

**ECONOMIC UNION : A COMPARISON OF
CANADIAN GOVERNMENT PROPOSALS AND
THE PLANS OF THE EUROPEAN COMMUNITY**

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INTRODUCTION

On 24 September 1991, the Canadian government released a 59-page document, “Shaping Canada’s Future Together: Proposals,” designed to serve as the basis for discussion on the shape of Canada’s political and economic future. Among the controversial proposals were those intended to remove internal economic barriers and restrictions and to strengthen the coordination and harmonization of macroeconomic policies. These ideas to promote Canadian economic integration were further elaborated upon in the document “Canadian Federalism and Economic Union: Partnership for Prosperity,” released on 26 September.

While Canada has recently been facing a real possibility of political, and perhaps economic, fragmentation, on the other side of the Atlantic Ocean the European Community is implementing an ambitious program to integrate 12 national markets into a single internal market that would lead eventually to economic and political union. What Canada can learn from European integration was illustrated in “The European Community – a Political Model for Canada,” one of the background papers accompanying the release of the government’s proposals. Although clearly there are political differences between the EC confederal model and the Canadian federation, the EC may offer some lessons for Canada on economic integration. Indeed, the similarities between the EC integration plans and the Canadian economic union proposals suggest that these lessons were studied carefully by the federal government.

The first section of this paper provides some background information on the EC, including its origins and main decision-making institutions. The second part summarizes “Europe 1992” and “Economic and Monetary Union” (EMU) plans to integrate the EC economically. The third section compares the Canadian government’s proposals for economic union with the process of European integration.

THE EUROPEAN COMMUNITY: BACKGROUND AND INSTITUTIONS

A. Background

The European Community is composed of three Communities; first, the European Coal and Steel Community (ECSC) was formed by the Treaty of Paris (1951) in order to integrate the coal and steel markets of Belgium, France, Italy, Luxembourg, the Netherlands and West Germany; second, the European Atomic Energy Community (Euratom), formed by the same six countries in the *Treaty of Rome* (1957), was aimed at co-ordinating and encouraging the development of nuclear power for peaceful purposes; third, the European Economic Community (EEC) originated with another *Treaty of Rome* (1957) establishing a common market that would lay the foundations for political and economic union. While legally there are three Communities, they now share the same institutions and budget and from a political standpoint they are viewed as a single “European Community.”

In order to understand the process of European integration it is useful to have some knowledge of the European Community’s institutions and decision-making procedure. The next section identifies the primary EC institutions and outlines their respective roles in the Community’s decision-making process. It is important to recognize that the EC is an association of countries which have chosen to be constrained by supranational institutions. The EC institutions cannot act independently of a majority of the member states. There is a vast difference between the EC government, which has no power to raise revenues directly through taxation but must rely on contributions from member states, and the Canadian federation, where the central government has its own wide-ranging taxation powers and can act independently of the constituent governments.

B. The Main Decision-Making Institutions of the European Community

1. The European Commission

The European Commission, consisting of 17 members appointed by agreement of the member states and assisted by over 15,000 employees, “is the engine of Community policy, the guardian of the treaties, and the advocate of the Community interest.” The Commission is charged with initiating proposals, which are examined and voted upon by other decision-making bodies. For instance, the Commission proposed the “White Paper on Completing the Internal

Market” (Europe 1992) and is responsible for drafting the legal instruments to implement the program. The Commission is also responsible for administering and supervising the treaties, including applying treaty rules to governments and firms. (For competition reasons, the Commission recently blocked the purchase by a European consortium of Canadian aircraft manufacturer de Havilland.)

2. The Council of Ministers

It has been said that the Commission proposes and the Council disposes. After a Commission initiative is considered by the European Parliament, it is voted upon by the Council of Ministers, which directly represents the member states’ governments. Membership of the Council is nominally composed of the foreign ministers of member governments but in practice membership changes with the topic under discussion. For instance, when agriculture is being discussed each country sends the Minister of Agriculture or the Minister’s deputy to the meeting. The position of President of the Council is held for six months by each member state in rotation.

Although the EEC Treaty established the principle of majority voting by the Council of Ministers on most issues, under the so-called “Luxembourg compromise” any member state had the right to block a decision that went against its vital national interest. This effectively gave member states the right to veto proposals to which they objected. The amendments to the EEC Treaty by the *Single European Act* considerably expanded the use of majority voting by the Council. A “qualified majority” in the Council of Ministers is defined as 54 votes out of a total of 76 votes. The distribution of voting rights in the Council is as follows: U.K., Germany, France and Italy have 10 votes each; Spain has 8 votes; Belgium, Greece, the Netherlands and Portugal have 5 votes each; Denmark and Ireland have 3 votes each; Luxembourg has 2 votes.

