Chapter One: Introduction and Overview

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It is a common ambition of federations to have an integrated internal market. Indeed, in the United States, Switzerland, Canada and Australia, the historic decision to create a federation out of formerly distinct units was at least partly motivated by the desire to create a larger, united economic space. While the European Union has evolved into a unique political creation, the ambition to create a unified "common market" was also at the core of its project right from the signing of the Treaty of Rome in 1957. Despite this common ambition, federations and the EU have varied in their success in creating integrated internal markets, just as they have in their conception of exactly what this means, how to pursue it, and the institutional tools they have available. Part of the reason for this mitigated success is, of course, the inherent tension that federal or multilevel governance regimes create around an objective such as an integrated internal market. These systems are decentralized because of the belief that some important decisions should be taken at the level of the constituent units or member states, but there is always the possibility that these decentralized choices will run counter to the integration of the national or common market. Such contrary decisions may be motivated by non-economic priorities, such as protecting safety or the environment, but they can also be motivated by a fairly clear desire to protect local employment or production. Thus there is always a judgment about the relative priority and even legitimacy to be assigned to the objective of an integrated internal market versus other objectives. The general trend in economic policy in market economies since the end of the second world war has been to work towards more open, integrated markets. This has certainly been true internationally, but as we shall see it has been true as well within federations and the European Union. That said, progress has varied a good deal amongst the five systems, as it has in addressing particular barriers within and features of their internal markets.

The internal market has received considerable attention within some federations (though focus on it has varied a good deal over time) and it has given rise to a virtual academic industry within the European Union. Surprisingly, however, there has never been a broad comparative study of how internal markets have been managed within federal or multi-level systems[1]. The very large literature on fiscal federalism has paid remarkably little attention to this aspect of the economics of federations[2]. This volume looks at the management of internal markets in four federations and the European Union. These are all advanced industrial economies where economic policy makers are committed to market mechanisms. While the EU is not a federation (it combines aspects of federalism, confederalism, and a treaty association) it is certainly an example of multi-tier governance whose experience in creating an internal market is of great interest. In fact, some aspects of the EU's internal market are now even more integrated than they are in federations, though in other aspects the EU falls well short of federal standards. Our study does not include those federations—Austria, Belgium, Germany and Spain—that are within the EU because EU policies have been so central in shaping their internal markets that the national and constituent units have relatively little discretion in such matters.[3] It was also decided not to include such well established federations as Brazil and India, both of which have significant internal market barriers, because their economic and developmental context is so different; however, they would make an excellent subject for a follow-on study.

The approach taken has been to have each case study follow a common template, which covers constitutional and legal provisions, processes and means for addressing barriers and enhancing the internal market, and some attempts to draw lessons. Our original idea was to focus on "barriers within internal markets", but we broadened our reach to include more positive policies addressing the enhanced functioning of the economy: in other words, we came to look at both "negative integration" and "positive integration", though as the chapters demonstrate experience around these two dimensions has varied considerably. The volume ends with a chapter that tries to draw some synthetic conclusions from the very different histories in these five systems, including some lessons for policy makers. This chapter provides a brief overview of each chapter.

Overview of Case Studies

The first case study is Cliff Walsh's examination of the evolution of the internal market in Australia. He explains that the country's 1901 Constitution included more than one provision intended to establish an economic union. As in most other federations, the courts have played a role in determining their practical effect. For example, in their interpretation of section 92, which provides that trade and commerce among the states "shall be absolutely free," the courts have on more than one occasion struck down burdens and restrictions on interstate trade. However, according to Walsh, this has not required harmonization of legislative and regulatory regimes across the states. Nor have the courts given a broad reading to the Commonwealth government's trade and commerce power. Various moves towards what has become a quite open internal market have in fact resulted from policy changes that addressed broader objectives than the internal market as such. Walsh describes how, from the mid-1980s, Australia took quite radical steps to transform the country's economy, which had long relied on high import barriers, into one that was more productive and competitive internationally. While the decision to open the economy was federal, it led to a cooperative effort involving the state and Commonwealth governments to regear the economy. One key element, the 1995 National Competition Policy, targeted anti-competitive provisions in intrastate and Commonwealth legislation. The second phase of economic reforms, initiated in 2006, was aimed in part at reducing regulatory fragmentation "to deliver a seamless national economy." The Productivity Commission has played an important role in advancing this agenda through major analyses, which have tended to provide significant estimates of the benefits of market reforms. Pressure from the business community has also been significant. As for the impact, Walsh's data suggest that the intensity of interstate trade in goods has increased significantly for all states; on services, there has been an increase for most states, but overall the increase has not been as great. In his conclusion, Walsh gives considerable credit to joint decision-making on the part of the Commonwealth and state first ministers and the other intergovernmental processes that supported their work and furthered the agenda. The preparedness of the Commonwealth government to provide financial incentives to the states was also important. He also makes the interesting observation that Australia's broad-based approach to economic restructuring "enabled reforms to be mutually reinforcing and helped ease adjustment burdens because the costs of some reforms were offset by the benefits of others."

