

THE INVESTMENT SUBSIDIES AND THE CANADIAN AGREEMENT ON INTERNAL TRADE

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In the 2001 Human Development Index released annually by the United Nations Development Programme, Canada fell from the first place ranking it had held for the preceding six years to third place, behind Norway and Australia.¹

Canada's decreasing standard of living was also acknowledged in the Government of Canada's innovation strategy report, "Achieving Excellence: Investing in People, Knowledge and Opportunity", released on February 12, 2002. The report stated that while Canada ranks seventh in the OECD in terms of income per capita, real income has been steadily declining over the past two decades compared to the United States.² Furthermore, Canada's overall productivity level – measured in terms of GDP per hour worked – is approximately 19% lower than that of the United States.³ In fact, Canada is only outperforming the United States in certain resource specific sectors, such as crude petroleum and natural gas, lumber and wood, paper and allied products, primary metal, and transportation equipment.⁴

In the name of promoting economic development and increasing international competitiveness, both federal and provincial governments have provided incentives to industry. Among the most common forms of subsidies provided by government are: tax incentives, financial incentives (ie. loans, grants), infrastructure assistance, fast-tracking of required per-

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¹ *Human Development Report 2001* (July 10, 2001), online: <<http://www.undp.org/hdr2001/pr7.pdf>> The report ranks 162 countries on factors such as life expectancy, educational enrolment, adult literacy, and per capita income.

² Industry Canada, *Achieving Excellence: Investing in People, Knowledge, and Opportunity* (February 2002), online: <<http://www.innovationstrategy.gc.ca/cmb/innovation.nsf/PageE/Section+2>>

³ *Ibid.*

⁴ *Ibid.*, from Industry Canada computations based on data from Statistics Canada, U.S. Bureau of Economic Analysis, and OECD.

mits, subsidization of fees and utility rates, protection from environmental liability, and employee training.⁵

In light of the somewhat fractious nature of the Canadian federation,⁶ federal governments have for many years incorporated business subsidies as part of their national unity programs. In this regard, "regional economic development" programs have featured prominently. The use of subsidies has allowed the federal government to maintain a visible profile with respect to the economic affairs of the nation, and to reap the short-term political benefits of subsidy announcements and ribbon-cutting ceremonies.

The incentives offered by the federal government are more than simply pocket change. In the fiscal year 2000/01, the following federal government agencies alone were budgeted to provide over \$1 billion in corporate subsidies:⁷

Atlantic Canada Opportunities Agency	\$308 million
Technology Partnerships Canada	\$300 million
Canada Economic Development for Quebec Regions	\$268 million
Western Economic Diversification Canada	\$198 million
Natural Sciences and Engineering Research Council	\$117 million

Increasingly more commonly, agencies such as the Atlantic Canada Opportunities Agency, Industrial Research Assistance Program, and the Federal Development Initiative in Northern Ontario are being characterized as "poorly managed institutions that apply inconsistent criteria and inadequately monitor the results of their efforts".⁸ The systemic and human issues surrounding government granting agencies may best be summed up by the comments of federal Auditor-General Denis Desautels, when he stated "Our audits in various departments over two decades have identified persistent shortcomings in the management of discretionary grant and contribution programs. These shortcomings have ranged from problems of non-compliance with program and legislative

⁵ Graham Richards, "Competition Between States and Provinces for New Investment: The Effect of Cross Border Incentives on Plant Location" (2001) 27 *Canada-United States Law Journal* 179 at 180.

⁶ Most notably demonstrated by the relationship of Quebec to the remainder of the federation, and the ever present threat of Quebec separation.

⁷ Sean Silcoff, "Manna From Hell: Some of Canada's Corporate Giants have Benefited from the Government's Helping Hand" *National Post* (November 18, 2000) D01.