3. The European Parliament

Although the 518-member European Parliament is now directly elected by voters in the member states, it does not have the power to propose legislation or even to defeat or amend proposals initiated by the Commission if the Council of Ministers chooses to override this. The European Parliament’s role is mainly that of a consultative body which considers and provides its opinion on Commission proposals. However, the Parliament does have the power to

reject proposed budgets and, by a two-thirds majority, force the resignation of the whole body of commissioners.

4. The European Council

The European Council, which includes the heads of member states' governments, should not be confused with the Council of Ministers. The European Council was not provided for in the original EEC Treaty but was institutionalized at the Paris summit of 1974, where it was agreed that the leaders and their foreign ministers, along with the President of the Commission and one of the Vice-Presidents of the Commission, would meet regularly. Subsequently enshrined in the *Single European Act*, the European Council provides the necessary political impetus to initiate Intergovernmental Conferences on significant reforms such as the single market program, economic and monetary union and political union.

ECONOMIC INTEGRATION IN THE EUROPEAN COMMUNITY

A. The *Single European Act*

Although the 1957 Treaty of Rome establishing the European Economic Community (EEC) envisaged the elimination of internal barriers to the free movement of goods, persons, services and capital (the "four freedoms"), the progress towards this goal was slow after tariffs and internal quotas were removed by 1968. In fact, during the late 1970s and early 1980s rising domestic unemployment combined with competition from Far Eastern countries increased protectionism among member states.

In 1985 the Commission of the European Community presented to the European Council a White Paper, "Completing the Internal Market," proposing more than 300 directives (later reduced to 279) intended to break down internal market impediments to the full realization of the four freedoms. These internal barriers were categorized as physical, technical or fiscal in nature. The proposed remedy came to be known as "Europe 1992" because of the 31 December 1992 deadline for full implementation of the plan.

The *Single European Act* (SEA), the first major revision of the EEC Treaty, set the goal of establishing the internal market and made the necessary changes to the Treaty to enable the introduction and passage of the Europe 1992 program. The SEA facilitated the

decision-making procedure by stipulating that qualified majority voting be used for measures which have as their object the establishment and functioning of the internal market. Exceptions were made for fiscal provisions and those relating to the free movement of people and to the rights and interests of employed persons.

Another important feature of the SEA was the incorporation in the EEC Treaty of the principle of “mutual recognition.” Article 100B of the Treaty requires the Commission during 1992 to draw up an inventory of laws, regulations and administrative provisions which have not been harmonized. The Council may decide, on the basis of a qualified majority, to declare the provisions in force in a member state to be equivalent to those applied by another member state. Finally, the SEA laid the groundwork for proposals for economic and monetary union and for political union, which were subsequently put forward.

B. Europe 1992: The Single Market Plan

1. Removal of Physical Barriers

- Abolition of border checks of goods and persons by removing the underlying reason for them through;
- Standardization of customs forms; elimination of bilateral permits rationing truck transportation between countries; adoption of EC-wide quotas against restricted outside country goods; removal of the need for adjustment of agricultural prices at internal borders; harmonization of VAT and excise taxes (fiscal measures); harmonization of product health standards (technical standards); approximation of drug and arms legislation.

2. Removal of Technical Barriers

a. Standards

- Harmonization at the Community level of essential standards of health and safety;
- Mutual recognition of other members’ technical standards where health and safety are not at stake.

b. Public Procurement

- Opening national public procurement to foreign suppliers by: closing loopholes in existing EC rules governing national procurement; providing firms with the right to take legal action with respect to how government contracts are awarded; enhancing supervision of member state procurement practices; and opening up to outside bidding the previously excluded sectors of energy, transport, telecommunications and water.

c. Free Movement of Labour and Professionals

- Measures to facilitate the free movement of labour and professionals through application of the principle of mutual recognition to degrees and diplomas of different states, establishing comparability of vocational training qualifications and removing residency obstacles.

d. Common Market for Services

- Integration of the European financial services market by: harmonization of capital adequacy standards and accounting requirements for financial institutions; mutual recognition of other member states' application of essential standards; home country control whereby supervision of the sale of financial products will primarily be the responsibility of authorities in a financial institution's home country;
- Removal of bilateral road transportation quotas and opening up rail, inland waterways, maritime transport, and air to more competition;
- Opening up to competition certain "value-added" communication services, such as fax, vision and data transmission;
- Removal of internal restrictions on the free flow of capital (although there is provision for derogation by member states for reasons of domestic monetary regulation, to control exceptional exchange rate movements or to prevent infringement of national laws.) Delayed implementation of the capital movement directive until the end of 1992 for Spain, Ireland, Portugal and Greece;
- Laws to encourage cross-border industrial cooperation, worker participation in management of companies, mergers across borders and protection of intellectual property.

3. Removal of Fiscal Barriers

- Approximation of VAT rates within bands in each country to remove the need for border controls on cross-border shoppers;
- Establishment of minimum excise tax rates for tobacco and alcohol and a range of rates for mineral oils.

C. Economic and Monetary Union

A three-stage plan has been established for the monetary and economic union of the EC. In stage one, monetary and economic policies would be more tightly coordinated and the currencies of Britain, Portugal and Greece would join the European Monetary System (EMS).

