

FEDERALISM AND THE MYTH OF THE FEDERAL SPENDING POWER

Andrew Petter*
Victoria

This article examines the power asserted by the federal government to spend funds on programs within provincial legislative jurisdiction, and the influence of that power upon federalism and responsible government. The author maintains that the existence of a "federal spending power" is inconsistent with Canadian constitutional doctrine and values, and that the political justifications commonly offered in its support do not withstand close scrutiny. At the same time, he contends that the extent of governmental reliance upon the spending power precludes the courts from curtailing its use. He therefore urges a program of political reform going beyond the modest limitations on the spending power proposed in the Meech Lake Constitutional Accord.

Dans cet article l'auteur examine le pouvoir que revendique le gouvernement fédéral de mettre des fonds dans des programmes qui relèvent de la compétence de la législature provinciale ainsi que l'influence qu'a ce pouvoir sur la nature du fédéralisme et de ce qu'on appelle le gouvernement responsable. Il affirme que l'existence de ce pouvoir fédéral est incompatible avec la doctrine et les valeurs constitutionnelles et que les justifications généralement avancées à son appui s'avèrent après examen n'avoir aucun fondement. Il soutient en même temps que ce pouvoir est si important pour le gouvernement que les tribunaux ne peuvent en limiter l'utilisation. Il préconise donc un programme de réformes politiques qui iraient plus loin que les limites modestes proposées dans l'accord constitutionnel du lac Meech.

Introduction

The past forty years have seen a fundamental change in the practice of Canadian federalism. The political commitment to what Edwin R. Black describes as "co-ordinate" federalism has been supplanted by an "administrative" vision of federal arrangements.¹ This change has been characterized by a breakdown of jurisdictional boundaries between the federal

*Andrew Petter, of the Faculty of Law, University of Victoria, Victoria, British Columbia.

This paper was delivered to the Legal Theory Workshop, Faculty of Law, University of Toronto, on December 2, 1988. Excerpts from an earlier version were published in *Meech Ado About Nothing? Federalism, Democracy and the Spending Power*, in K.E. Swinton and C.J. Rogerson (eds.), *Competing Constitutional Visions: The Meech Lake Accord* (1988), pp. 187-201. I would like to thank the many friends and colleagues who provided me with helpful comments and suggestions throughout this project. I also wish to acknowledge the British Columbia Ministry of the Attorney General for providing research funds.

¹ E.R. Black, *Divided Loyalties* (1975). "Co-ordinate" or "classical" federalism refers to a conception of federalism in which each order of government is supreme and

and provincial orders of government and, particularly, by increased federal involvement in matters of provincial legislative responsibility.

What is remarkable about this change is that it has been achieved without constitutional amendment and without the blessing of the Supreme Court of Canada, the institution charged with legal guardianship of Canadian federalism in the post-war period. Moreover, except in Quebec, it has generated little controversy within political and academic communities. Most politicians and constitutional scholars outside Quebec seem to have accepted the shift from co-ordinate to administrative federalism as an innocuous development—an inevitable step forward in the evolution of the Canadian state.

The purpose of this article is to challenge this view. Administrative federalism, I shall argue, has been built upon a precarious constitutional foundation. Far from being innocuous, it threatens to weaken provincial autonomy and to undermine political accountability. If left unchecked, it could impair seriously both the federal and the democratic character of the Canadian state. My focus throughout will be on the federal spending power, the power claimed by Ottawa to spend funds on matters falling outside its legislative jurisdiction. It is this power that has made the "new federalism" possible; it is the mortar with which the new constitutional order has been built.

The inquiry will begin with an examination of the forces that have given rise to administrative federalism. It will then consider its constitutional basis and explore its political implications. Finally, consideration will be given to proposals for reform contained in the Meech Lake Constitutional Accord. The Accord marks the first concerted effort by Canadian governments to place explicit constitutional limitations on the federal spending power; it therefore merits special attention.

I. The Demise of Co-ordinate Federalism

From Confederation until the Second World War, institutional arrangements in Canada were shaped by a common belief among the courts, constitutional scholars and most political actors that a clear division of political responsibilities between two co-ordinate orders of government was an essential characteristic of the Canadian state. This co-ordinate vision of Canadian federalism was shared by centralists and decentralists alike. It influenced the recommendations of the Rowell-Sirois Report² as

operates independently of the other within clearly defined spheres of responsibility. "Administrative" or "co-operative" federalism refers to a conception of federalism in which jurisdictional boundaries overlap, giving rise to a high degree of shared responsibility and requiring inter-governmental co-operation between the two orders of government.

² Report of the Royal Commission on Dominion-Provincial Relations (1940). As noted by D.V. Smiley, *Conditional Grants and Canadian Federalism* (1963), p. 6: "The general solution of the Rowell-Sirois Commission was. . . towards a situation in which

much as it animated the constitutional jurisprudence of the Judicial Committee of the Privy Council.³ It so permeated Canadian scholarship during the same period that the leading constitutional treatise of the 1920s referred to "the generally accepted theory that Canada is a federation in which sovereign power is divided among co-ordinate governments, none of which are delegations and among which the provincial governments are not new creations, but retain 'their independence and autonomy'".⁴

The demise of co-ordinate federalism can be traced to the social and economic initiatives undertaken by the federal government, and acceded to by most provinces, in the period of reconstruction following the Second World War.⁵ The seeds of that demise, however, were sown during the war itself. Under wartime tax agreements, the provinces agreed to cease levying taxes on personal and corporate incomes. To compensate the provinces for relinquishing this tax room, Ottawa assumed all provincial debts, agreed to pay the provinces unconditional grants based upon fiscal need, and took over responsibility for the welfare of unemployed employables.

The wartime tax agreements, like the assumption of emergency powers, were intended as temporary measures to enable the central government to deal with crisis conditions. Following the war, however, Ottawa exhibited little desire to relinquish the revenues and the authority that it had acquired. Instead, buoyed by the revitalized sense of national purpose instilled in Canadians by the war effort, and responding to the demands for social and economic reform which followed the war, federal authorities sought to "continue to levy the major taxes in order to finance peacetime reconstruction and to use centralized fiscal policy as a tool of national economic management".⁶

the functional responsibilities of the federal and provincial governments were delineated in a relatively clear-cut fashion, with each level being assured adequate revenues to discharge the obligations conferred upon it."

³ Lord Watson's statement in *The Liquidators of the Maritime Bank of Canada v. The Receiver-General of New Brunswick*, [1892] A.C. 437, at pp. 441-442, typifies the view of the Privy Council:

The object of the [British North America] Act was neither to weld the provinces into one, nor to subordinate provincial governments to a central authority, but to create a federal government in which they should all be represented, entrusted with the exclusive administration of affairs in which they had a common interest, each province retaining its independence and autonomy.

⁴ W.P.M. Kennedy, *The Constitution of Canada* (1922), p. 411.

⁵ It is true that federal efforts to overcome the rigidity of co-ordinate federalism were initiated following the First World War and that such efforts were renewed in response to the political pressures placed upon Ottawa during the Great Depression of the 1930s. However, it was not until the period following the Second World War that federal authorities mounted a sustained attack on the co-ordinate federalist model.

⁶ P.W. Hogg, *Constitutional Law of Canada* (2nd ed., 1985), p. 114.

The major constitutional obstacles confronting the federal government in this enterprise were the division of legislative powers and the principle of co-ordinate federalism. The division of powers gave to the provinces jurisdiction over most areas of social policy and many aspects of economic regulation, while co-ordinate federalism posited a constitutional barrier that protected provincial powers from federal encroachment.