⁸ *Ibid.*

authorities to weaknesses in program design, poor financial and management controls, and deficiencies in measuring and reporting results".⁹

To provide just one example, the Canadian Taxpayers Federation recently released a report regarding the federal government's Technology Partnerships Canada program (TPC), administered through Industry Canada. The report found that since 1996, TPC awarded a total of \$947 million in conditionally repayable loans to Canadian corporations, but to date has only recouped a total of \$24.4 million (3%). The report also found that:

- Over 57% of all \$1.7 billion in project authorizations were destined for Quebec companies;
- TPC practices 'March Madness' spend it or lose it budgeting with an average of 56% of all projects approved in March of each fiscal year;
- No annual reports have been released since 1998/1999;
- 26 projects worth \$378 million have not been announced;
- TPC is violating several sections of its own Accountability Framework including requirements for periodic audits and a comprehensive four-year audit;
- Job creation estimates reveal that taxpayers have been on the hook for \$58,891 per supposed job created; and
- Three projects worth \$147 million were announced publicly before all approvals were given within government.¹⁰

Reports such as these, combined with the poor performance of the Canadian dollar, increasing concern regarding the economic performance of Canada in comparison to the United States, and high taxes, lead to questions on whether the funds being used to provide business subsidies could be expended in a more productive manner. It is the authors' position that in order to truly promote national unity, the federal government must play a genuinely visible role in demonstrating a concrete and positive concern for the lives of individual Canadians. Rather than simply providing transfer payments to the provinces, or spending billions of dollars on subsidies to business, the federal government should with many programs attempt to place those funds directly in the hands of individual Canadian citizens. In this manner, citizens are empowered to make their own market choices regarding spending, and it is hoped that in return

⁹ *Ibid.*

¹⁰ Canadian Taxpayers Federation press release (February 27, 2002), online: <<http://www.taxpayer.com/lts/mb/February27-02.htm>>.

they will gain an appreciation for the positive role that the federal government can play in their lives.¹¹

Subsidies are often addressed within various regional and international trade agreements. Canada actually has its own internal "NAFTA", the Canadian Agreement on Internal Trade (CAIT). It would strike an outsider as odd that a country with over 130 years of united existence requires such an agreement. The situation is even odder if one recalls that the predominant purpose of the federal government, as stated in the Constitution Act, 1867, was to manage an economic union. Nonetheless, a long course of court decisions and governmental practices have resulted in the existence of many internal trade barriers. This article will examine how subsidies are dealt with by our CAIT. It will attempt to show that in this area, as in many others, the CAIT is not as stringent in its requirements and as enforceable as it ought to be. It will be argued that in order for Canada to maximize competitiveness, both internally and internationally, investment incentives should be minimized to the greatest extent possible in order to ensure long-term prosperity through improvements to the business climate as a whole, rather than through targeted subsidies to individual enterprises. One possible solution to the "prisoner's dilemma" that the provincial governments currently face, both internally and internationally, may be an independent federal-provincial agency, set up under the CAIT, to coordinate and supervise the awarding of direct incentives by the provinces. Such an agency would limit the extent to which provinces can be played off against each other by private investors, and give provinces an external restraint in the face of local demands for preferential economic treatment.

CANADIAN AGREEMENT ON INTERNAL TRADE (CAIT)

The Canadian Agreement on Internal Trade (CAIT) formally took effect in July, 1995. The objective of the CAIT is stated as follows:

...to reduce and eliminate, to the extent possible, barriers to the free movement of persons, goods, services and investments within Canada and to establish an open, efficient and stable domestic market. All Parties recognize and agree that enhancing trade and mobility within Canada would contribute to the attainment of this goal.¹²

¹¹ For further discussion on this issue, please see Bryan Schwartz, "Visible Federalism: A Strategy for the Federal Government in the Aftermath of the Referendum" (1997) 24(2) *Manitoba Law Journal* 533.

¹² "Article 100", Canadian Agreement on Internal Trade, online: <http://www.intrasec.mb.ca/index_he.htm>.

While the objective is laudable, the nature and language of the agreement have in some areas hindered true progress from being made. The CAIT is not legally binding on its signatories and, as shall be evidenced from the discussion below, the language used leaves a great deal of discretion with the parties to determine whether their behaviour is appropriate. In addition, the formal – and non-binding – dispute settlement mechanism is slow, complicated and expensive. In the case of investment incentives, the formal dispute settlement mechanism is only applicable in cases where it is alleged that a party's conduct has violated Articles 4 through 7 (which prohibit incentives that are contingent on an enterprise's relocating from another province) of the Code of Conduct on Incentives; this mechanism is not available for disputes regarding Articles 8 and 9 of the Code (which discourages incentives that are excessive, prop up enterprises that are not likely to be liable in the long run, or increase capacity in areas where the market does not warrant it).¹³ In order to show a true commitment to the objective of a strong internal economic union, these underlying issues must be dealt with by the signatories.