In stage two, currency fluctuations would be more tightly controlled, a European System of Central Banks (ESCB) would be established and macroeconomic policies would be coordinated by the European Council comprising the heads of member states and governments.

In the third stage, exchange rates would be fixed permanently and national monetary units would be replaced by a common currency. Monetary policy would be determined by the European Central Bank (ECB) operating through the ESCB. The EC would establish binding guidelines for the budgetary policies of member states.

COMPARISON OF EEC TREATY WITH PROPOSED SECTION 121 OF THE CONSTITUTION

A. Prohibition on Internal Barriers

1. The Canadian Government Proposals

The Canadian government proposes to amend section 121 of the Constitution to prohibit federal or provincial laws, programs or practices that create barriers or restrictions to the free movement of persons, goods, services and capital. The first two parts of the proposed section 121 would read as follows:

- (1) Canada is an economic union within which persons, goods, services and capital may move freely without barriers or restrictions based on provincial or territorial boundaries.
- (2) Neither the Parliament or Government of Canada nor the legislatures or governments of the provinces shall by law or practice contravene the principle expressed in subsection (1).

2. The European Economic Community Rules

Article 3 of the Treaty establishing the European Economic Community states that the activities of the Community shall include:

- (a) the elimination, as between Member States, of customs duties and of quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect;
...
- (c) the abolition, as between Member States, of obstacles to freedom of movement for persons, services and capital.

The *Single European Act*, which provides for the integration of the internal market (Europe 1992), amended Article 8A to the EEC Treaty. This states: “The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty.”

Article 5 requires member states to carry out their obligations under the Treaty and to “abstain from any measure that could jeopardize the attainment of the objectives of this Treaty.”

Member states’ obligations with respect to the four freedoms (goods, persons, services and capital) are expanded upon in the Treaty: free movement of goods (Articles 9-37); free movement of persons (Articles 48-58); free movement of services (Articles 59-66); free movement of capital (Articles 67-73).

Article 95 of the Treaty prohibits the imposition of higher taxes on products of other member states than on similar domestic products. Internal taxation measures must not provide indirect protection to other products.

Article 2 of the Draft Treaty on Economic and Monetary Union would amend the objectives of the EEC Treaty to state that the task of the Community is to achieve economic and monetary union.

3. Analysis

Among sovereign states, a treaty is the main legal instrument for restraining the behaviour of national governments. By the Treaty of Rome, the signatories have agreed to permit the free flow between EC member states of good, persons, services and capital. In a federation such as Canada, the Constitution provides the primary legal instrument for binding constituent governments. The existing protection for the Canadian common market derives mainly from two sections of the Constitution. The first, section 121, provides that: “All Articles of the Growth, Produce, or Manufacture of any one of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces.”

As it stands, section 121 of the Canadian Constitution provides for unimpeded interprovincial trade in goods only; interprovincial trade in services, labour and capital is not included. Second, it is unclear whether existing section 121 applies to foreign-made goods in addition to those produced within the provinces. Third, the section seems to apply to duties but not to non-tariff barriers. Fourth, the section appears to constrain the provincial governments but not the federal government.

The second protection for the Canadian common market derives from section 91 of the Constitution, which gives the federal government exclusive legislative authority over “the Regulation of Trade and Commerce.” Although Canadian courts have interpreted this section as granting the federal government exclusive jurisdiction over international and interprovincial trade, this has been circumscribed by the exclusive constitutional powers granted the provinces over “Property and Civil Rights in the Province” and “Generally all Matters of a merely local or private nature in the Provinces.” These provisions have permitted the provinces to erect an array of interprovincial non-tariff trade barriers.

The government proposal to strengthen the Constitution’s common market clause and expressly to prohibit federal or provincial measures limiting the four freedoms would likely provide the Canadian courts with a more active role in striking down internal economic barriers. Courts in the United States and the European Community have been significant forces for market integration.

In the European Community, member states’ obligations set out in the Treaty of Rome are enforceable under EC law and the European Court of Justice has proved to be one of the most powerful forces for integration of the EC internal market. One noteworthy example is

the Cassis de Dijon case. The European Court of Justice ruled in this case that West Germany could not block the importation of the French liqueur, Cassis de Dijon, simply because it did not contain the required minimum 32% level of alcohol necessary to qualify as a liqueur under West German standards. This ruling has been instrumental in striking down other disguised trade barriers in the EC such as the German beer purity law and Italian regulations requiring pasta to be made exclusively from durum wheat. There are numerous other cases where the European Court has ruled against market impediments.

Unlike the proposed Canadian constitutional amendment, the existing EEC Treaty does not call the EEC an “economic union.” However, the draft amendments to the EEC Treaty proposed by the Commission state that “the Community ... shall have as its task progressively to achieve economic and monetary union.”