Ottawa's strategy to overcome these obstacles was set forth in the "Green Book" proposals that were presented to the Dominion-Provincial Conference on Reconstruction in the summer of 1945. The Green Book strategy was a simple one. Given the difficulties of persuading the provinces to agree to a major reallocation of legislative powers, the Green Book proposed that the federal government seek to achieve its policy objectives by means of fiscal intervention rather than constitutional reform. In particular, it recommended that Ottawa build upon its wartime tax base by obtaining provincial agreement to continue to stay out of the personal and corporate income tax fields, and to refrain from imposing inheritance taxes, in return for a flat per capita subsidy. The federal government would then draw upon this tax base to implement, and to push provincial governments to implement, a postwar agenda of social and economic reform.⁷

The Green Book proposals represented an attack on the co-ordinate orthodoxy that had prevailed before the war. Unlike the recommendations of the Rowell-Sirois Report, to which the federal government had committed itself three years earlier, the proposals showed little regard for the need to preserve a clear division of legislative powers or for the desire to promote political accountability within a federal state. While the Rowell-Sirois recommendations sought to reallocate powers within a co-ordinate framework, each order of government retaining exclusive responsibility to implement policy within its sphere, the Green Book rejected notions of exclusivity in favour of overlapping governmental responsibilities and administrative integration. And while the Rowell-Sirois Report decried the use of federal spending as a means of overcoming problems of limited jurisdiction, spending was at the heart of the Green Book proposals. Spending was the means by which federal authorities would exert influence over social and economic spheres previously denied them by the division of legislative powers.

Although the Reconstruction Conference broke down in 1946, it laid the political groundwork for what was to follow. In 1947, all prov-

⁷ Included in that agenda were universal old age pensions, health insurance grants, and employment measures encompassing unemployment insurance, welfare benefits and an anti-cyclical public investment strategy. "Taken as a whole, the proposals represented an integrated and ambitious social security and economic welfare program of staggering proportions." A.M. Moore, J.H. Perry and D.I. Beach, *The Financing of Canadian Federation* (1966), p. 23.

inces except Ontario and Quebec agreed to stay out of the three tax fields in exchange for tax rental agreements that provided them with somewhat larger subsidies than those proposed in the Green Book.⁸ The significance of this arrangement was that it gave the federal government exclusive access to major sources of wartime taxation, and limited the provincial share in those sources, at a time of post-war expansion and social reconstruction.

The economic impact of these agreements was to enable the federal government to consolidate and build upon the "temporary" fiscal gains that it had realized during the war. In 1939, the year that Canada entered the war, federal income from personal and corporate income taxes⁹ was \$123 million, about twenty-two per cent of federal budgetary revenue. By 1963, the year after the tax rental agreements expired, federal income from these taxes, plus inheritance taxes, stood at \$3.6 billion, over fifty per cent of federal budgetary revenue.¹⁰ While provincial income from the three taxes rose from \$51 million in 1939 to \$887 million in 1963,¹¹ a factor of seventeen, federal income from these taxes increased by almost twice as much, a factor of thirty, over the same period.

Having secured for itself exclusive access to these three major sources of tax revenue, Ottawa proceeded to implement a strategy similar to the one mapped out in its Green Book proposals. One by one, the federal government established conditional grant programs dealing with highways, education, health and other social services—all matters falling within provincial legislative jurisdiction. Some of these programs provided financial assistance directly to individuals, corporations and provincially regulated institutions such as universities. However, the most significant took the form of shared-cost programs under which the federal government agreed to transfer funds to the provinces for social and economic initiatives undertaken by them in accordance with conditions laid down in federal legislation. As Black has observed:¹²

Joint programs like the Trans-Canada Highway proliferated after the Second World War and became one of Ottawa's major policy instruments. The bulk of the funds went into health and welfare which, together with the highway project, accounted for more than 90 percent of the federal share of all joint programs in 1959, a proportion that remained representative of the nineteen-sixties as well. Frustrated as it was in securing implementation of its comprehensive post-war Reconstruction proposals. . . , the federal government was able to achieve most of its social policy aims in a piecemeal fashion through its conditional grant projects of the late forties and early fifties.

⁸ Ontario joined the system when the agreements were renewed in 1952, although the province retained the right to levy inheritance taxes.

⁹ There was no federal inheritance tax in 1939.

¹⁰ F.H. Leacy (ed.), *Historical Statistics of Canada* (2nd ed., 1983), series H1-18.

¹¹ *Ibid.*, series H92-112.

¹² Black, *op. cit.*, footnote 1, p. 73 (note in text deleted).

It would be difficult to exaggerate the growth of conditional transfers as an instrument of federal government policy in the past forty years. Since the Second World War, Ottawa has initiated over 100 shared-cost programs, most of them of a continuing nature.¹³ In 1945, conditional transfers from Ottawa to the provinces stood at \$46 million annually,¹⁴ less than one per cent of federal budgetary expenditures.¹⁵ By 1965, such transfers had grown to \$1.2 billion,¹⁶ over thirteen per cent of federal expenditures.¹⁷ And by 1975, conditional transfers had reached \$6.7 billion,¹⁸ almost twenty per cent of federal expenditures.¹⁹ Thus, by expanding its revenue base and by channeling new revenues into shared-cost programs and direct grants, Ottawa has been able to circumvent limitations on its legislative jurisdiction and to have a major influence on public policy falling within the sphere of provincial legislative responsibility.

Almost as remarkable as the rise in administrative federalism has been the lack of controversy it has generated, at least outside Quebec. The lack of political debate is perhaps understandable. Government spending is less likely to provoke public criticism than is "command and control" regulation. Citizens and provincial governments who benefit from federal spending initiatives are not prone to complain about them, even if they dislike some of the conditions that accompany such programs. It is true that provincial governments have from time to time objected to the use of federal spending to influence provincial decision-making. However, in all provinces except Quebec, such objections have taken a back seat to the desire of provincial administrations to share in federal revenues and to secure provincial spending powers.

It might be thought that those whose taxes have funded federal spending programs would be inclined to challenge the constitutionality of such programs in court. Yet, for good reasons, this has not been the case. First, the federal government has been careful to separate its spending programs from the revenue measures that have made them possible. This has obscured the relationship between spending and taxing, making

¹³ Hogg, *op. cit.*, footnote 6, p. 120.

¹⁴ Moore, Perry and Beach, *op. cit.*, footnote 7, p. 33.

¹⁵ Leacy, *op. cit.*, footnote 10, series H34.

¹⁶ *Ibid.*, series H474-493. This figure includes the value of tax points and cash compensation payments to Quebec for established programs and also includes the value of tax abatements to provinces for the financing of post-secondary education.

¹⁷ *Ibid.*, series H34.

¹⁸ *Ibid.*, series H474-493.

¹⁹ *Ibid.*, series H34. This percentage has decreased only slightly in the past decade. Conditional transfers to the provinces in 1984 (including the established programs and contracting out tax transfers) stood at about 20.9 billion, nearly 18 per cent of federal expenditures: Canadian Tax Foundation, *The National Finances, 1986-87* (1987), p. 16:26, and letter from R.A. McLarty, Department of Finance, Canada, August 6, 1987.

it difficult for taxpayers to discern a clear link between particular taxing and spending initiatives. Second, because of this difficulty, taxpayers seeking to challenge a spending program would, until relatively recently, have found it virtually impossible to demonstrate sufficient interest in the program to be granted standing before the courts.²⁰

The lack of academic controversy, particularly among legal academics, is more difficult to fathom. Constitutional scholars from English Canada have viewed the shift from co-ordinate to administrative federalism with uncritical eyes. Rather than questioning its legitimacy, the bulk of their energies has been devoted to devising doctrinal justifications for the federal spending power.²¹ Scant attention has been paid to the theoretical implications of that power, and to the political nature of the "new federalism" which it has spawned.