The provisions of the CAIT that deal with investment incentives are found in Chapter 6 of the Agreement. As stated by Doern and MacDonald,¹⁴ “[t]he investment provisions of Chapter 6 of the agreement were, in many respects, the centerpiece of the negotiations surrounding the mobility of capital in the Canadian economic union.”

The term “incentive” is defined in Annex 608.3, the Code of Conduct on Incentives,¹⁵ as:

- (a) a contribution with a financial value that confers a benefit on the recipient, including cash grants, loans, debt guarantees or an equity injection, made on preferential terms;
- (b) a reduction in taxes or government levies otherwise payable aimed at a specific enterprise, whether organized as one legal entity or as a group of legal entities, but does not include a reduction resulting from a provision of general application of a tax law of a Party; or
- (c) any form of income or price support that results directly or indirectly in a draw on the public purse.

¹³ Articles 13 and 14, Annex 608.3

¹⁴ G. Bruce Doern & Mark MacDonald, *Free Trade Federalism: Negotiating the Canadian Agreement on Internal Trade* (Toronto: University of Toronto Press, 1999) at 99.

¹⁵ Annex 608.3

The Code of Conduct, and the CAIT itself, does not contain a blanket statement that prohibits the signatories from offering incentives to business. In fact, the Code merely provides that if subsidies are offered, the parties shall "minimize the adverse effects of their incentives on the economic interests of other Parties".¹⁶ The Code also affirms that parties to the Agreement may offer incentives in the name of economic development,¹⁷ provided that the incentive:

- (a) does not sustain, for an extended period of time, an economically non-viable operation whose production adversely affects the competitive position of a facility located in the territory of another Party;
- (b) does not increase capacity in sectors where the increase is not warranted by market conditions; or
- (c) is not excessive, either in absolute terms or relative to the total value of the specific project for which the incentive is provided, taking into account such factors as the economic viability of the project and the magnitude of the economic disadvantage that the incentive is designed to overcome.

Incentives are only prohibited in two circumstances. First, an incentive is prohibited if it is "in law or in fact, contingent on, and would directly result in, an enterprise located in the territory of any other Party relocating an existing operation to its territory".¹⁸ This prohibition may be overcome if the government offering the incentives can demonstrate that the enterprise was considering relocation outside of Canada. It must be shown that this relocation was "imminent, well-known, and under active consideration".¹⁹ Second, an incentive is prohibited if the primary reason for its provision is to allow an enterprise to undercut its competitors when obtaining a specific contract in the territory of another party.²⁰

Article 9 of the Code of Conduct provides that signatories "shall endeavour to refrain from engaging in bidding wars to attract prospective investors seeking the most beneficial incentive package". The weak language in Article 9 is subjective in interpretation as to whether or not a province has genuinely "endeavoured" to avoid entering into a bidding war. In some cases, the provinces have chosen to reinforce the provisions of this Article with bi-lateral agreements. For instance, on January 23,

¹⁶ Article 3, Annex 608.3

¹⁷ Article 8, Annex 608.3

¹⁸ Article 4, Annex 608.3

¹⁹ Article 5, Annex 608.3

²⁰ Article 6, Annex 608.3

2002, Premiers Gary Doer of Manitoba and Bernard Lord of New Brunswick signed a memorandum of understanding, which included among the ten key issues an agreement to avoid "poaching" enterprises from the respective provinces. Doer stated "I am pleased Premier Lord and I have agreed to avoid situations that pit our two provinces against each other in unproductive 'bidding' competition for business investment using public tax dollars."²¹ However, it should be noted that this memorandum of understanding is no more legally binding on the signatories than the CAIT.

The Chapter 6 provisions of the CAIT have been only formally challenged once.²² In January 1995 (after the Agreement was signed, but before it came into force), United Parcel Services (UPS) announced that it would be consolidating its activities and moving 870 positions from British Columbia, Manitoba and Ontario to a customer service centre in New Brunswick. According to UPS senior vice president Michael Tierney, the move was "a business decision that cut administrative costs".²³ Then-Premier of New Brunswick, Frank McKenna, stated that UPS chose New Brunswick due to the availability of bilingual staff and the province's superior digital communications networks.²⁴ However, Tierney and McKenna's statements must be examined in view of the fact that the government of New Brunswick had also agreed to provide UPS with approximately \$6 million in forgivable loans and training assistance grants.²⁵

The government of British Columbia took the position that the \$6 million incentive package provided by New Brunswick violated Article 4 of the Code of Conduct, and opted to take advantage of the remedies available to it under the CAIT. New Brunswick took the position that the CAIT did not apply since the incentives were offered before the agreement came into force, but in any event, they stated that the incentives were not contrary to the provisions of the CAIT, since the consolidation of an existing enterprise was not covered by the agreement.