In the next chapter, Bill Dymond and Monique Moreau recall that one of the major objectives of uniting the four British colonies that became Canada in 1867 was to create a single market. What is generally referred to as the trade and commerce power (s. 121 of the *Constitution Act, 1867*) was assigned to the federal government, along with other potentially important powers. For Dymond and Moreau, these provisions provided "a robust basis for preventing the fragmentation of the internal Canadian market." However, judicial decisions soon began a process that enhanced provincial powers – in large measure through an expansive interpretation of provincial governments' responsibility for property and civil rights. The impediments to a single market attracted little attention until the late 1980s when Canada signed a free trade agreement with the United States; this was expanded to include Mexico in 1994. The agreements led to some loosening of provincial discriminatory measures on beer, wine and distilled spirits. In 1995, partly to send a message to Quebecers about the functioning of the federation, the federal and provincial governments signed the Agreement on Internal Trade (AIT), which included principles and processes aimed at reducing internal market barriers. The general view, which the authors share, is that the AIT has not had a significant impact and has had significant design weaknesses, for example in its dispute resolution mechanism. Most econometric estimates of the benefits of reduced barriers in Canada have indicated modest possibilities and this has no doubt contributed to the lack of political resolve. A positive step with the AIT was the amendment in 2008 to address the significant restrictions on labour mobility caused by the different occupational certification rules among the provinces. Another example of heightened interest is the Trade, Investment and Labour Mobility Agreement (TILMA) that British Columbia and Alberta concluded in 2007 (and expanded in 2010 to include Saskatchewan). As for the federal government, Dymond and Moreau underline that, over time, it has not asserted its right to regulate trade and commerce on a national basis, though this may be changing somewhat with the Harper government's 2010 decision to ask the Supreme Court of Canada whether the federal government has the authority to establish a single national securities regulator. Moreover, federal governments have been complicit over many years in erecting or maintaining certain internal barriers through federal regulation of agricultural and labour markets. The authors find that the Canadian debate on the internal market has been relatively narrow, with a focus on internal barriers, and that progress has been hampered by the reluctance of some provinces to surrender powers or accept disciplines. They see few positive lessons in Canada's experience for other countries.

In his chapter on the European Union (EU) Jacques Pelkmans underlines the centrality of issues related to the internal market to the evolution of the institutions and law agreed to by the six original members who signed the Treaty of Rome in 1957. From the outset, the framework encapsulated four 'free movements' – goods, services, capital and persons (if not workers) – and the 'right of establishment' anywhere within the signatory countries. In Pelkmans's words, deep and wide integration of "the internal market was the 'core business'". As additional countries joined and the treaties evolved, significant 'negative integration' occurred through a process of liberalization that restricted the barriers member states could create on the activities of economic agents operating across borders. This was bolstered by 'positive integration' through EU regulation and common policies (as in competition and trade). There are certain exceptions to this trend, the most notable being the Common Agricultural Policy. These two forms of integration were possible because members states agreed to "hard international law and institutions that can deliver". They pooled their sovereignty and the process benefited from

"credibility and ambition". It had strong institutional support from the European Commission and the decision-making procedures that were developed, notably weighted majority voting, so there has been a progressive transfer of sovereignty to the centre. The internal market falls under supranational decision-making and case law, with the Court of Justice of the European Union having the final say. Against that, the EU's integration in more limited than that of federations in areas such as tax and expenditure, its labour market remains essentially national, and the Euro covers only some members. Pelkmans notes that the role of member states has been growing steadily in the implementation processes. In addition, certain issues – e.g. the 2006 Bolkenstein services directive – have been politically divisive. In the future, as in the past, the salience of subsidiarity (which was given somewhat greater weight in the Lisbon treaty) will probably be the largest obstacle to further strengthening of the economic union. In the author's words, "[s]ince it is the internal market which is most intrusive and incredibly wide in scope, subsidiarity debates frequently touch the nature and demarcation of the EU internal market."

Next we turn to the chapter on Switzerland by Thomas Cottier and Matthias Oesch. Switzerland is a highly decentralized federation whose roots can be traced to the 13th century. When the country adopted a federal constitution in 1848, it was riddled with internal tariff and other barriers to trade and addressing these was an import part of the country's liberalization agenda in the nineteenth century. The issue was then put aside for a long time, but became active again in the late twentieth century, largely because of the impact of EU law, but also because of concerns about the country's 'dual economy' in which the internally focused sectors were not competitive. While Switzerland depends strongly on exports, much of the country's internal trade continued to benefit from protection. Although in 1992 the Swiss population rejected joining the European Economic Area (much less what is now the European Union), the country has become "closely linked to European integration" by some 130 bilateral agreements. The authors demonstrate how, through a series of relatively gradual steps, this process has had "important spin-offs" in a number of important areas for the internal market. In 1996, three important statutes (on the internal market, on technical barriers to trade and on cartels and competition) gave legislative effect to some international agreements and introduced further measures to integrate the internal market. Amendments to the constitution in 1999 went further in this direction. These measures, notably the empowerment of the competition authority, have been significant. However, as the authors recount, major obstacles remain in health services (patients are not always able to access health care in cantons other than the one in which they reside) and in labour mobility (again in the health field, but also in the education and media sectors). The cantons have jurisdiction in these areas, and most of them guard it quite jealously, though they have entered voluntary *concordats,* e.g. on procurement. Cottier and Oesch find that the Federal Supreme Court, since 1912 when the power to apply and implement freedom of commerce was shifted to them from the central executive, traditionally gave priority to protecting federalism and cantonal rights when adjudicating freedom of commerce cases. This reflected, in the authors' view the judges' lack of integration of economic theory into legal reasoning and their career origins in the cantonal courts. This has started to change with the revision of the Internal Market Act and the strengthening of the competition authority's standing in judicial proceedings. Today, the main challenge relates to cantonal subsidies. Looking to the future, the authors are sceptical that Swiss citizens and the cantons will agree to much more harmonization and coordination on their own. The motor of change is more likely to be efforts and forces from outside, with the evolution of the WTO and the EU.