What accounts for the uncritical stance adopted by these scholars? There are a number of probable explanations. For some, support for administrative federalism has stemmed from their desire to broaden the authority of the central government. It is no coincidence that one of the earliest and most outspoken proponents of the federal spending power was F.R. Scott,²² as ardent a centralist as this country is likely to see. For others, support of the spending power appears to be related to their support for political initiatives with which it has been associated.²³ After all, what "progressive" constitutionalist in the post-war period would want to be seen objecting to federal government support of highways, education and universal health insurance? Still others have been inclined to approve of the "new federalism" because it coincides with their desire to limit judicial intervention in the political process.²⁴ The shift from co-ordinate to administrative arrangements has diminished the adjudicative powers of the judiciary, leaving jurisdictional issues to be resolved through a process of political bargaining. Finally some younger scholars seem simply to accept the spending power as a *fait accompli*, a precondition to the functioning of a modern federal state.²⁵ Having been weaned

²⁰ Prior to the decision of the Supreme Court of Canada in *Thorson v. Attorney General of Canada*, [1975] 1 S.C.R. 138, (1974), 43 D.L.R. (3d) 1, citizens had to be able to show that they were "specially affected" by a governmental measure in order to obtain standing to challenge the constitutionality of that measure in court.

²¹ See, *infra*, footnotes 26-28.

²² F.R. Scott, *The Constitutional Background of Taxation Agreements* (1955), 2 McGill L.J. 1.

²³ See, for example, G.V. La Forest, *The Allocation of Taxing Power Under the Canadian Constitution* (2nd ed., 1981), pp. 45-51.

²⁴ See Hogg, *op. cit.*, footnote 6, pp. 111-131. See also E.A. Driedger, *The Spending Power* (1981-82), 7 Queen's L.J. 124.

²⁵ See K. Hanssen, *The Constitutionality of Conditional Grant Legislation* (1966-67), 2 Man. L.J. 191; J.E. Magnet, *The Constitutional Distribution of Taxation Powers in Canada* (1978), 10 Ottawa L. Rev. 473.

on administrative federalism, such scholars apparently have difficulty conceiving of contemporary government functioning in any other way.

It is nevertheless astounding that such a major restructuring of the Canadian state should have attracted so little critical commentary. This is especially so given that the constitutional foundation of the "new federalism" is, at best, shaky.

II. Constitutional Doctrine

Administrative federalism has been nurtured and sustained by the federal spending power, the power asserted by Ottawa to spend funds on matters falling outside its legislative jurisdiction. Yet this power is mentioned nowhere in sections 91 or 92 of the Constitution Act, 1867. What then is its basis in constitutional doctrine? Legal scholars have proposed a number of theories. Some have suggested that the power flows from the royal prerogative,²⁶ others from federal authority with respect to appropriation,²⁷ and still others from Parliament's power to legislate in relation to the public debt and property.²⁸

None of these theories is particularly convincing. The suggestion that the spending power flows from the prerogative ignores two important facts. The first is that all funds spent by the executive must be expended in accordance with the terms of appropriating legislation, such legislation being subject to the division of powers in sections 91 and 92. The second is that, even if one could view the act of spending independently from its authorizing legislation, it is a well established principle of Canadian constitutional law that the grant of prerogative powers follows that of legislative powers.²⁹

Sections 102 and 106 of the Constitution Act, 1867, establish a Consolidated Revenue Fund of Canada "to be appropriated for the Public Service of Canada". Some have sought to read into these provisions a conferral of power upon Parliament to enact appropriating legislation for any purpose including one which would otherwise fall within provincial jurisdiction. Even if it were accepted that the limiting words "Public Service" in section 106 and "Public Service of Canada" in section 102 do not, of themselves, restrict spending to purposes falling within the federal legislative sphere, it is improbable that the framers of these

²⁶ See Scott, *loc. cit.*, footnote 22; Hanssen, *loc. cit.*, footnote 25; Driedger, *loc. cit.*, footnote 24.

²⁷ See Driedger, *loc. cit.*, footnote 24; La Forest, *op. cit.*, footnote 23; Hogg, *op. cit.*, footnote 6.

²⁸ See Hanssen, *loc. cit.*, footnote 25; Magnet, *loc. cit.*, footnote 25; La Forest, *op. cit.*, footnote 23; Hogg, *op. cit.*, footnote 6.

²⁹ See *Liquidators of the Maritime Bank of Canada v. Receiver-General of New Brunswick*, *supra*, footnote 3.

sections intended them to have so broad an effect. The primary purpose of these clauses is to establish the Consolidated Revenue Fund and to provide the means for its appropriation. To read them as somehow qualifying the division of powers in sections 91 and 92 is to give them a significance that their wording and placement in the Constitution simply do not justify. Had so fundamental a qualification been intended, one would expect to see it spelled out in unequivocal language.³⁰ In the absence of such language, it seems more credible to interpret these appropriation provisions as not disturbing the general pattern of legislative powers provided elsewhere in the Constitution.

Arguments supporting the federal spending power on the basis of Parliament's authority to legislate with respect to the public debt and property are also problematic. Such arguments are founded upon the assertion that, for the purposes of constitutional characterization, a law which provides for an expenditure of funds should be viewed differently from a law which establishes a scheme of compulsory regulation. Proponents of the spending power argue that, while a law regulating a matter ought to be characterized as a law in relation to that matter, a law authorizing funds to be spent on that matter should be characterized as a law in relation to spending (that is, the disposition of public property), a subject that falls within section 91(1A).

An initial problem with this spending/regulating dichotomy is that it finds little support in the words of the Constitution. The opening words of section 92 of the Constitution Act, 1867 bestow upon provincial legislatures exclusive power to make laws "in relation to matters", not to make laws *regulating* those matters. There is no basis in language or in logic for suggesting that when Parliament authorizes expenditures of funds with respect to some matter it acts any less "in relation" to that matter than when it regulates with respect to the same matter. Put another way, there is no greater justification for characterizing a law that provides for expenditures on hospitals as a law in relation to spending than there is for characterizing a law that regulates hospitals as a law in relation to regulation.

The argument in favour of viewing "spending" as a separate matter embraced within the above classes of subjects is analogous to arguments made in the past by federal and provincial governments with respect to the implementation of treaties and Crown immunity. In the *Labour Conventions* case,³¹ the federal government maintained that labour legis-

³⁰ It is significant that, despite similarly worded provisions in sections 81 and 83 of the Australian Constitution, the framers saw fit to provide explicitly in section 96 for a parliamentary power to "grant financial assistance to any State on such terms and conditions as the Parliament thinks fit".

³¹ *Attorney-General for Canada v. Attorney-General for Ontario*, [1937] A.C. 326, [1937] 1 D.L.R. 673 (P.C.).

lation enacted by Parliament in fulfillment of Canada's treaty obligations should be upheld as a law "in relation" to treaties, and therefore outside the scope of powers assigned to the provinces under section 92 of the Constitution Act, 1867. The Privy Council rejected this argument on the ground that it was inappropriate to characterize legislation in such a way as to avoid the division of powers in sections 91 and 92. For the purpose of the federal distribution of legislative powers, said Lord Atkin, "there is no such thing as treaty legislation as such. The distribution is based on classes of subjects; and as a treaty deals with a particular class of subjects so will the legislative power of performing it be ascertained".³² What Lord Atkin said about treaty implementation can be said with equal force with respect to spending. Just as treaties are not implemented for their own sake, Parliament does not appropriate funds for the purpose of giving away property. In each case, there is some underlying purpose which identifies the "matter" of the legislation.

In *Amax Potash Ltd. v. The Government of Saskatchewan*,³³ the Saskatchewan government argued that a statute enabling it to retain taxes collected unconstitutionally was legislation in relation to Crown immunity and could be supported on the basis of a number of heads of section 92, including amendment of the constitution of the province (section 92(1)), "property and civil rights in the province" (section 92(13)), "administration of justice in the province" (section 92(14)), and matters of a local nature in the province (section 92(16)). The Supreme Court of Canada rejected Saskatchewan's claim on the basis that Crown immunity was not a valid characterization of the legislation. Rather, the court held that one had to look behind the immunity to ascertain the purpose for which the immunity was being invoked. Again, the same can be said with respect to spending.