B. Exceptions to the Prohibition on Internal Barriers

1. The Canadian Government Proposals

The Government has proposed that the prohibition on trade barriers would make exceptions for regional development policies or laws declared by Parliament to be in the national interest. Proposed subsection 121(3) in the Constitution states:

- (3) Subsection (2) does not render invalid:
 - (a) a law of the Parliament of Canada enacted to further the principles of equalization or regional development
 - (b) a law of a provincial legislature enacted in relation to the reduction of economic disparities between regions wholly within a province that does not create barriers or restrictions that are more onerous in relation to persons, goods, services or capital from outside the province than it does in relation to persons, goods, services or capital from a region within the provinces; or
 - (c) a law of the Parliament of Canada or of the legislature of a province that has been declared by Parliament to be in the national interest.
- (4) A declaration referred to in paragraph (3)(c) shall have no effect unless it is approved by the governments of at least two-thirds of the provinces that have in aggregate, according to the then latest

general census, at least 50% of the population of all the provinces.

2. The European Economic Community Rules

a. Exceptions to the Free Movement of Goods

Article 36 of the EEC Treaty permits prohibitions or restrictions on trade in goods where this is “justified on the basis of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial property and commercial property.” These prohibitions or restrictions must not constitute a means of arbitrary discrimination or a disguised restriction on trade between member states.

b. Exceptions to the Free Movement of Persons

Article 48(3) of the EEC Treaty permits member states to exclude persons from its territory “on grounds of public policy, public security or public health.” Member states’ discretion in applying the public policy proviso is circumscribed by EC law. An individual’s conduct must constitute a genuine and serious threat to public policy and affect one of the fundamental interests of society. For instance, diseases such as tuberculosis or syphilis, drug addiction, and profound mental disturbance might be construed as threatening public health. An individual’s conduct might also constitute a reason for exclusion from the territory of a member state if it posed a genuine and serious threat to public security and affected one of the fundamental interests of society. Article 48(4) states that the freedom of movement for workers established in Article 48 does not apply to employment in the public service.

c. Exceptions to the Free Movement of Services

Services are considered “services” within the meaning of the Treaty insofar as they are not governed by the provisions relating to freedom of movement for goods, capital and persons. This implies that member states may impose restrictions on foreign persons selling services within their borders. Thus, restrictions on grounds of public policy, public health or public security could apply, as in the case of freedom of movement for persons. Restrictions might also

apply where the provider of services performs activities that are connected, even occasionally, to the exercise of official authority. (Article 55)

d. Exceptions to the Free Movement of Capital

The existing EEC Treaty permits a member state to take protective measures to prevent disturbances in its capital market (Article 73) or to overcome balance of payments difficulties (Articles 108 and 109). However, the draft amendments to the Treaty for economic and monetary union would prohibit restrictions on the movement of capital. (The repeal of Articles 68 to 73 has still to be considered.)

e. Other Exceptions

Article 100A, which was amended to the Treaty by the *Single European Act*, provides in paragraph 4 a derogation from the harmonization of laws and regulations where a “Member State deems it necessary to apply national provisions on grounds of major needs referred to in Article 36, or relating to the protection of the environment or the working environment ...” (Note the earlier reference to Article 36 relating to exceptions to the free movement for goods.) The member state must notify the European Commission of national provisions which derogate from the harmonization of laws provided for in Article 100A. The Commission must confirm the national provisions after determining that they are not a means of arbitrary discrimination or a disguised restriction on trade.

Article 8C of the EEC Treaty directs the Commission when drawing up its single market proposals to “take into account the extent of the effort that certain economies showing differences in development will have to sustain during the period of the establishment of the internal market.” Any derogations must be temporary and impose the least possible disturbance to the functioning of the internal market.

3. Analysis

Although they appear numerous, the derogations in the EEC Treaty from the common market principle tend to be for specific reasons (i.e., health and safety, the environment, etc.) The European Court of Justice, the final arbiter of what constitutes acceptable derogations, has interpreted these exceptions strictly. In a number of cases where a member state has used,

for instance, health and safety as grounds for restricting imports, the Court has found these derogations to be unjustified.

By contrast, the exceptions in the Canadian government proposal are fewer in number but more general in nature. The exceptions for regional development and laws declared in the national interest provide ample room for deviation from the economic union principle. The requirement that exceptions for laws declared in the national interest be ratified by the provinces using the 7/50 formula does provide a brake on the use of this derogation.

Although the existing EEC Treaty does not allow for opting out upon agreement, a proposed amendment to the EEC Treaty dealing with economic and monetary union would introduce an innovation in Community law. Upon a qualified majority vote by the Council of Ministers (with at least eight member states in favour), member states in economic difficulty would be permitted to derogate temporarily from full participation in the final stage of economic and monetary union.