The parties did hold consultations, and in July 1996, British Columbia requested the assistance of the Committee on Internal Trade in resolving the dispute. However, no formal dispute panel was requested by

²¹ Manitoba Government Press Release (January 23, 2002), Government of Manitoba website, online: <<http://www.gov.mb.ca>>.

²² Dispute/Complaint Tracking Summary Statistics, Internal Trade Secretariat website, online: <<http://www.intrasec.mb.ca>>.

²³ Keith Damsell, "B.C. Files Objection to Loss of UPS to N.B." *The Financial Post* (April 27, 1996) 14.

²⁴ "Time for a Firm Stand Against Business Subsidies" *The Financial Post* (January 14, 1995) 16.

²⁵ *Ibid.*

British Columbia under Chapter 17, and even had the request been made, it was feared that New Brunswick had the ability to block the panel's formation by refusing to appoint a representative.²⁶ In addition, as previously stated, the parties would not have been bound by a panel decision. Non-implementation of the panel decision will merely result in publication of the panel's report, and the matter is added to the Committee's agenda for annual meetings until such time as it is resolved.²⁷

The non-binding nature of the dispute resolution mechanism, and the ability for parties to effectively bypass the system by refusing to appoint a panel representative, are major weaknesses in maintaining an effective and workable regime.²⁸ If the dispute resolution mechanism is not strengthened, parties have no incentive to abide by the terms of the CAIT unless it suits their political objectives. Indeed, this sentiment is echoed by Nancy Hughes Anthony, President and CEO of the Canadian Chamber of Commerce, who stated that the CAIT could be made more effective by "strengthen[ing] the dispute settlement process so that complaints get handled more quickly and there are penalties for non-compliance...the process is overly complicated and costly and some governments aren't taking it seriously enough".²⁹

In certain circumstances, the CAIT does "authorize" parties to engage in proportionate retaliation against other members of the federation who

²⁶ While Article 1705 provides that each party shall appoint two panelists within 30 days of the request for panel formation, the Article does not provide for what shall happen in the circumstance that the parties do not appoint a representative.

²⁷ Articles 1719 and 1720, Canadian Agreement on Internal Trade.

²⁸ The need for a binding dispute settlement mechanism is discussed in Fanny S. Demers, Michel Demers, Murray G. Smith, "Subsidies to Investment and the Fragmentation of the Canadian Economic Union: What Can We Learn from the European and International Experience" (April 1998), online: <http://strategis.ic.gc.ca/SSG/SSG/il00039e.html> See also "To the Extent Possible: A Comment on Dispute Settlement in the Agreement on Internal Trade" in Michael J. Trebilcock & Daniel Schwanen, eds., *Getting There: An Assessment of the Agreement on Internal Trade* (C.D. Howe Institute, 1995) 211, where author Patrick J. Monahan states at page 211 that: "[t]he dispute resolution provisions in the agreement will be of central importance in determining if it actually leads to a reduction in trade barriers or merely serves to legitimize existing trade restrictions. The agreement can fulfill its potential only if aggrieved parties are permitted access to a dispute settlement procedure that is timely and fair and that results in authoritative interpretations of the terms of the agreement."

²⁹ Nancy Hughes Anthony, "Internal Trade in Canada: A Matter of National Importance," presentation at the Internal Trade Secretariat Conference "Strengthening Canada: Challenges for Internal Trade and Mobility," Toronto (May 31 - June 1, 2001).

have breached its norms.³⁰ The federal level of government and some provinces have enacted statutes to authorize such steps. However, the spectacle of sister provinces engaging in punitive economic measures against each other is neither going to heighten Canadian unity nor lead to economic prosperity. Retaliatory steps tend to damage not only the target province, but the provinces who are engaged in them. This behaviour is particularly counterproductive if the province engaged in imposing retaliatory measures finds that it has simply opened up more market space for competitors. One of the outstanding achievements of the Uruguay Round of the world trade system negotiations was to make respect for the rule of law a core principle. The decisions of dispute panels became legally enforceable on their own, without the need to be backed up by a political consensus. It is long overdue that Canada's internal trade system move firmly in a similar direction.