In the final country chapter, on the United States, Conrad Weiler recounts that foreign and internal trade were important issues for the framers of the American constitution. Congress was assigned a number of broad economic responsibilities, including taxing, spending, borrowing powers, the authority to regulate commerce among the states, as well as the very potent supremacy clause. Over time, these powers were enhanced through constitutional amendments and broad court interpretations. Moreover, during the earliest days of the republic the Marshall court developed the "dormant commerce power", which gave the court great scope for striking down internal barriers. However, the issue of the internal market (except for slavery) generated little political interest and few court cases until, in the late 19th century, the federal government became more active in the regulation of economic activity. Congress created the Interstate Commerce Commission to regulate the railroads, and passed a number of laws to regulate competition, consumer protection, and even morals in the market place. In 1914, it created the Federal Trade Commission. However, most economic regulation was still at the state level and the court tended to restrict federal powers in preference for laissez-faire. It was the Great Depression that led to a major shift, with Congress passing a wide range of statutes in relation to the New Deal. Initially the Supreme Court struck down or restricted some of this legislation, but then in 1937 it changed course and "finally deferred to Congress on economic regulation". According to Weiler, since the 1930s, Congress has passed an array of legislation establishing new agencies and regulating competition in the internal market and affecting states – including in securities, banking, transportation, telecommunications and energy—though the pendulum swung back towards deregulation starting in the 1970s (with some reregulation by the states). These developments have typically taken place on an ad hoc basis, not within any larger agenda about reforming the internal market; they have also been unilateral initiatives at the federal level with little involvement of the states. The states themselves have made a few modest agreements in areas within their jurisdiction. At the same time, some internal market barriers remain in areas such as liquor laws, procurement (e.g. 'buy local' provisions), investment subsidies, electronic products and taxation. The World Trade Organization and the European Union have criticized these and other alleged barriers though with little impact within the US. There has been very little focus on the internal market in general in the US and the scanty research suggests the potential benefit of reducing existing barriers is quite small. In light of the continuing movement towards freer trade globally, there will no doubt be changes in the regulation of some of the matters listed above. Weiler concludes that, when this occurs, the US will follow "its normal pragmatic approach to dealing with issues as they arise."

Some conclusions and lessons

In the last chapter, I try to draw some comparative conclusions and potential lessons. The chapter reviews the very different institutional arrangements in and political characters of the five systems, and notes that the authority of the central government and the courts to deal with the functioning of the internal market varies a good deal, both in breadth and depth. One of the consequences of this is that the level of market integration across the five systems needs to be looked at by subject area—regimes which have a high level of integration in one area may be low in another; for example, integration of goods markets is high in all systems, while integration of services is partial and the federations (in contrast to the EU) perform poorly on

investment subsidies. Each regime has its own history of dealing with internal market issues: what they have in common is interest that waxes and wanes, with major reform efforts usually arising from a precipitating event or set of circumstances. Success in achieving internal market reform is more likely if there are strong institutional champions, a broad agenda with attractive potential, creative approaches to decision-making—notably in avoiding the need for full consensus, and enshrining the reforms in law, so that they have real effect.

[1] Brown's book on Canadian and Australian experience is a rare example of a comparative study of this subject. Books such as Wallack and Srinivasan and Wibbels touch on the subject but end up concentrating much more on fiscal issues, with little detailed examination of microeconomic policies or internal barriers.

[2] The excellent , 600 page volume on fiscal federalism by Boadway and Shah, for example, has only eleven pages on the internal market, with few empirical references and a good deal of attention to fiscal issues such as the tax regime and macro-economic policy.

[3] Which is not to say there is no story at all. The constituent units of the EU federations have some areas of independence relating to internal market issues, which has complicated relations between those member states and Brussels. In some cases, the constituent units join their national governments in negotiations in Brussels. However, the constituent units may resist central directives and so they have sometimes been held responsible for non-compliance with EU policies. Michelmann reviews Austrian, Belgian, Germany and Spanish experience within the EU, as well as Swiss experience with its deep but partial integration. The role of constituent units within the EU federations can also be important for the internal market in areas where the EU plays little or no role, such as tax policy and some labour market issues.

References

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