**Think like a Canadian Economist**

**Episode 2: Internal Trade Barriers.**

**VIDEO SCRIPT:**

Canada is regularly described as a “trading nation” – it’s even in our citizenship manual! Trade has defined our history, has influenced our laws, our everyday lives, and our economy.

Just how important is trade for our economy today?

Approximately 40 cents of every dollar earned by Canadians is from an export sale and about 40 cents of every dollar spent by Canadians is on imported goods and services.

Last year, Canada’s total international exports and imports both exceeded $500 billion dollars for the first time.

But what about trade within Canada?

A car manufacturer in Ontario selling to a buyer in BC – that’s trade.

A lumber mill in BC selling 2-by-4s to a home builder in Ontario – that’s trade.

It doesn’t get as much attention as international trade. But it’s almost as important. In 2011, trade flows between provinces totalled over $350 billion!

This trade isn’t easy, though. There are many roadblocks buyers and sellers must overcome.

There aren’t border guards at provincial borders, just friendly welcome signs. So what are these internal barriers?

They take a wide variety of forms.

Any time provincial rules penalize producers from outside the province, that’s a trade barrier.

Any time a province prohibits you from, or charges you for, buying a good or service from outside the province, that’s a trade barrier.

As a stark example, consider a recently repealed restriction in Quebec. It used to be that margarine in Quebec had to be colorless, instead of the butter-coloured margarine produced in other provinces. This effectively prevented margarine producers in other provinces from selling in Quebec without completely re-formulating their production (which would be very costly).

Want to buy a used car from another province? Chances are you’ll have to pay for a costly inspection first.

Want to use an accountant or stock broker from another province? Unless he’s gone through your province’s certification process, you can’t.

Sometimes governments have explicit “buy local” policies. In Ontario, if you’re bidding on a government contract for an infrastructure project, they give a bonus to Ontario companies. Even if they are less efficient, they may win the contract. They call it a “Local Knowledge” award; but its effect is to inhibit inter-provincial trade.

Let’s get to the tough questions.

* How can we measure the overall effect of barriers on Canada’s internal trade?
* How large are they?
* Do they inhibit trade?
* Do they harm our economy?

One way to measure the size of trade costs is to look at how much households and businesses spend on imports. The higher trade costs are, the lower the share of spending on imports. Let’s use Alberta as an example.

Within Canada, less than fifteen cents of every dollar spent by Albertans is on imports from other provinces, the rest is from Alberta’s own producers.

How much would they import if there were no trade costs? Imagine they could instantly access imports for free – perhaps using the transporter technology from Star Trek.

Trade economists have a way of estimating this hypothetical amount. Turns out it is (basically) equal to how much economic activity takes place in the rest of Canada.

Of course, we will never live in such a world. It will always be costly to ship goods from one location to another.

Instead, we can look at trade costs unrelated to distance. How? Well, Economists like math, and we have made a lot of progress writing mathematical representations of economies and their trade flows. We call these “models”.

We can combine a model with trade data to estimate what trade would be if only distance mattered.

Comparing actual trade to what it would be if only distance mattered, we can attribute the difference to internal trade costs.

Applying these methods, Canadian economists have found internal trade barriers add 8-15% to the cost of goods traded within Canada. That’s like imposing a 15% tax on purchases from other provinces.

How does this affect Canada’s economy?

Trade costs prevent the best firms and workers from supplying their goods and services to consumers. A producer that isn’t particularly good at making its product is essentially “protected” by the trade costs ~~–~~that make it harder for companies outside the province to compete. This lowers Canada’s productivity, which lowers our incomes and our standard of living.

While it’s hard to pin down precisely, research suggests internal trade barriers lower total GDP by between 3-7%. Since Canada’s economy generates almost $2 trillion dollars per year, these small costs add up to between $60 and $140 billion dollars!

Of course, there is more work to do. The results depend on the model being a reasonable representation of the Canadian economy. Future work – with new models and better data - will push our understanding of trade costs even further.

Until then, Canadian Economists are confident that internal trade barriers are all around us and they harm the Canadian economy.

So what can we do about it?

For starters, governments must sit down and talk to each other to work out their differences.

The “New West Partnership Trade Agreement” is perhaps the best recent attempt to improve internal trade, to streamline regulations and remove trade barriers between BC, Alberta, and Saskatchewan.

For the Gold Standard in dealing with internal trade barriers, we turn to Australia

Way back in 1992, they adopted the idea of mutual recognition more broadly than anywhere else.

The agreement is comprehensive. Goods that can be sold in one region may be sold in any other without having to meet additional requirements. Workers licensed to practice their trade in one region are permitted to move and work in any other. No occupation is exempt.

Canada can dramatically improve its internal market by following a similar approach.

Improvements are possible.

Follow us on twitter @tlcecon. And visit our website for more videos.

**SUGGESTED REFERENCES FOR MORE INFORMATION**

Lukas Albrecht and Trevor Tombe (2016), "Internal Trade, Productivity, and Interconnected Industries: A Quantitative Analysis," *Canadian Journal of Economics. Forthcoming.* LINK: <https://ideas.repec.org/p/clg/wpaper/2015-05.html>

Delina Agnoteva, James Anderson, and Yoto Yotov (2015), "Intra-national Trade Costs: Assaying Regional Frictions" LINK: <https://www2.bc.edu/james-anderson/InternalCostsJan23.pdf>

Trevor Tombe and Jennifer Winter (2014), "What's Inside Counts: Migration, Taxes, and the Internal Gains from Trade," LINK: <https://ideas.repec.org/p/clg/wpaper/2013-28.html>

James Anderson and Yoto Yotov (2010), "The Changing Incidence of Gravity," *American Economic Review* 100: 2157-2186

**References for more information:**