

BEYOND THE AGREEMENT ON INTERNAL TRADE: OPENNESS AS THE KEY TO INNOVATION AND GROWTH

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OVER THE PAST DAY AND A HALF, we have heard a great deal about the state of Canada's internal market. We have heard about the importance of enhancing the free flow of people, goods, services and investment within Canada's borders, and about how to improve the workings of the *Agreement on Internal Trade*. We also have heard concerns about the potential impact of a unified internal market on everything from regional development and social programs to environmental, labour and consumer standards.

The common thread here is that there is more to this discussion than an evaluation of legal and regulatory barriers. This is a discussion about what kind of country we want, and how we can work together to give all Canadians a better shot at prosperity.

I believe that how Canada moves forward in improving its internal market will have a powerful impact not just on the cost base of Canadian companies, but on the pace of innovation across our economy and on our efforts to build a compelling Canadian brand in the global market. And I believe the key to success does not lie in browbeating provincial governments into improving and honouring the *Agreement on Internal Trade*.

Rather, I would suggest that what we have to do is build a better understanding across our society of the way internal trade barriers are hurting the very people and regions they are supposed to be helping. More broadly, we need to discuss and build consensus on what economic strategies governments can pursue to achieve the social outcomes we want.

Before I go into detail, let me outline where I am coming from. The Business Council on National Issues (BCNI) is made up of the chief executives of most of Canada's largest enterprises, both Canadian based and foreign-owned. They head leading players in every sector of the Canadian economy and as such operate both from coast to coast and around the world.

The BCNI was the driving force in the private sector in building support for the Canada - United States Free Trade Agreement. It has been a

consistent supporter of trade and investment liberalization worldwide, for the simple reason that a small country as trade dependent as ours relies on a strong multilateral framework to offset the greater clout of our larger trading partners and competitors. The BCNI also has backed sound fiscal and monetary policy and acted to promote better governance – including a more effective economic union.

A couple of years ago, it became clear that while Canada had succeeded in vastly improving its macroeconomic environment, there were still some important pieces missing from the puzzle of national strategy. Our country had made important gains, but others were catching up and passing us by. Canada's performance on productivity, on research, on innovation and other indicators of future competitiveness was lagging. This prompted the BCNI to launch what we called the *Canada Global Leadership Initiative*, with the goal of making Canada "the best place in the world in which to live, to work, to invest and to grow."

After a year of research and consultation, the Council presented its preliminary thoughts to the *CEO Summit 2000* a year ago in Toronto. Its message was broad, highlighting the key links between economic and social progress. But it was seen, especially in the media, as a harsh criticism of the federal government for acting too slowly to reduce taxes.

We did indeed see tax cuts as an important first step in a broader agenda, and by the time of the autumn budget update, the government had come to the same conclusion. However, the BCNI's message was always about much more than taxes.

One result of our continuing work, if you will pardon the unavoidable book plug, was published last month by Stoddard. In *Northern Edge: How Canadians Can Triumph in the Global Economy*, BCNI President and Chief Executive Thomas d' Aquino and I cast a pretty wide net. We look at everything from fiscal policy to improving public schools, from globalization to Parliamentary reform. Today, I want to focus on just one part of the big picture, the need for a more collaborative approach to national economic strategy.

What I have to say today flows in part from detailed discussions that the two of us had with the chief executives of more than 50 major corporations. In these discussions, we explored the strategies that Canadian enterprises are pursuing in the global marketplace, the factors that are driving these strategies and the potential impact of these corporate strategies on Canada's economy and society.

It became very clear to us that Canada is home to plenty of companies that are seizing the opportunities of global integration. Their global strategies, however, often seem to be leading to looser ties to Canada, with potentially serious consequences for our country.

The subject of today's discussion, internal barriers to the movement

of goods, services, people and capital, cropped up fairly often, in conversations across a wide range of industries.

Some of these concerns were fairly simple. The fragmentation of regulation on transportation, for instance, adds needlessly to the complexity and cost of moving goods from one province to another. Barriers to labour mobility mean that companies have been forced to leave positions vacant and slow their growth because they have been both unable to hire qualified Canadians from other provinces and prevented from recruiting abroad.

Factors such as these raise the cost and difficulty of doing business in this country. In the process, they hurt both consumers and the ability of Canadian enterprises to grow. But the damage done by internal barriers is far more serious than simply raising the cost of doing business.