By 1997, British Columbia had abandoned its formal claim against the government of New Brunswick.³¹ No other formal complaints have been brought under the CAIT in regard to violation of Chapter 6, perhaps in part due to the weaknesses of the dispute resolution mechanisms, and the great amounts of time and money to be expended by parties going through the process. However, provinces still continue to provide investment incentives, potentially in contravention of the CAIT.

In 1996, the New Brunswick government again came under fire for providing a \$5.3 million forgivable loan to Air Canada in return for the location of its national reservation and information service in Saint John.³² The government of New Brunswick defended the incentive by saying that the call centre was not relocation of an existing business, but rather an expansion. Kym Robertson, manager of corporate communications for Air Canada, stated that the loan was merely one factor in the decision – other factors for locating in New Brunswick included “a bilingual workforce, cheap rental costs, and a technological infrastructure”.³³ Although British

³⁰ Article 1709 provides that where a dispute panel has found a complaint to be valid, and the non-conforming party has not implemented its remedial recommendation, the panel may make its report public. If that does not work, Article 1710 provides a last resort: the complaining party may suspend a benefit in relation to the non-conforming party, or if that is not practical, adopt a retaliatory measure. Any such response must be “equivalent in effect” to the measure that provoked it.

³¹ For more detailed analysis of the UPS dispute, see Doern & MacDonald, *supra* note 14 at 142.

³² “NB Government Again Defends Job Hunt Tactics” Canadian Business and Current Affairs, *Canadian Press Newswire* (September 6 1996).

³³ Tony Van Alphen, “New Brunswick Denies ‘Job Poaching’ Charges; Province’s Loan to Air Canada Seeks 650 Jobs” *Toronto Star* (September 6, 1996) E1.

Columbia again raised concerns regarding the deal, Ontario's Minister of Economic Development stated that his government had reviewed the matter and found no violation of the AIT.³⁴

British Columbia also raised concerns over a \$5 million forgivable loan given by the Saskatchewan government to Intercontinental Packers Ltd. in May of 1995. Shortly thereafter, Intercon closed its Vancouver plant and consolidated its meat-packing operations in Saskatoon.³⁵ Despite British Columbia's concerns, neither of these matters were formally pursued.

WHY OFFER SUBSIDIES?

Advocates of investment incentives – primarily the governments offering them – justify the use of incentives in order to provide a competitive advantage on other jurisdictions competing for investments. The position, as summed up by Professor Matthew Schaefer, is that “a state aggressively utilizing subsidies can create jobs, cure economic difficulties, or enhance economic growth, and thus increase net tax revenues at a much quicker pace than through longer-term policies such as increasing state education levels.”³⁶

The position against investment incentives was summed up by the Foreign Investment Advisory Service,³⁷ which stated in May, 1999, that:

[i]n our experience most incentive schemes are simply not effective. They attract very little additional investment and they have costs. They are a drain on treasuries and sometimes counter-productive because they make investment procedures too complex...In fact, a significant number of multinationals make investment decisions in complete disregard of tax and fiscal incentives. They take into account only what they consider to be more basic factors. Of course, after a positive internal decision, they will bargain as hard as possible for any incentives that are available.³⁸

³⁴ Tony Van Alphen, “Province ‘Job Poaching by Attrition’; New Brunswick Broke Rules, B.C. Says” *Toronto Star* (September 13 1996) E3.

³⁵ “Trade Deal Won’t Stop Job Poaching: Economist” *Canadian Business and Current Affairs, Canadian Press Newswire* (December 4, 1996).

³⁶ Matthew Schaefer, “State Investment Subsidy Wars Resulting from a Prisoner’s Dilemma: The Inadequacy of State Constitutional Solutions and the Appropriateness of a Federal Legislative Response” (1998) 28 *New Mexico Law Review* 303.

³⁷ The Foreign Investment Advisory Service is a joint service of the World Bank and the International Finance Corporation.

³⁸ *Supra* note 5 at 181, from: <<http://www.ifc.org/ifc/FIAS/pubs/insights/incentives/incentives.htm>>.