COMPARISON OF EEC INTEGRATION WITH PROPOSED NEW CONSTITUTIONAL POWER

A. The Canadian Government Proposals

The Government is proposing the creation of a new constitutional power for the Parliament of Canada that would allow it exclusively to pass legislation for the efficient functioning of the economic union. However, these laws would have no effect unless approved by the governments of at least two thirds of the provinces that have, in the aggregate, at least 50% of the population of all the provinces. Furthermore, the legislative assembly of any province could declare by a resolution supported by 60% of its members that these laws did not apply in the province, although such a declaration would expire after three years unless an earlier expiry date was specified in the declaration.

The Government is also proposing the formation of a “Council of the Federation,” which would ratify the legislation enacted under this new constitutional power. Although the Government’s proposals do not state this explicitly, they imply that the Council would consist of representatives from each province and that the required provincial approval (by at least two-thirds of the provinces) would take place in the Council.

Pending the coming into force of new section 121 of the Constitution on 1 July 1995, the Government proposes that the Council of the Federation be used by governments to address the problem of internal barriers.

B. Economic Integration in the European Community

As outlined earlier, the European Commission is responsible for initiating EC legislation while the European Parliament reviews the legislation and votes on it. It is the member states themselves, however, represented on the Council of Ministers, which finally have the power to adopt or defeat proposed legislation.

Although this legislative process applies to laws that fall within the ambit of the EC treaties, initiatives requiring revisions to the treaties, such as the *Single European Act*, Economic and Monetary Union, and European Political Union, have first been placed before the heads of governments at meetings of the European Council. This body has then authorized intergovernmental conferences to hammer out agreed amendments to the treaties. The revised treaties enter into force after ratification by the national legislatures of the member states. The specific EC laws to implement the proposals are introduced by the Commission and pass through the EC legislative process.

As an example, take the Europe 1992 program. This plan began with the “White Paper on Completing the Internal Market” published by the European Commission and presented to the European Council in 1985. Over the objections of Britain, Denmark and Greece, the European Council voted to hold an intergovernmental conference to draft the necessary enabling amendments to the EEC Treaty. The result of that conference, the *Single European Act*, was signed and ratified by all 12 member states and came into force in 1987.

With the parameters of the EEC Treaty sufficiently broadened, the European Commission has been putting the 279 separate measures of the White Paper into EC law. At this point, over two-thirds of the proposals have passed through the required legislative process and have been adopted by the Council of Ministers. About two-thirds of the measures to implement the single market require a qualified majority vote by the Council (54 votes out of 76). Measures concerned with harmonization of taxes, free movement of persons and the rights and interests of employed persons can still be blocked in the Council of Ministers by a single country.

Much of the single market program is being implemented by EC Directives, legal instruments that do not enter into force in a member state until transposed into national law. At May 1991, about three-quarters of the directives adopted by the Council of Ministers had been transposed into national law. The single market proposals are also being implemented through EC regulations, which are directly binding on member states without the introduction of domestic legislation. Decisions, also legal instruments, are EC Commission instructions; these are binding in their entirety on the governments, companies or individuals to whom they are addressed.

C. Analysis

The creation of a new constitutional power to make laws for the efficient functioning of the Canadian economic union would permit the federal government to introduce a single market plan for Canada along the lines of "Europe 1992." The ratification of such measures by the provincial governments in a new Council of the Federation according to the 7/50 rule can be compared with the EC legislative requirement for a qualified majority vote by the Council of Ministers. It is worth noting, however, that EC member states have reserved the right to veto certain measures to implement the single market. This would not be possible under the Canadian proposal.

It would be possible under the Canadian proposal for a province to derogate from laws made under the economic union power for a period of up to three years. The EEC Treaty, by contrast, does not provide member states with the option of temporary derogation simply by a vote of the national legislature. However, with the agreement of the Council of Ministers, member states in economic difficulty would be permitted to derogate temporarily from participation in the final stage of economic and monetary union. As noted earlier, the EC *Single European Act* did direct the Commission, when drawing up the plan to complete the internal market, to take into account the need for temporary derogations by less developed member states. The implication is, however, that such a derogation would have to be justified on specific grounds and be approved by the Commission.

IMPROVING FINANCIAL SECTOR REGULATION

A. Canadian Government Proposals

The Government's paper recognizes the unnecessary costs imposed on Canadian financial institutions (and ultimately on consumers) by overlapping federal and provincial regulation. For instance, a federally incorporated or provincially incorporated trust or loan company operating across the country could potentially face 10 or 11 sets of rules in its Canada-wide operations.

The paper states that:

the Government intends to address the issue of overlap and duplication in the regulation of trust companies. ... Many have argued that Canada should adopt some version of Europe 1992, which envisages the creation of a single European financial market... This would involve each jurisdiction recognizing and accepting, for regulatory purposes, the prudential regime of the jurisdiction within which a financial institution is chartered, subject to acceptable basic standards.

The federal government is prepared to explore with the provinces the possibility of moving toward a regulatory regime based on lead jurisdiction or mutual recognition. For federally incorporated [trust and loan] companies, such arrangement could be achieved by provinces delegating their administrative and regulatory power to the federal government.

