential 2005–06, this report discusses the potential for increased prosperity and the challenges facing Canada in this new world of integrative trade.*
- **Fighting Over Fabrics: The Textile Wars and the Politics of Free Trade**  
Executive Action Report by Charles A. Barrett, Roland Paris. November 2005, Source: The Conference Board of Canada, 5 pages  
*This report outlines the recent history of the global textile industry, the response to the elimination of quotas and the dramatic restructuring that is now taking place.*
- **In Search of a New Equilibrium in the Canada–U.S. Relationship**  
Report. January 2005, Source: The Conference Board of Canada, 41 pages  
*This report sets out a framework for considering how the Canada–U.S. economic partnership aligns with our overall role in the world in the post–Cold War, post–September 11 era. It is based on an extensive review of the academic and policy literature, a series of confidential interviews with experts on Canada–U.S. affairs, and a bi-national round table of business leaders held in June 2004.*
- **Performance and Potential 2005–06: The World and Canada: Trends Reshaping Our Future**  
Special Report. October 2005, Source: The Conference Board of Canada, 192 pages  
*This 10th anniversary edition takes a critical look at Canada’s performance and potential. It evaluates our progress since the mid-1990s and examines the global trends that are reshaping our future prosperity and well-being. This report explores the potential impact and policy implications emerging from four major global trends: economic transformation, growth in demand for resources, aging populations, and new and increased security risks.*



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