Another problem with the alleged dichotomy between spending and regulating is its tenuous and artificial nature. The monies that governments spend are, for the most part, monies that have been generated through compulsory measures such as taxation. Thus it is unrealistic to characterize spending as though it were an independent governmental function. Rather, spending should properly be viewed as one component of a larger reallocative activity. This is a point that has been glossed over by many writers, yet it is key to understanding the significance of the limited case law on the spending power.

There is only one case concerning the federal spending power which has reached the Supreme Court of Canada or the Privy Council.³⁴ The

³² *Ibid.*, at pp. 351 (A.C.), 682 (D.L.R.).

³³ [1977] 2 S.C.R. 576, (1976), 71 D.L.R. (3rd) 1.

³⁴ There have been a number of cases decided by lower courts, the most recent being *Winterhaven Stables Ltd. v. Attorney-General of Canada* (1988), 53 D.L.R. (4th)

*Employment and Social Insurance Act Reference*³⁵ concerned the constitutionality of a statutory scheme of unemployment insurance proposed by the depression-era government of R.B. Bennett. Under the scheme, a fund was to be created by means of compulsory contributions from employers and employees. The purpose of the fund was to provide a pool of monies from which insurance benefits could be paid to contributing employees who became unemployed. The federal government argued before the Supreme Court that the scheme could be sustained on the basis that the compulsory contributions constituted a form of taxation within the meaning of section 91(3), and that the fund comprised public property which Parliament had an unfettered right to dispose of as it wished under section 91(1A).

The Supreme Court majority rejected this argument, but their reasons for doing so are confusing and contradictory. On the one hand, the majority voiced support in principle for unlimited powers of taxation and spending. Kerwin J. (with the concurrence of Rinfret and Crockett JJ.) said:³⁶

It is quite true that Parliament, by properly framed legislation may raise money by taxation and dispose of its public property in any manner that it sees fit. As to the latter point, it is evident that the Dominion may grant sums of money to individuals or organizations and that the gift may be accomplished by such restrictions and conditions as Parliament may see fit to enact.

On the other hand, the majority refused to invoke these powers to uphold the legislation, deciding instead that the combination of mandatory collection and spending made the statute, in pith and substance, a law in relation to employment services and unemployment insurance rather than one in relation to taxation and public property. Rinfret J. (with the concurrence of Kerwin and Crockett JJ.) put it this way:³⁷

The object of the Act, the end sought to be accomplished by it is a scheme for employment service and unemployment insurance; the contributions levied from the employers and employees are only incidents of the proposed scheme, and, in fact, merely means of carrying it into effect. The Act does not possess the character of a taxing statute, but it is legislation intending to do precisely what the title says: to establish an employment insurance commission, to provide for a national employment service, for insurance against unemployment, for aid to unemployed persons, or other forms of social insurance and security and for purposes related thereto.

It being well understood and, in fact, conceded that these are subject-matters falling within the legislative authority of the provinces, the Dominion Parliament

413 (Alta. C.A.). For a discussion of the lower court decisions, see A. Lajoie, *The Federal Spending Power and Meech Lake*, in K.E. Swinton and C.J. Rogerson (eds.), *Competing Constitutional Visions: The Meech Lake Accord* (1988), pp. 175-185.

³⁵ *Attorney-General for Canada v. Attorney-General for Ontario*, [1937] A.C. 355, [1937] 1 D.L.R. 684 (P.C.), affg., [1936] S.C.R. 427, [1936] 3 D.L.R. 644.

³⁶ *Ibid.*, at pp. 457 (S.C.R.), 669 (D.L.R.).

³⁷ *Ibid.*, at pp. 454 (S.C.R.), 666-667 (D.L.R.).

may not, under pretext of the exercise of the power to deal with its property, or to raise money by taxation, indirectly accomplish the ends sought for in this legislation. If it were otherwise, the Dominion Parliament, under colour of the taxing power, would be permitted to invade almost any of the fields exclusively reserved by the Constitution to the legislatures in each province.

It is difficult to know how to reconcile these two positions. What the majority seems to have failed to grasp is that the only reason that Parliament need resort to spending powers is to achieve indirectly ends that fall within provincial legislative competence. Nor does it help to emphasize, as the majority did elsewhere,³⁸ the fact that the conditions imposed by the Act (that is, the contributions) were made compulsory. Taxation is by its nature compulsory.

When the case reached the Privy Council, it fell to Lord Atkin to try to resolve the confusion created by the conflicting views contained within the majority opinions of the Supreme Court. He did so in the following terms:³⁹

That the Dominion may impose taxation for the purpose of creating a fund for special purposes, and may apply that fund for making contributions in the public interest to individuals, corporations or public authorities could not as a general proposition be denied. Whether in such an Act as the present compulsion applied to an employed person to make a contribution to an insurance fund out of which he will receive benefit for a period proportionate to the number of his contributions is in fact taxation it is not necessary finally to decide. . . . But assuming that the Dominion has collected by means of taxation a fund, it by no means follows that any legislation which disposes of it is necessarily within Dominion competence.

It may still be legislation affecting the classes of subjects enumerated in s. 92, and, if so, would be *ultra vires*. In other words, Dominion legislation, even though it deals with Dominion property, may yet be so framed as to invade civil rights within the Province, or to encroach upon the classes of subjects which are reserved to Provincial competence. It is not necessary that it should be a colourable device, or a pretence. If on the true view of the legislation it is found that in reality in pith and substance the legislation invades civil rights within the Province, or in respect of other classes of subjects otherwise encroaches upon the provincial field, the legislation will be invalid. To hold otherwise would afford the Dominion an easy passage into the Provincial domain.

Some writers have sought to minimize the impact of this passage. La Forest, for example, describes Lord Atkin's words as having "a somewhat delphic character" and argues that they must be read in light of the Supreme Court's judgment.⁴⁰ Yet the basic thrust of the passage seems straight forward enough. Unlike the Supreme Court, the Privy Council rejected the notion that money raised by means of taxation could be disposed of by Parliament "in any manner that it sees fit". While allow-

³⁸ *Ibid.*, at pp. 455 (S.C.R.), 667 (D.L.R.) (per Rinfret J.).

³⁹ *Attorney-General for Canada v. Attorney-General for Ontario*, *supra*, footnote 35, at pp. 366-367 (A.C.), 687 (D.L.R.).

⁴⁰ La Forest, *op. cit.*, footnote 23, p. 48.

ing that the contributions required under the legislation might be regarded as taxation, Lord Atkin went on to state that legislation disposing of these contributions would nevertheless be unconstitutional if its pith and substance fell within provincial heads of power. The clear implication is that laws governing spending must be characterized according to the underlying purpose that the spending seeks to achieve. On this basis, Lord Atkin was able to agree with the Supreme Court majority that "in pith and substance this Act is an insurance Act affecting the civil rights of employers and employed in each Province, and as such is invalid".⁴¹

The federal government appears to have interpreted the Privy Council decision as being confined to situations in which federal spending is directly related to a specific revenue raising measure. Smiley has noted that:⁴²

. . . the effect of the Privy Council judgment . . . has been to inhibit the federal government from supporting an activity within provincial jurisdiction partly or wholly from a federal levy made for that purpose. Thus, when the government decided to finance its program of old age pensions to persons 70 and over partly through a special income tax levy, an amendment to the B.N.A. Act was secured with unanimous provincial consent to give Parliament concurrent jurisdiction in that field. If the policy had been to make these payments from the Consolidated Revenue Fund, as in the case of family allowances, no such amendment would have been necessary according to the understanding of the federal spending power which has prevailed in Ottawa in recent years.