With respect to securities regulation, the Government is prepared to explore an approach where all jurisdictions could delegate all or part of securities regulation to a jointly operated agency. Other approaches include "more formalized federal-provincial action to coordinate approaches to regulation, international negotiation and standard-setting for securities."

B. The European Economic Community Rules

Liberalization of financial markets under the 1992 program depends upon three principles. The first principle, harmonization, requires member states to agree upon common standards of capital adequacy, solvency and accounting requirements for financial institutions. The second principle, mutual recognition, means that member states must trust the others' application of the common standards laid out by the Council. The third principle, home country

control, signifies that supervision of the sale of financial products will primarily be the responsibility of authorities in a financial institution's home country. (Host country control will continue to apply with respect to the liquidity of credit institutions and measures affecting monetary policy and reserve requirements for operations of credit institutions in securities markets.) Underlying these three principles is the requirement that capital be permitted to move freely across borders.

The ultimate goal of these liberalization measures is to enable a financial institution to sell financial services across borders or to establish branches in other member states without facing regulatory overlap and duplication. The principles of harmonization, mutual recognition and home country control would apply to the regulation of banking services, investment services and, eventually, insurance services.

C. Analysis

Under the EC plan, banks and building societies (essentially deposit-taking institutions) complying with harmonized capital adequacy and solvency standards would be provided with a "single banking licence" permitting the sale of a defined menu of banking services anywhere in the Community, providing their home (chartering) country did not prohibit them from offering these services. The services authorized by the single banking licence could be offered in a member state even if the host country did not permit its own firms to sell these. This could give rise to foreign chartered firms selling financial services that domestically chartered firms were not authorized to sell. Obviously, there will be pressure for countries that define banking services more narrowly to harmonize their services with the menu of services authorized by the single banking licence. Otherwise, domestically chartered firms could be placed at a disadvantage.

Because the Canadian proposals on improving financial sector reform lack specifics, it is difficult to determine how the government intends the principles of harmonization, mutual recognition and home country rule to operate in Canada. One possibility would be to adopt the EC model practically intact and authorize institutions to sell throughout Canada a specific set of financial services based on acceptance of certain prudential standards by all provinces. As in the EC, jurisdictions authorizing the sale of fewer financial services by an institution would be encouraged by competitive pressures to bring their services into harmony

with those authorized by the single licence. However, a drawback is the intrusion into provincial jurisdiction that this implies.

An alternative interpretation of the EC model applied to Canada was offered by the May 1990 Report “Canada 1992: Toward a National Market in Financial Services” issued by the Standing Senate Committee on Banking, Trade and Commerce. This system would still require a consensus on key prudential standards (harmonization), primary regulation by the chartering province (home country control) and mutual recognition of this regulation by other provinces. The key difference between this “designated jurisdiction” model and the EC plan is the requirement for host-province licensing and compliance with the menu of services authorized by the host province.

An example of the application of the designated jurisdiction model may help to illustrate. Suppose a trust company chartered in Quebec, which allows the sale of insurance on the premises of deposit-taking institutions, also operated in Ontario, where the sale of insurance on premises is not currently permitted. Under the designated jurisdiction model, the trust company would not be permitted to sell insurance on premises in Ontario. It could only do in Ontario what an Ontario chartered firm was permitted to do.

At the same time, Quebec would accord to trusts operating in Quebec but chartered outside the province the same privileges as Quebec chartered firms. The main advantage of the designated jurisdiction model over the *status quo* is that regulation would primarily be the responsibility of the chartering jurisdiction. In the case of the Quebec trust company operating in Ontario, Quebec would regulate the firm’s overall capital and solvency standards and Ontario would not attempt to duplicate this. And, in contrast to the EC model, each province could maintain its own conduct of business rules within its jurisdiction without pressure to harmonize these with a specific menu of financial services.

CO-ORDINATION AND HARMONIZATION OF MACROECONOMIC POLICIES

A. Canadian Government Proposals

The government proposes to develop a more open and visible federal and provincial budget-making process that would include:

- a relatively fixed budget cycle;

- a fixed annual schedule of Finance Ministers' meetings
- the publication by the 11 governments of pre-budget economic/fiscal outlooks;
- common accounting conventions.

The government proposes to develop, with the provinces, guidelines to improve the coordination of fiscal policies and the harmonization of fiscal policies with Canada's monetary policy. For example, budgets might have to be balanced over the full course of the business cycle. (A balanced budget could be defined to exclude expenditures on capital formation.) These guidelines would be set in legislation under the proposed new economic power. Accordingly, this would require agreement of at least seven of the ten provinces with at least 50% of the population.

The government proposes the establishment of an independent agency to monitor and evaluate the macroeconomic policies of the federal and provincial governments.