Various studies have confirmed the position of the Foreign Investment Advisory Service.³⁹ Why, then, if investment incentives are largely ineffective in generating investment, do provinces continue to offer packages to business? The theory has been advanced by scholars such as Schaefer⁴⁰ that without proper controls on the ability of provinces to offer incentives, governments are caught in a prisoner's dilemma situation. Governments feel bound to offer investment incentives because they fear the adverse impact on their economy that they believe will ensue if they unilaterally choose not to offer incentives when all other jurisdictions may continue to do so.

The costs of providing these (sometimes enormous) subsidies fall on the shoulders of the jurisdiction's taxpayers. Large amounts of resources are expended upon projects that may (or may not) provide long-term economic benefits to the region, at the expense of other social and economic programs that may not provide a short-term political bang, but would ensure long-term growth. The ill effects of investment incentives are also felt by the small businesses that are not eligible to receive these corporate subsidies and are then forced to compete in a field stacked against them.

The "subsidy culture" might be having important, but difficult-to-quantify, impacts on the initiative and morale of the Canadian business community and the quality of political life in Canada. Those who might otherwise be engaging in product development and private-sector marketing may find their thoughts and energies diverted to the bureaucratic and political lobbying involved with seeking grants. It must be discouraging to those who have taken great personal financial risk to start up their businesses to see the government absorb the risk for their competitors. It must be downright galling for some business people when they notice that the beneficiaries of governmental hand-outs tend to be large enterprises in which owners and managers tend to be well-remunerated and free of any personal financial risk.

The "subsidy culture" also is, in our view, visibly damaging to the quality of political life in Canada. Politicians and bureaucrats are placed in the position of having to pick potential economic winners – something on which they have no particular expertise – in a context where their choices are influenced by partisan considerations, or are least seen as being so influenced. One of the virtues of trade agreements is that the disciplines they impose can to some extent insulate politicians from the

³⁹ See Richards, *supra* note 5 at 180-182.

⁴⁰ Schaefer, *supra* note 35. See also, Daniel P. Petrov, "Prisoners No More: State Investment Relocation Incentives and the Prisoners' Dilemma" (2001) 33 Case Western Journal of International Law 71.

pressure to unnecessarily or arbitrarily intervene in business matters. For example, the NAFTA and WTO agreements, and to some extent the CAIT, have imposed disciplines on the way the federal government engages in procurement. The federal government is now in the position where it can often say "sorry, we can't help you, there are transparent legal procedures that must exclusively be followed." To the extent that the CAIT can impose some reasonable discipline on selective government hand-outs to business, it may improve the integrity and effectiveness of government in Canada.

In essence, the choice comes down to short-term political gain, or long-term economic growth. Investment incentives are determined by governments, and allocated by government agencies. Politicians want to be seen as acting to stimulate economic growth, and the announcement of investment incentives is viewed as a symbol of a business-friendly climate. However, the long-term viability of enterprises that have received initial investment incentives must also be examined, in order to determine whether the initial announcement is more than merely good publicity, and whether the enterprise can thrive on its own in the marketplace once the incentives have run out.

In 1995, the Ontario government, under the leadership of Premier Mike Harris, chose to stop offering direct incentives to business, and to focus instead on a long-term program that improved the general business climate of the province. Included in this program were tax cuts, balancing the budget, reducing debt, streamlining labour laws, increasing government efficiency, reducing red tape, and investing in areas such as research and development, education and skills training, healthcare, and technology.⁴¹ This investment (including research and development tax credits) are available to all business, not merely to specifically targeted enterprises. The Ontario government estimated that between 1995 and 1999, it abolished over 50 business subsidy programs, resulting in a savings of approximately \$300 million per year for Ontario taxpayers.⁴²

While the Ontario system is not perfect⁴³ (tax credits are still offered to business in areas such as research & development, for instance), this is an example of a government that has chosen to put long-term economic

⁴¹ *Supra* note 5 at 185.

⁴² Government of Ontario website, <http://www.premier.gov.on.ca/english/news/archive99/rls.corpwelfare_bkgd2.htm>.

⁴³ It should be noted that while the authors use the case of Ontario as a jurisdiction that has chosen to focus on long-term improvements to the business climate, rather than short-term use of subsidies, the authors do not endorse either the Harris government or all aspects of its policies.

benefit before short-term political gain. By choosing to improve the overall business climate of the province, rather than merely making life easier for a few targeted enterprises, it has made the playing field more equitable for all business in a manner that might help to promote overall prosperity.