What this federal position amounts to is an assertion that legislation appropriating monies from the Consolidated Revenue should be characterized differently for constitutional purposes from legislation appropriating monies from other funds. The federal government seems to believe that if the relationship between the spending measure and the taxing measure is not made explicit, the constitutional problem will simply evaporate. Not only does this interpretation disregard Lord Atkins' emphasis upon the disposition of tax revenues, but it treats as mindlessly formalistic the objections expressed in the Supreme Court and the Privy Council that Parliament not be able to use taxing and spending as means of circumventing the division of legislative responsibilities set out in sections 91 and 92. Indeed, if the federal position were correct, it would mean that precisely the same scheme of unemployment insurance that was struck down by the Supreme Court and the Privy Council would have been upheld had the contributions been collected under separate legislation and channelled through the Consolidated Revenue Fund before being spent in the form of insurance benefits.

⁴¹ *Attorney-General for Canada v. Attorney-General for Ontario*, *supra*, footnote 35, at pp. 367 (A.C.), 687-688 (D.L.R.).

⁴² Smiley, *op. cit.*, footnote 2, p. 23 (notes in text deleted).

This brings us back to a point raised earlier. Underlying the federal position, and the position of many constitutional writers, is the belief that spending is somehow different from, and less in need of constitutional containment than, other forms of governmental activity. Scott⁴³ and Driedger⁴⁴ equate spending with gifting, and express shock at the suggestion that private persons could make gifts but that governments could not. Hogg states:⁴⁵

There is a distinction, in my view, between compulsory regulation, which can obviously be accomplished only by legislation enacted within the limits of legislative power, and spending or lending or contracting, which either imposes no obligations on the recipient . . . or obligations which are voluntarily assumed by the recipient. . . . There is no compelling reason to confine spending or lending or contracting within the limits of legislative power, because in those functions the government is not purporting to exercise any peculiarly governmental authority over its subjects.

With respect, the views of these scholars have a sense of unreality about them. What they seem to forget is that governmental spending is not an isolated activity. When a government spends, it must derive the revenue from somewhere. The way that government usually does this is through the imposition of taxation, something which is, without doubt, the exercise of a "peculiarly governmental authority". The importance of the Privy Council judgment in the *Employment and Social Insurance Act Reference* is that it recognized this relationship and rejected arguments that it should characterize the spending function as though it were unrelated to the taxing function. Rather, it correctly saw them as part and parcel of a single redistributive activity.

The corollary to the suggestion that Parliament has unlimited spending power with respect to tax revenues is that Parliament has the power to levy taxes for any purposes. Yet this is a proposition that flies directly in the face of the well-established limitation against Parliament levying direct taxation for provincial purposes.⁴⁶ It also flies in the face of sections 54 and 90 of the Constitution Act, 1867 which, as Laskin pointed out,⁴⁷ clearly contemplate that governmental responsibility for the raising of a revenue for provincial purposes by any means of taxation rests exclusively with the provincial authorities.⁴⁸

⁴³ *Loc. cit.*, footnote 22, at p. 6.

⁴⁴ *Loc. cit.*, footnote 24.

⁴⁵ *Op. cit.*, footnote 6, p. 126.

⁴⁶ *Caron v. The King*, [1924] A.C. 999, [1924] 4 D.L.R. 105 (P.C.).

⁴⁷ B. Laskin, *Provincial Marketing Levies: Indirect Taxation and Federal Power* (1959-60), 13 U.T.L.J. 1, at pp. 20-21.

⁴⁸ It is ironic that La Forest, recognizing this, has argued that such limitations on federal taxation should be ignored because "[t]hey were made when the device of transfer payments might still have been considered doubtful. . . .": *op. cit.*, footnote 23, p. 52. This is bizarre reasoning. It relies upon a contentious political practice to cast doubt upon an established constitutional limitation. Neither the Privy Council nor the Supreme

It might be asserted that, since non-tax revenues are derived through activities which are not "peculiarly governmental", the federal government ought to have unlimited authority to spend these revenues.⁴⁹ Put another way, it could be argued that legislation disposing of non-tax revenues should be characterized as a purely allocative activity falling within federal jurisdiction over public debt and property. This, however, is a much narrower claim and one that has little relevance to conditional grants. An examination of the growth of federal spending following the Second World War establishes that the rise in conditional grant programs has been directly related to the rise in tax revenues. Indeed, the federal government has done nothing to disguise this relationship, as evidenced by the fact that, in 1977, when it changed the formula with respect to contributions for post secondary education, hospital insurance and medicare (the "established programs"), it shifted from cash payments to a combination of cash payments and tax points. Perhaps the most obvious indication that conditional grants are largely attributable to tax revenues, however, is the fact that the amount of such grants far exceeds the amount of federal non-tax revenues. In 1984, for example, conditional transfers to the provinces alone exceeded all federal non-tax revenues by more than eleven billion dollars.⁵⁰

There is a related point that needs to be addressed. It concerns the difficulty of distinguishing between tax and non-tax revenues flowing through the Consolidated Revenue Fund. Trudeau argued in 1957 that this difficulty "makes it impossible, in practice, to know what money may be used without limitations for grants, and what money may not".⁵¹ This conclusion may have made sense at a time when conditional grants for provincial programs constituted a small percentage of total federal expenditures and could be attributed solely to non-tax revenues.⁵² But where, as is the case today, conditional grants comprise a substantial portion of federal expenditures, one that far exceeds non-tax revenues, there can be no justification for shielding such grants from constitutional scrutiny simply because they have been "laundered" through the Con-

Court has passed judgment on the constitutionality of transfer payments whereas both institutions have held that Parliament does not possess the authority to levy direct taxes for provincial purposes. If a conflict arises, therefore, surely it is more appropriate to invoke the established limitation to cast doubt on the contentious practice, rather than the other way around.

⁴⁹ See P.E. Trudeau, *Federal Grants to Universities*, in *Federalism and the French Canadians* (1968), pp. 79 and 99.

⁵⁰ Canadian Tax Foundation, *op. cit.*, footnote 19, pp. 3:2 and 16:26, and letter from McLarty, *supra*, footnote 19.

⁵¹ Trudeau, *op. cit.*, footnote 49, p. 98. See also La Forest, *op. cit.*, footnote 23.

⁵² In 1957, federal expenditures on conditional transfers stood at \$145 million, just 2.6 per cent of total budgetary expenditures and less than one third of the \$426 million derived from non-tax revenues: Leacy, *op. cit.*, footnote 10, series H16, H34 and H489.

solidated Revenue Fund. On the contrary, there is ample reason to proceed on the assumption that such grants derive from tax revenues.

III. Constitutional Values

The preceding discussion has called into question the doctrinal position favouring the constitutionality of the federal spending power. It would be naïve, however, to suggest that doctrine alone can resolve a question of such fundamental political importance. Where major public issues are involved, legal doctrine inevitably takes a back seat to broader political and practical concerns. Nowhere is this more obviously true than in the field of constitutional law. Constitutional decision-making requires courts to resolve important issues of public policy based upon vague, broadly framed provisions—provisions that in many cases were written to take account of social and economic conditions that have long since changed. The realization that constitutional decision-making is political does not end debate on constitutional issues; it helps to inform it. While constitutional provisions may be vague, broadly framed and anachronistic, we tolerate them on the basis that they reflect certain abiding political values. The purpose of a constitution is to protect those values, and the role of the courts is to interpret and apply the constitution in a manner consistent with those values.⁵³

There are many values which find voice in the Canadian Constitution but, in terms of the structure of government, the two most fundamental are federalism and responsible government. Although federalism has many forms, at root it implies a division of legislative and executive responsibilities between two orders of government, neither of which is subordinate to the other.⁵⁴ Responsible government is a system of repre-

⁵³ As Dickson C.J.C. put it in *Reference re Manitoba Language Rights*, [1985] 1 S.C.R. 721, at pp. 751-752, (1985), 19 D.L.R. (4th) 1, at pp. 24-25:

This Court cannot take a narrow and literal approach to constitutional interpretation. The jurisprudence of the Court evidences a willingness to supplement textual analysis with historical, contextual and purposive interpretation in order to ascertain the intent of the makers of our Constitution.