First of all, they have a damaging impact on Canada's reputation abroad, especially when it comes to attracting investment. Canada has the advantage of preferred access to the United States market. But ours is the smaller country, and if all we do is imitate the Americans, we are still likely to come out second best when it comes to attracting investment in operations serving the continental market. We have to demonstrate in convincing fashion that Canada is not just as good as the United States but in fact the better place to do business.

In this respect, the more serious damage of internal barriers to trade and mobility is done to the country's reputation. The direct costs of such barriers are of relatively little concern when it comes to operations serving all of North America, since most of the flows will be international.

These domestic irritants, however, reinforce the perception that Canadians are parochial and that our governments are both shortsighted and interventionist. Yes, internal barriers raise costs, and that alone is a concern. But the message they send is that Canada is not a friendly place to do business, that investing here involves a level of risk greater than that of our neighbour to the south.

In this respect, a single incident may have repercussions that go much further. This has been the case, for instance, in the stand-off between Inco and the government of Newfoundland and Labrador over the development of Voisey's Bay. In terms of direct economic costs, the result of an insistence that all ore be processed not just within Canada but within the province, has been simply no mine and no jobs. That is bad enough. But more broadly, it has left the impression abroad that Canada remains a country in which governments intervene constantly to put short-term political considerations ahead of economic good sense.

Our conversations with the heads of foreign-owned subsidiaries in Canada confirmed that we already have a substantial legacy of interventionist reputation to overcome, and every incident of frustrated invest-

ment makes it harder for the country as a whole to put that reputation behind it.

Perhaps even more serious than the damage that internal barriers do to our reputation abroad, however, is the damage we do to the competitiveness of our own enterprises.

Over the years, researchers at Statistics Canada and elsewhere have demonstrated quite convincingly that inward flows of foreign investment are important not just in creating jobs, but in creating conduits for the diffusion of new ideas and innovative technologies within the Canadian economy. Foreign-owned plants have consistently increased productivity faster than domestic plants of similar size. Foreign-owned subsidiaries perform more research than domestic firms, surpass Canadian companies in introducing world-first and Canada-first innovations, and are more likely to use their innovations to boost exports.

In a study last year, however, Statistics Canada showed that the key to innovative behaviour was not foreign ownership. When it compared the innovation performance of foreign firms to that of Canadian-owned multinationals, the results were almost identical. The degree of research and innovation was a reflection not of the nationality of their shareholders, but rather of their international orientation. As we put it in our book, global engagement is the key to the research and innovative attitudes that in turn drive productivity growth and competitive advantage.

The signing of the Free Trade Agreement with the United States certainly had a powerful impact in exposing many Canadian companies to competitors from abroad and jolting them into action. The restructuring of the 1990s was painful, but its benefits are now clear. Companies that responded to the new competitive pressures are larger, stronger and much more likely to be shipping goods and providing services beyond Canada's borders. The continued process of global economic integration – with or without the completion of any further regional or global agreements – will keep Canadian companies under pressure. That pressure in turn is the key to innovation, to survival and to growth.

In this environment, barriers to internal trade can be extremely counterproductive. Take for example, local or regional preferences on procurement. While provincial governments have grudgingly accepted the notion of open competition, restrictions are still permitted for smaller contracts and for the vast range of goods and services purchased by the broader public sector, including municipalities, schools, hospitals and Crown corporations.

The value of such preferences has always been dubious. Even where they work to keep jobs and profits locally, they do so by paying the local firm more money than the public sector purchaser would otherwise have to pay. That difference in price requires higher taxes or a lower level of

service than taxpayers would otherwise enjoy – meaning that benefits to some local businesses come only at a cost to all the rest and to individual taxpayers.

But that is just the beginning of the damage. Another aspect of global economic integration is a reorganization of corporate activities, one that is ripping apart the traditional country subsidiary and consolidating plants and corporate functions into clusters of expertise that serve customers worldwide.

Consider one of the examples we mention in our book. A decade ago, IBM Canada Ltd. was like most multinational subsidiaries, a company primarily devoted to sales and service related to Canadian customers. Today, despite a dramatic downsizing in the early 1990s, the company has more employees than ever and twice as many executives. Significantly, many of these executives and about a third of its employees are involved in functions with a North American rather than Canadian mandate. All of IBM's telephone technical support for North America, for instance, is provided from Toronto – highly skilled work that Canadians are able to supply not only at a competitive price, but in 23 languages.

Similarly, Canada's most successful homegrown enterprises are expanding beyond our country's borders. Their international success is in turn driving the creation of well paid jobs at home. Whether within foreign-owned or Canadian companies, the key to growth is the ability to compete in the wider continental and global market.