ESCAPING THE PRISONER'S DILEMMA

The Canadian Chamber of Commerce has recommended to governments that they

[e]liminate all remaining direct and indirect subsidies to all industries and businesses unless these measures (including tax credits and other measures in the tax system) play a key role in promoting knowledge and innovation or are critical to building and maintaining infrastructure of the economy. Instead, ensure that the operating environment is conducive for business and industry to grow and prosper on their own.⁴⁴

The prisoner's dilemma is not limited merely to competition between Canadian provinces and territories. It is important to note that even if subsidies can be completely eliminated in the Canadian internal trade union, other foreign nations may still compete with the Canadian nation and individual provinces for investment by offering incentives. Therefore, the federal and provincial governments may continue to feel trapped in the prisoner's dilemma and continue to offer incentives when dealing with competition from international jurisdictions. The CAIT does make allowances for this situation to some degree, by allowing for incentives if a company is seriously considering relocation outside of Canada.⁴⁵ From this standpoint, the CAIT seeks to level the playing field within Canadian borders, while still allowing the freedom to compete with other international jurisdictions who are not subject to the Agreement.

While an international agreement calling for mutual subsidy disarmament may be the most desirable solution, Canada must first look at ways to eliminate or improve upon its subsidy regime in order to ensure that the internal economic union is functioning at its full potential. Unnecessary competition between provinces results in a zero sum equation for the nation as a whole, as the gain of an enterprise in one province results in the loss of that enterprise in another.

⁴⁴ The Canadian Chamber of Commerce website, <<http://www.chamber.ca/new-pages/policy.html> under Finance and Taxation.> (2001)

⁴⁵ Article 5, Annex 608.3

A strengthened CAIT has a role to play in easing the pressures caused by the prisoner's dilemma. Governments may feel that their backs are against the wall when competing with other jurisdictions offering large incentive packages, especially when the businesses themselves are fuelling the competition and pushing for more breaks. A legally binding agreement that does not allow incentives, or that has specific rules that determine when incentives may be granted, provides the necessary external disciplinary restraint on the government in question and allows them to deflect the short-term political pressure that may come to bear when an enterprise, and the jobs and perceived economic growth that come along with it, are lost to another jurisdiction. In addition, this external restraint would prevent the offering of subsidies merely to keep up with the Joneses, allowing the money allocated for the incentives to be spent on improving the overall business climate for long-term prosperity. In essence, this would lead to a form of 'cleaner' government, whereby funding decisions are not unduly influenced by short-term political agendas.

Government ineptitude and overtly political decision-making when allocating incentives may also be eliminated by following the European model, and allowing a central independent body to coordinate the granting of subsidies. Under the European model, states must report any proposed state aid measure to the European Commission. The Commission then reviews the proposal and determines whether it is in accordance with the common market. If so, the state may implement the measure. If the measure is incompatible with the common market, and the state implements the measure regardless, the Commission may order that the aid measure be modified or revoked.⁴⁶

An independent, non-political body under the CAIT regime would provide a consistent evaluation of provincial incentives and assist in providing a framework for a cohesive national front on economic policy whereby subsidies are distributed in a disciplined manner that does not allow one province to be played off against another. It is suggested that the body be a joint federal-provincial agency, with input from both levels of government. In terms of responsibilities, proposed subsidies would receive pre-clearance from this body before they were awarded. The agency would ideally have the authority to make legally binding decisions; however, when dealing with organizational change, incremental development is generally preferred. Therefore, the agency could start with reviewing subsidy proposals and making non-binding recommendations; in time, the ability to make legally binding decisions could be implemented. In addition to the ability to require a province to modify or revoke a sub-

⁴⁶ Demers et al., *supra* note 28.

sidy proposal, the power to order compensation for those provinces that sustained a loss when a subsidy was illegally implemented by another province could fall under the agency's authority.

CONCLUSION

A strong internal economic union is necessary in order to ensure the prosperity of the Canadian nation, promote national unity, and ensure cleaner and more open government. In order to demonstrate this commitment to the economic union, the CAIT must be revamped in order to build upon past successes and learn from past failures.

In terms of the provision of investment subsidies, a legally binding CAIT or a federal-provincial panel to coordinate the distribution of subsidies would provide the necessary external restraints to ensure that subsidies are distributed in as fair and non-political a manner as possible.