The Court has in the past inferred constitutional principles from the preambles to the Constitution Acts and the general object and purpose of the Constitution. In the *Patriation Reference* . . . the Court found the federal principle to be inherent in the Constitution in this way.

In other words, in the process of Constitutional adjudication, the Court may have regard to unwritten postulates which form the very foundation of the Constitution of Canada.

⁵⁴ Some writers have posited visions of federalism that deviate from this norm. However, as Professor Hogg notes, in doing so "they have so eroded the concept of federalism that it has become too vague to be useful": *op. cit.*, footnote 6, p. 81. Moreover, whatever the merit of these visions in conceptual terms, it is clear that they have little application to the vision of federalism represented in the Canadian Constitu-

sentative democracy in which the head of state acts upon the advice of an executive that, in turn, is directly answerable to a democratically elected legislature. Viewed in light of these constitutional values, the debate over the federal spending power takes on new importance. It becomes a debate not just about constitutional doctrine, but about the integrity of the federal system and the preservation of political accountability in Canadian government.

The underlying rationale for federalism is a belief that while some matters are better decided by the national political community, others should be left to regional political communities. Implicit in this belief is a view that, with respect to certain matters, regional governments can better reflect the political attitudes and aspirations of citizens. It is not hard to see why this might be the case. In a country as large and diverse as Canada, the opinions and priorities of the inhabitants of one region may well differ from those of other regions. A system of regional governments is more likely to be responsive to these regional variations than is a single central government. This is so not only because regional governments have more extensive knowledge of local conditions and preferences, but also because they depend for their existence upon local voter support. Thus while a central government can afford to ignore the preferences of a particular region of the country (and may have to do so to garner voter support in other regions), a regional government cannot.

In this way, federalism is a democratizing force. It provides citizens greater influence over policies that have been assigned to regional governments than they would have had those same policies been assigned to a central government. Put another way, it ensures that the preferences of more citizens can be reflected in government policy. As Breton and Scott have noted, "an increase in the number of governmental units increases the probability that any person living in any jurisdiction will be a member of a majority able to secure for him or herself the quantity and quality of public policies that he or she (and others of his or her group) prefer".⁵⁵

tion. Sections 91 and 92 of the Constitution Act, 1867 divide political powers between Parliament and the provincial Legislatures in a manner that seeks to avoid the possibility of overlapping jurisdiction. Under s. 92, the provinces are given the power to "exclusively make Laws in relation to Matters coming within the Classes of Subject next hereinafter enumerated", while, under s. 91, Parliament is given authority to make laws "in relation to all Matters not coming within the Classes of subjects by this Act assigned exclusively to the Legislatures of the Provinces". It is true that the Constitution Act, 1867 provides for a few areas of concurrency, but these stand out as narrow exceptions to the general pattern of division in ss. 91 and 92. See G.P. Browne, *The Judicial Committee and the British North America Act (1967)*, esp. pp. 29-32; Black, *op. cit.*, footnote 1, pp. 7-8.

⁵⁵ A. Breton and A. Scott, *The Design of Federations* (1980), p. 15.

The *raison d'être* of the federal spending power (and of conditional grants in particular) is to permit the federal government to use fiscal means to influence decision-making at the provincial level. In other words, it allows national majorities to set priorities and to determine policy within spheres of influence allocated under the Constitution to regional majorities. Thus, both by design and effect, the spending power runs counter to the political purposes of a federal system.

Supporters of the federal spending power have sought to address this concern by contending that conditional grants are offered on a "voluntary" basis and that provincial governments are free to reject them if they wish. However, claims about the voluntary nature of conditional grants are unconvincing. Even those writers who have stressed the theory of "voluntary" grants have had to concede their coercive impact upon provincial decision-making. Hogg describes this impact in the following terms:⁵⁶

The programme proposed may be well down on a province's list of priorities, or a different kind of programme may be preferable to the province; nevertheless, the federal offer is very difficult to refuse, because refusal would deny to the province the federal grant. Indeed, refusal of the grant wears an aspect of taxation without benefit, since the residents of a non-participating province would still have to pay the federal taxes which finance the federal share of the programme in the other provinces. The result is that the provinces have usually felt sufficiently tempted by "50-cent dollars" to join the federally-initiated shared-cost programmes.

Moreover, the suggestion that conditional grants are "voluntary" again ignores the relationship between spending and taxation. The impact of such grants upon provincial decision-making is a function not only of the carrot of federal spending, but also of the stick of federal taxation. The extent to which funding for such grants is derived from the imposition of federal taxation is the extent to which tax dollars are depleted. The point here is not simply that provincial refusal of such grants would subject residents of that province to taxation without benefit; it is that federal occupation of the available tax room for provincial purposes limits the amount of tax room left to provinces, thus restricting the capacity of provinces to initiate policies they favour. In this way, federal spending that derives from federal taxation has a coercive impact upon provinces as well as provincial taxpayers.

An even more powerful political objection to the federal spending power concerns its impact upon responsible government. The organizing principle of responsible government is political accountability: accountability of the executive to the legislature and of the legislature to the electorate. It is this thread of accountability that transforms what would otherwise be a despotic system of government into a democratic one.

⁵⁶ Hogg, *op. cit.*, footnote 6, p. 120. See also Hanssen, *loc. cit.*, footnote 25, at p. 197.

Yet if a legislature is to be held accountable to its electorate, citizens must have a definite understanding of the scope of that legislature's powers. An electorate that cannot attribute political responsibility to one order of government or the other lacks both the ability to express its political will and the assurance that its will can be translated into action.⁵⁷

By allowing the federal government to use fiscal means to influence provincial policies, the spending power compromises political accountability and thereby weakens the ability of electors to exercise democratic control over government. The argument has been put most forcefully by Smiley:⁵⁸

... there is an increasing number of important public functions for which the federal authorities assert the provinces have the primary responsibilities but on behalf of which federal financial assistance is available. In these circumstances it is almost impossible to enforce accountability, and no satisfactory answer can be given to the broad question of whether the provinces have in fact been delinquent in not providing adequate support for particular services or, alternatively, whether some or all of them could not reasonably be expected to do better in the light of the existing distribution of tax sources, revenues and functional responsibilities. Further, if we were to assume that the federal government has *some* direct responsibilities in relation to particular provincial programs, it is almost impossible to gauge whether their level of support for these activities has been satisfactory. On a day-to-day basis, also, it is sometimes open to the provinces to avoid responsibility for their actions in conditional grant programs by attributing alleged deficiencies to federal policies.

An illustration of the above concerns is provided by the Canada Health Act.⁵⁹ Under the terms of that Act, funds are made available to provinces that establish hospital insurance and medicare programs in accordance with federally stipulated criteria. Provinces that fail to adhere to these criteria are denied full federal funding. The purpose of the Act is to influence provincial policy with respect to the provision of public health insurance. The extent to which it achieves this purpose is the extent to which decisions assigned under the Constitution to regional political communities have been effectively transferred to the national political community. Moreover, the diffusion of political responsibility serves to weaken the ability of either community to attribute political responsibility for the strengths and deficiencies of the public health care system.

Suppose, for example, that a majority of citizens in a particular province came to believe that medical user fees should be imposed upon

⁵⁷ Trudeau made the same point when he wrote: "Since the same citizens vote in both federal and provincial elections, they must be able to determine readily which government is responsible for what; otherwise democratic control of power becomes impossible." *op. cit.*, footnote 49, p. 80.

⁵⁸ Smiley, *op. cit.*, footnote 2, p. 54.

⁵⁹ R.S.C. 1985, c. C-6.

higher income earners in order to finance a preventive health care initiative aimed at school-age children. Under the Act, the imposition of such fees would produce reductions in federal transfers to the province with no commensurate reductions in federal taxation. The political pressure created by the combined threat of declining federal grants and continued federal occupation of the tax field would make even the most sympathetic provincial government balk at implementing a policy of this kind.

