Paul Jenkins: How trade and impediments to internal trade affect the Canadian economy

Opening statement by Mr Paul Jenkins, Senior Deputy Governor of the Bank of Canada, to the Standing Senate Committee on Banking, Trade and Commerce, Ottawa, 12 March 2008.

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Thank you, Mr. Chairman, for the opportunity to appear before this committee. With me is John Murray, a deputy governor at the Bank of Canada and member of the Bank's Governing Council.

Let me start by saying that the issue of internal trade barriers is critically important, and I'm very pleased, Mr. Chairman, that your committee is examining it. We have reviewed previous submissions to this committee, and you will see that our focus will be slightly different. Rather than address the details of any given restrictions to internal trade, I'd like to focus on how trade and impediments to internal trade affect the overall performance of the Canadian economy.

In these remarks, I'd like to address two important issues from that perspective: the need for flexibility in adjusting to economic change, and the need for economic policies that promote flexibility in markets for goods, services, capital, and labour.

Economic flexibility refers to the ability of an economy to adjust to changing circumstances. Changes in economic conditions often relate to movements in relative prices, which in turn send important signals to markets. A flexible economy is one that adjusts to these signals and returns to its production potential as quickly, and with as little cost, as possible. Over the past decade or so, economic expansion in Canada and around the world has been robust, despite a series of major shocks. These shocks included:

- the 1997-98 financial crisis in Asia, which spread to Russia and Latin America
- the worldwide collapse of the high-tech bubble
- the 9/11 terrorist attacks in the United States
- SARS and BSE
- intensified competition from China and India
- and, since 2003, a sharp increase in commodity prices and an associated sharp increase in the external value of our currency.

More recently, of course, we have been faced with the fallout of credit market turbulence associated with problems in the American subprime-mortgage market and the increased use of structured financial products. It's important to note that all of these shocks were international in origin and/or in dimension.

Many of these shocks – notably, the Asian crisis and the recent sharp run-up in commodity prices – involved large movements in relative prices, that is, in the prices of energy and non-energy commodities, as well as large movements in the exchange rate for the Canadian dollar. And these movements have in turn triggered important shifts in economic activity, as well as reallocations of production resources across sectors and regions of the country.

All of this underscores the fact that we live in an era of rapid change, and we operate in a global environment that is constantly shifting. Uncertainty, risks, and shocks are constant features of the economic landscape. For Canada, it is particularly important that we recognize this reality, given how open our economy is to international trade and capital flows.

The best approach to dealing with risks and sudden developments is to constantly ask ourselves what steps we can take to make our economy and domestic markets more flexible, and thus better able to adapt to changing circumstances. And we need to recognize that this is a *shared* responsibility among firms, workers, and policy makers.

Firms and their workers need to be able to respond quickly to technological advances and to shocks that require changes in the way they conduct business, the kinds of goods and services they produce, and the markets they choose to develop. A well-functioning market-based economy that sends clear relative price signals is critical in this context.

At the same time, policy-makers need to be wary of barriers to adjustment, such as labour regulations that inhibit the movement of workers from one type of job, or from one sector or region, to another. To enhance flexibility, to raise the growth potential of the economy, and to increase its resilience to shocks, we need policies that encourage structural reforms. For Canada, structural reform has a broad context, with priorities across a number of jurisdictions.

The financial system, with its vital role in supporting a healthy modern economy, has been and will continue to be one priority. An efficient and sound financial system enhances overall economic flexibility by helping to redirect capital and resources to the most productive uses, in a cost-effective way, following a shock.

Removing internal barriers to the free movement of goods, services, and labour is another priority. These barriers are rightly attracting attention in Canada as differences in regional economic performance and shortages of skilled labour are becoming more pronounced, and as demographic challenges intensify.

A number of initiatives to remove internal barriers have been undertaken over the years, but with mixed and generally modest results. The Red Seal Program was introduced more than 45 years ago to help standardize and recognize workers' trade qualifications. The Agreement on Internal Trade (AIT), signed by First Ministers in 1994, aimed to reduce barriers to the movement of goods, services, investment, and labour. One very important recent example is the Trade, Investment and Labour Mobility Agreement (TILMA) reached in April 2006 between British Columbia and Alberta to strengthen enforcement and dispute resolution and to harmonize labour credentials and business regulations and standards by early 2009.

Considerably more needs to be done to enhance the flexibility and functioning of our internal markets from coast to coast. Business regulations and standards, including those of the financial sector, need to be harmonized across Canada. Dispute resolution and enforcement under the AIT need to be strengthened. And to make our labour markets more flexible, trades and professional designations should be recognized and fully transferable across the country. A significant step forward would be for others to adopt the British Columbia-Alberta accord.

The Bank of Canada also has an important role to play in helping the economy to adjust to economic change. The Bank's monetary policy aims at keeping inflation low, stable, and predictable, which in turn helps Canadian businesses to read price signals more clearly, respond to relative price movements more promptly, and allocate production resources more efficiently.

I'll conclude by saying that uncertainty, risks, and shocks will be as much a part of tomorrow's economic picture as they have been in the past. We all have a stake in Canada's economic well-being, and we all have a role to play in improving our flexibility and adaptability. From that perspective alone, this committee's study of issues related to internal barriers to trade is timely and important.

Thank you, Mr. Chairman. John and I would be happy to respond to your questions and comments.