The *Bank of Canada Act* would be amended to make it clear that the Bank's mandate is to achieve and preserve price stability. Canada's regions would be represented on the Board of Directors of the Bank of Canada by individuals nominated by the federal government after consultation with provincial governments. Regional consultative panels would be created to advise the Directors of the Bank on regional economic conditions. The appointment of the governor of the Bank of Canada would be subject to Senate ratification. To increase the transparency of monetary policy, the Governor of the Bank of Canada would be required to testify regularly before Parliament. The Governor would also be required to meet with the federal and provincial Ministers of Finance to present views on the state of the economy and the interaction of monetary policy and fiscal policy.

B. The European Community Proposals

The *Single European Act* introduced into the EEC Treaty the objective of achieving economic and monetary union. Article 102A requires member states to cooperate "in order to ensure the convergence of economic and monetary policies which is necessary for the further development of the Community."

The Report of the Delors Committee, released in April 1989, set out a three-stage plan to achieve the goal of economic and monetary union. The conclusions of the report were

endorsed by the European Council meeting in Madrid in July 1989. At the Rome meetings of the European Council in October and December 1990, 11 of the 12 members agreed to follow the concept of EMU put forward by the Delors plan and to convene an intergovernmental conference. (The United Kingdom was the sole objector to the EMU plan.)

Stage 1 – During the first stage of EMU, which came into effect on 1 July 1990, member states' monetary and economic policies are to be more tightly coordinated. Monetary and economic plans are to be submitted to the EC Commission and Ecofin (Council of Ministers for Economics and Finance). The currencies of Britain, Portugal and Greece are expected to join the European Monetary System (EMS). Currencies are to be allowed to fluctuate within plus or minus 2.25% of the central rate.

Stage 2 – The second stage is set to begin on 1 January 1994. Currency fluctuations would be more tightly controlled, a European Central Bank (ECB) and a European System of Central Banks (ESCB) similar to the U.S. Federal Reserve System would be established and begin determining ED-wide monetary policy. Macroeconomic policies would be coordinated by the European Council, which would set guidelines for individual countries and decide on remedies for member states that ran excessive budget deficits.

Stage 3 – A precise date for commencement of this stage has yet to be established. Exchange rates would be fixed permanently and national monetary units would be replaced by a common currency. The ECB/ESCB would determine EC monetary policy. The European Commission would submit multi-annual guidelines (normally three to five years) to the European Council on:

- the development of member states budget balances;
- the control of production costs;
- the level and promotion of savings and investment;
- the adaptation of Community policies for achieving economic and social cohesion;
- the development of structural policies.

Where a member state failed to implement the multi-annual guidelines, the Commission might make recommendations to the Council regarding the necessary policy adjustments. Financial assistance could be offered to member states in financial difficulty.

Proposed Article 104A would prohibit financing budget deficits through direct assistance from the European System of Central Banks or by privileged access by public authorities to the Capital market. The community would not be permitted to guarantee the public debt of a member state. Excessive budget deficits would have to be avoided by member states.

Monetary policy would be set by a majority on the Council of the Bank according to the formula of one person, one vote. The Council of the Bank would include the 12 governors of the national central banks along with the six-member Executive Board of the ECB including the President. The members of the Executive Board of the ECB would be appointed for a period of eight years by the European Council after the Council of the Bank had given its opinion. In the case of the appointment of the President and Vice-President, the European Parliament would be consulted also.

In a limited number of clearly defined cases relating to decisions on capital, transfer of reserve assets and profits of the ECB, a system of weighted voting is proposed. Members of the Executive Board would not vote and the votes of the national central bank governors would be weighted according to the relative size of each member state's economy.

According to the Draft Statute for the European System of Central Banks (ESCB) and the European Central Bank (ECB), the primary objective of the System will be to maintain price stability. However, the second objective states, "without prejudice to the objective of price stability, the System shall support the general economic policy of the Community." Although the ECB/ESCB would have responsibility for conducting foreign exchange operations, decisions regarding the exchange rate regime would be made in conjunction with the Ecofin Council.

Implementation of the final stage of EMU could be delayed for member states in financial difficulty where the Council of Ministers voted to permit a temporary derogation.

C. Analysis

The Canadian proposals for co-ordination and harmonization of economic policies appear to incorporate the following aspects of the EC plan for economic and monetary union:

- co-ordination of fiscal policies and harmonization with monetary policy
- binding multi-annual economic policy guidelines that would be ratified by a Council
- restricting the use of deficit financing by governments

- surveillance of macroeconomic policies by a monitoring agency (in the EC this would be the Commission)
- regional representation on the Board of the central bank.

The Canadian proposals would make achieving and preserving price stability the sole mandate of the Bank of Canada. The European Central Bank (ECB) would be given the specific goal of maintaining price stability. Nevertheless, the ECB's secondary objective, to support the economic policy of the Community, raises questions about the Bank's degree of freedom to pursue the goal of price stability. There would be the possibility of conflicting objectives if the ECB were expected to support general economic policy, for example by reducing unemployment, while simultaneously maintaining price stability. Furthermore, exchange rates would be partially determined in the political arena, according to guidelines laid down by the Council of Ministers (Ecofin). Again, there is the possibility of conflicting central bank objectives.