Some may say that the solution is for citizens who favour such a policy to organize at the national rather than the provincial level. The first thing to note about this suggestion is that it qualifies as a solution only if one is prepared to abandon the political purposes of assigning health care to provincial control in the first place. The problem, however, runs much deeper than that. Even if citizens, by organizing nationally, were able to convince the federal government to endorse their proposal, that government would be forced to rely solely upon fiscal measures to implement the reform. While such measures probably could be structured so as to compel provincial acquiescence with federal requirements, they could not give the federal government direct regulatory control over the policy. Thus the policy, although well conceived at the federal level, could suffer from incompetence or lack of political support on the part of the provincial authorities charged with its administration.

What the above example shows is that the spending power does not simply shift political responsibility from one order of government to the other; it intersperses responsibility between both orders. The result is to require those advocating a particular reform to fight a battle on two fronts. At the same time, it becomes virtually impossible for citizens to determine which order of government to hold accountable for policies that fail or, for that matter, for ones that succeed. The consequence is to diminish the influence of ordinary citizens over government policy-making and to heighten the power of governmental elites. Political decisions become less a product of responding to public opinion and more a product of intergovernmental accommodation among senior politicians and bureaucrats.

Moreover the problem is not confined to those areas in which the spending power is currently exercised. Once the authority of the federal government to spend where it pleases is accepted, it becomes possible for politicians and citizens to attribute responsibility for almost any deficiency in provincial policy to an absence of federal support. Thus provincial governments routinely blame their failure to provide adequate programs, such as welfare, daycare and housing, on a lack of federal support, encouraging voters and interest groups to look to Ottawa for solutions to these problems.

In sum, reliance upon the spending power to overcome legislative limitations in a federal system of responsible government creates the

worst of all possible worlds. It imposes upon citizens the costs and inconvenience of supporting two orders of government while denying them the benefits of local control. In addition, it creates a situation in which political power is so diffused that citizens possess less ability to influence and control government decision-making than they would even in a unitary state.

IV. *Realpolitik*

The discussion thus far has focused on constitutional doctrine and values. Yet those who support the federal spending power seem less concerned with constitutionalism than with *realpolitik*. They suggest that, without the spending power, politics in Canada would regress: regional disparities would increase; there would be a lack of revenue for social programs; political advances would grind to a halt. These are the myths, but what are the realities?

One of the strongest political claims made on behalf of the federal spending power is that the power is required to promote the principle of equalization. This argument takes a number of forms. Its most common version maintains that conditional grants promote equalization both by guaranteeing all Canadians equal access to a minimal level of social services and by redistributing tax revenues from richer to poorer parts of the country. The problem with the argument is that it makes an unwarranted link between the principle of equalization and the need for federal interference in the delivery of particular social programs. If the federal government is concerned about the need to equalize the position of citizens across the country, it is free to achieve this goal through unconditional grants, either to provincial governments or directly to individuals.⁶⁰ Given that the goal of equalization can be met through unconditional payments, equalization cannot provide the rationale for conditional grants. Conditional grants are necessary only if the federal government wishes to influence the way in which equalization payments are spent—in other words, if it wishes to use equalization as a pretext for influencing policies within provincial jurisdiction.

Some commentators have expressed concern that, if the federal government were unable to attach conditions to provincial subsidies, it would be less inclined to equalize regional disparities. This concern should not

⁶⁰ Given that equalization of wealth among regions is a discrete function that falls beyond the scope of provincial legislative power, a federal law whose purpose is limited to equalization should be sustainable on the basis of the national dimensions component of the peace, order and good government power. Moreover, since 1982, the Constitution has explicitly acknowledged the right of the federal government to make "equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation": Constitution Act, 1982, s. 36(2).

be discounted, but neither should it be exaggerated. The pressures that regional communities can bring to bear at the federal level serve as a strong inducement for Ottawa to provide equalization grants even on an unconditional basis. This is evidenced by the history of unconditional transfers provided to the provinces since Confederation⁶¹ and by the entrenchment in the Constitution Act, 1982 of a federal commitment to "the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation".⁶² It is further evidenced by the fact that, in recent years, federal governments have maintained their commitment to equalization while loosening the purse-strings on conditional programs (with the exception of medicare) and increasing the proportion of unconditional subsidies and tax transfers to the provinces.⁶³ Moreover, this concern could be addressed by spelling out the federal government's commitment to regional equalization more specifically in the text of the Constitution.

It is also worth noting that conditional grants, because of their pre-occupation with guaranteeing particular social benefits to Canadians in all parts of the country, serve as an inefficient mechanism for equalizing revenues on a regional basis. The degree of regional equalization achieved by such grants could be attained far less expensively by means of unconditional transfers. Thus even a lowered federal commitment in dollar terms to the provision of unconditional grants could produce the same degree of regional equalization that is currently achieved by means of conditional payments.⁶⁴

A second argument commonly made in support of the federal spending power is even more problematic than the first. According to this claim, the spending power is necessary because the provinces lack the financial capacity to fund social programs themselves. Yet how can this be so? If a province's incapacity to fund social programs stems from regional disparities, these disparities can be redressed through unconditional equalization grants. On the other hand, if that incapacity stems from an absence of taxable revenues, then this absence should inhibit the delivery of federal programs as much as provincial ones. It is true that provinces can levy only direct taxes but, given that income taxes are direct, this limitation does not pose a major constraint on provincial revenue-raising.

Of course, it may well be that there is insufficient tax room *at present* to allow provinces to assume the full cost of funding existing

⁶¹ See La Forest, *op. cit.*, footnote 23, ch. 1 and pp. 150-151.

⁶² Section 36(2).

⁶³ Hogg, *op. cit.*, footnote 6, p. 129.

⁶⁴ See Smiley, *op. cit.*, footnote 2, pp. 59-60.

shared-cost social programs. But, if so, this is because the federal government is currently generating revenues to fund provincial programs. In the words of Trudeau, the federal government is violating its duty "to ensure that it does not collect taxes for that part of the public interest not within its jurisdiction".⁶⁵ If the federal government were to relinquish the tax room it now occupies to fund initiatives within provincial legislative competence, that room would provide the same revenue-raising capacity to the provinces.

A third argument commonly made on behalf of the federal spending power is that such a power is necessary to promote new, and to protect existing, social programs and initiatives. Underlying this claim is an assumption that the central government is better trusted with the social welfare of Canadians than are provincial governments. There are two responses to this argument. The first is to question the relationship between the assumption and the solution. If it were true that the central government is more trustworthy, surely the solution would be to seek a constitutional amendment transferring jurisdiction to the central authorities. The use of the spending power to overcome jurisdictional shortcomings is a poor alternative. As shown above, the spending power provides federal authorities limited control over the programs it funds, while compromising the ability of both regional and national majorities to influence policy and to hold governments politically accountable.

The second response is to challenge the centralist assumption on which the argument is based. Why should it be that the central government is more trustworthy in terms of social policy? The national electorate, after all, is simply the sum of the regional electorates. What reason is there for believing that voters, when they enter a federal polling booth, possess different attitudes about questions of social welfare than when they enter a provincial polling booth? Perhaps there is a view that central Canadians, who comprise the bulk of the national population, are more enlightened in their attitudes to social welfare than Atlantic or western Canadians. If so, there is no evidence to support this view. On the contrary, Poel's statistical study of the diffusion of legislation among the Canadian provinces shows that, in the period from 1945 to 1975, Saskatchewan was by far the most innovative province in terms of initiating social welfare programs.⁶⁶ Besides, even if it were true that the population of central Canada is more strongly dedicated to a particular vision of social justice, what political justification would this provide for requiring that view to be imposed upon those in other regions who embrace a different vision?

⁶⁵ Trudeau, *op. cit.*, footnote 49, p. 87.

⁶⁶ D.H. Poel, *The Diffusion of Legislation among the Canadian Provinces: A Statistical Analysis* (1976), 9 Can. J. Pol. Sc. 605.