Companies that tap into the global pool of ideas, talent, opportunity and capital are forging ahead – and the evidence suggests that those who keep their heads stuck in the domestic sand are continuing to fall behind in terms of productivity, innovation and competitiveness.

The link to regional preferences is obvious. By offering preferences to local firms, provincial public sector customers may provide a stable source of revenue. While that security blanket may stop the local small fry from crying, however, it clearly stunts their growth. The productivity and innovation divide within the Canadian private sector is well documented. By offering easy money for staying close to home, provincial governments and public sector institutions in fact discourage local enterprises from making the risky investments needed to take on the competition anywhere else.

What is more, one of the key lessons of the global economy is that leadership pays, that like attracts like with frightening speed. Talented people want to work for and with other leaders in their field. As communications technologies reduce the impact of distance, Canada's regions have real opportunities to present themselves as attractive locations for investment in competitive operations serving the world market.

But high tax rates flowing from policies that give preferential treat-

ment to uncompetitive local players directly undermine such efforts. Efforts to pamper local players tend to limit their ability to compete and grow anywhere else. At the same time, parochial attitudes turn off both companies with wider ambitions and skilled people who see themselves as global citizens.

So what does this imply for the future of the *Agreement on Internal Trade*? Let me be clear. I am fully supportive of measures to strengthen the provisions of the *AIT*, to extend its coverage and to give it teeth. I also would support moves to make it easier for companies and provinces to launch challenges and to resolve disputes quickly and at low cost.

But frankly, the time has come to move beyond the *AIT*. I am less concerned here with legalistic progress than with the need to change political and public attitudes. As long as provincial political leaders remain convinced that the *AIT* is a necessary evil and that the interests of their provinces may still be served by the erection of barriers against other Canadians, they will find ways to frustrate its intentions. If that attitude prevails, we can expect little progress either in enhancing the *Agreement* itself or in improving the dispute settlement and enforcement process.

Leadership attitudes matter, and as James Downey suggested at lunch, a re-commitment by First Ministers to the principles of the *AIT* would be a good start. But it will not mean much if they have to have their arms twisted to do so. They must mean it because they understand the benefits both to the country and to their own constituents.

I see two major arguments that might prove persuasive in building their support for further progress. The first comes back to scale. Competitive federalism has many positive aspects. Enabling different provinces to try different approaches allows all Canadians to judge which approaches work best and to adopt best practices. While this may justify some differences in areas such as environmental, consumer and labour regulations, we have to remain conscious of the benefits of working together.

Let us take one hypothetical example. California has some of the toughest environmental rules on automotive emissions in the United States. The result is that auto makers who want to sell cars in California have to manufacture products that conform to its higher standards. Canada as a whole is roughly on par with California. It already maintains distinct standards in some respects and could conceivably raise them to new heights. But if Prince Edward Island alone were to try adopting sharply higher standards for auto emissions than California, the result would either be no new cars in the province or dramatically higher prices flowing from the need to convert each new vehicle individually. For Canadians in any part of the country who favour higher environmental standards, pan-Canadian collaboration is likely to be far more effective

than a fragmented province-by-province approach.

I would add here that nothing in the process of global economic integration prevents Canada from setting and maintaining its own distinct standards in any field. Indeed, leadership in areas such as environmental policy could become a powerful element in our global brand. But we cannot succeed in such an approach unless we work together within our own borders.

My second argument comes back to the damage that is done by internal barriers even to the local companies they are supposed to be helping. If political leaders come to realize at the gut level how shortsighted such barriers are, we will see more than just progress in improving the AIT. We will see a degree of progress in provincial policy-making sufficient to make the AIT unnecessary.

My fundamental message is this. Infusing all policies with a spirit of openness will unleash creativity, foster innovation and spur economic growth. By making this country work more effectively as a whole, we will help Canadian enterprises to become more productive and grow globally. We will be more successful in attracting investment in operations serving the global market. And the greatest benefits will be seen in the very regions that have been most protectionist. In short, we must be Canadians first – because it pays off for all of us.

Abandoning internal barriers to the mobility of goods, services, people and capital is not a sacrifice – it is smart policy, both for provincial governments and the country as a whole. There is an ocean of opportunity out there for Canadians and for Canadian enterprises. But if we take our eyes off that broad horizon and instead look only down at our own small puddle, the best we can hope for in the end is a face full of mud.

We can do better. We must do better. But the first step is to understand that openness is the key to a better future for all.