Although the government intends to increase regional representation on the Board of Directors of the Bank of Canada, there is no mention of permitting the Board to participate in the formulation of monetary policy. Currently, monetary policy is decided by the Governor of the Bank of Canada in consultation with the senior Deputy Governor and with the advice of the staff of the Bank; the Board of Directors may be consulted on regional economic conditions but it has little direct influence on the country's monetary policy.

By contrast, regional representation would be much more strongly felt at the European Central Bank (ECB). The Draft Statute of the ECB indicates that monetary policy in the EC would be decided by a majority vote of the Council of the Bank, which would include the 12 national central bank governors and the six-member Executive Board.

CONCLUSION

Since the 1930s it has been well established that "beggar-my-neighbour" trade policies are ultimately self-defeating. While it is theoretically possible for a large country to make itself better off by erecting trade barriers, these gains can be erased if other countries follow suit; the result is a decline in world economic output. Since World War II, Canada and other countries have used the GATT and separate trade agreements to lower international trade

barriers. Yet, despite progress at the international level, the Canadian internal market remains fragmented by numerous interprovincial trade barriers. Aside from the anachronism these present now that the country is moving toward international free trade with both the U.S. and Mexico, internal barriers cost Canadian jobs and economic output.

The Canadian government proposals would enshrine in law the principle of free movement for persons, goods, services and capital and would prohibit laws that contravene this principle. Experience in the EC, however, indicates that merely establishing the principle of the four freedoms in law is not sufficient to clear away internal barriers; an active approach is also necessary. It was for this reason that the EC introduced a legislative program (Europe 1992) that directly addresses the remaining internal market impediments.

The Canadian government's proposals also admit that a revised common market clause in the Constitution might not address the full range of trade barriers. Consequently, the government proposes that Parliament should have the power to make laws to remove internal impediments. (Perhaps the government intends to introduce a "Canada 1992" program to completely integrate the Canadian internal market.) As in the EC, these laws would be subject to ratification in a "Council" by a specific majority of member states/provinces.

The Canadian proposals also admit exceptions to the four freedoms principle on the specific grounds of furthering regional development or equalization. Beyond this, governments could exclude a law from application of the economic union clause if Parliament declared the exclusion to be in the national interest and if this was ratified according to the 7/50 formula. Furthermore, a province that did not agree with laws made by Parliament under the new economic union power could unilaterally opt out by declaration with the support of 60% of the provincial legislature.

By contrast, trade barriers within the EC must be justified on specific grounds, such as health and safety; the EEC Treaty does not currently permit a nation to opt out of objectionable provisions, either with agreement of a majority of member states, or by a majority vote of its own national legislature. However, the draft treaty for economic and monetary union would allow member states in financial difficulty to delay implementing the final stage of EMU if the Council of Ministers agreed to a temporary derogation.

The Canadian proposals for improving regulation of financial institutions are borrowed from the "Europe 1992" program, which established the principles of harmonization, mutual recognition, and home country control. Application of these principles, which were more

fully developed for the Canadian context in the May 1990 report of the Standing Senate Committee on Banking, Trade and Commerce, would be a significant step towards reducing regulatory overlap and duplication in this country's financial sector.

Like the EC, the Canadian government is proposing to improve co-ordination of fiscal policy and harmonization of fiscal policy with monetary policy. With the agreement of provincial governments (7 provinces and 50% of the population), the Canadian government would be able to establish binding guidelines restricting the use of deficit financing by governments. As in the EC, the macroeconomic policies of governments would be monitored and assessed by an agency.

With respect to monetary policy, Canada already has a central bank and a single currency, items that the EC is proposing to introduce. The Canadian government is suggesting that the Bank of Canada be provided with the single goal of achieving and preserving price stability. While this would also be the primary objective of the European Central Bank, subordinate and potentially conflicting goals are also proposed for that Bank.

It is uncertain how much power the Canadian government expects Bank of Canada Directors would exercise under the proposed rules. Providing more effective regional representation would move the Bank of Canada in the direction of the European Central Bank, where 12 of the 18 members of the Bank Council would be national central bank governors appointed directly by the individual member states. There is no evidence, however, that the Canadian government is suggesting that the Board of Directors of the Bank of Canada would take an active role in the formulation of monetary policy along the lines proposed for members of the Council of the European Central Bank.

In conclusion, while there are considerable differences between the EC and the Canadian political systems, it appears that the Canadian government has drawn some lessons from the economic integration plans of the European Community. Not only would the government proposals strengthen the Canadian common market by ensuring the realization of the four freedoms, they would open the door to full economic union through the co-ordination and harmonization of fiscal policies. At first glance, some of these proposals may appear dramatic but when examined alongside the plans of the European Community, which is, after all, an association of sovereign states, they do not seem extraordinary.

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