Another ground for questioning the centralist assumption concerns the nature of national and provincial politics. In a country as large and varied as Canada, national politics are necessarily preoccupied with mediating among competing regional, cultural and linguistic interests. Preoccupation with these "traditional" political cleavages has tended to inhibit the development of class-based politics at the national level. It is within the smaller and less diverse provincial units that traditional cleavages are diminished and ideological cleavages are more likely to come to the fore.⁶⁷ Thus it is no coincidence that, while the two mainstream political parties have dominated national politics since Confederation, ideological parties have fared much better at the provincial level. In the past twenty years, for example, social democratic parties have formed governments in four provinces and served as the official opposition in two others.⁶⁸

There is also the question of size and numbers. Provinces provide special opportunities for social innovation simply because they are small and because there are ten of them. Given their limited and relatively homogeneous populations, it is generally easier to forge a provincial consensus on a given social issue than it is a national consensus. Moreover, even in conservative times, there are usually a few provinces whose governments remain sympathetic to a reformist agenda. And successful implementation of a reform by one provincial regime inevitably lends legitimacy to that reform and fuels political demand for its implementation elsewhere. As Breton and Scott have observed, federalism permits creative provincial governments to undertake "pilot projects" for the rest of the country while avoiding the political risks "implicit in large or national projects".⁶⁹

This is a phenomenon that is familiar to most Canadians. Hospital insurance, medicare, labour codes, human right codes, even bills of

⁶⁷ There is a whole body of literature concerning the impact of federalism upon class and power in Canada. The orthodox view among leftist writers appears to be that federalism, by reinforcing traditional political cleavages, has inhibited the development of class-based politics at the national level, thereby imposing "a conservative tone on the Canadian political system": J. Porter, *The Vertical Mosaic: An Analysis of Social Class and Power in Canada* (1965), p. 385. The difficulty with this view is that it underestimates the extent to which these traditional cleavages would exist absent federalism and, at the same time, discounts the impact of federalism on regional politics. What writers like Porter fail to note is that, while federalism serves to reinforce traditional cleavages at the national level, it creates a second tier of political decision-making at the regional level in which traditional cleavages are minimized and which therefore is more conducive to the development class-based politics.

⁶⁸ In the past twenty years, the New Democratic Party has formed governments in Manitoba (1969-77; 1981-88); Saskatchewan (1971-82); British Columbia (1972-75), while the Parti Québécois formed the government of Quebec (1976-85). The New Democratic Party has served, and continues to serve, as the official opposition in both Alberta and Ontario.

⁶⁹ Breton and Scott, *op. cit.*, footnote 55, p. 18.

rights, were pioneered by innovative provincial regimes before gaining political acceptance across the country. The same pattern continues today with initiatives such as public auto insurance, gay rights and pay equity. The implementation of public auto insurance in Saskatchewan fueled demand for a similar scheme in Manitoba; the example set by the two prairie provinces paved the way for voter acceptance of government plans in British Columbia and Quebec; and the track record of these four provinces has bolstered campaigns for public auto insurance in Ontario and elsewhere. Similarly, the move to amend human rights codes to prohibit discrimination on the basis of sexual orientation began in Quebec and has since spread to the Yukon, Ontario and Manitoba. The example set by these provinces will undoubtedly encourage other provinces, and eventually the federal government, to follow suit. The same process is likely to occur with respect to pay equity. Ontario's enactment of pay equity legislation applying to the provincial private sector is already placing pressure on other provincial governments to undertake similar initiatives.

The point is not that provincial politics is invariably preferable to national politics. There are many problems that, for a variety of reasons, may demand national as opposed to regional resolution. Moreover, just as provincial political units are more amenable to calls for social reform, they are also more responsive to demands for social retrenchment. The recent British Columbia experience with human rights codes, labour legislation and abortion stand as stark reminders. The point is simply that, for those concerned with social progress, there is nothing inherently reactionary about provincial politics. On the contrary, there is much to recommend provincial politics as a staging ground for social reform.⁷⁰

Having confronted the myths, it is time to deal with some realities. One such reality is that we live in a country that for the past four decades has structured its political system around the assumption of a federal spending power. Terminating that power would pull the rug out from under a vast array of grants, programs and tax expenditures.⁷¹ For exam-

⁷⁰ As Trudeau put it to Canadian socialists in 1961: "Federalism must be welcomed as a valuable tool which permits dynamic parties to plant socialist governments in certain provinces, from which the seed of radicalism can slowly spread.", *The Practice and Theory of Federalism*, in *Federalism and the French Canadians*, *op. cit.*, footnote 49, p. 127.

⁷¹ It might also call into question the right of governments to control various Crown corporations, although a strong case could be made that, even in the absence of the spending power, government ownership of such corporations (including those outside its normal regulatory jurisdiction) is supported by federal authority over public property and provincial authority over property. It should be noted that this argument is quite different from the one that seeks general support for the spending power on the basis of federal jurisdiction over the public debt and property. That argument is based on the assertion that a law authorizing the expenditure of federal funds for *any* purpose should be characterized as a law in relation to public debt and property. The argument here is based on

ple, the validity of federal health grants, student loans and child tax credits would be undermined. Any proposal for reform that failed to anticipate and to counteract such political disruption would be doomed from the start.

A second reality is that Canada is no longer the same society that it was even four decades ago. Social relations have become increasingly interdependent and complex. Problems that were once of local concern today attract national attention. New issues have emerged that require innovative solutions or fall between the cracks in the constitutional order. These changes demand constitutional adaption and, in some instances, the spending power has served as a tool for such adaption. If that tool is to be taken away, formal mechanisms for constitutional adjustment must be made more flexible.

These two realities point to a third: there are limits on the ability of courts to use legal norms to control governmental behaviour. At some point, the requirements of constitutionalism must yield to the demands of political practice. To quote Trudeau once again: "There are areas in which even the courts cannot provide enlightenment: no matter how clear one's rights, the federal system must ultimately rest upon a basis of collaboration."⁷² While the authority wielded by judges may enable them to strike down particular programs, it does not permit them to dismantle the structure of modern government.⁷³ It is simply beyond the capacity of courts to undo forty years of political development.⁷⁴

the narrower and more tenable proposition that a law authorizing the expenditure of federal funds for the particular purpose of acquiring a government interest in property ought to be characterized as a law in relation to public property. Similarly, the right of provinces to acquire Crown corporations would be grounded upon the provincial power over property, which presumably includes provincial public property.

⁷² Trudeau, *op. cit.*, footnote 49, p. 99.

⁷³ Some may believe that judges, while incapable of assuming full responsibility for reforming the spending power, could still play an important role as catalysts for such reform. The Supreme Court of Canada has recently shown how this might be done. In *Reference re Manitoba Language Rights*, *supra*, footnote 53, the court believed that striking down all Manitoba legislation enacted only in English would be too politically disruptive. It therefore issued an order declaring such legislation to be unconstitutional but allowing the Manitoba government a period of grace in which to translate the laws in question. Presumably a similar order could be issued here, declaring the spending power to be unconstitutional but allowing governments time to adjust to this ruling. Such an order would place the burden upon governments to initiate the institutional reforms required to preserve existing programs. The trouble with this scenario is that the changes that would be required to preserve programs threatened by the elimination of the spending power are far more complex and contentious than the translation of laws. For this reason, the potential disruption that would be caused by such a court order would be far greater, making it improbable that any Canadian court would assume the political risks of even this form of action.

⁷⁴ This assessment is supported by the cursory manner in which the Alberta Court of Appeal dismissed the recent constitutional challenge to federal health, education and

And so we have come full circle. Having determined that the federal spending power cannot be supported on the basis of doctrine or constitutional values, we are confronted with the cold reality that courts are incapable of doing anything about it. Reform of the spending power can be accomplished only through political action. Such reform requires a carefully managed process of governmental collaboration aimed at producing maximum jurisdictional disentanglement and minimum social cost.

What are the chances of politicians rising to this challenge? The history of the past forty years would seem to suggest that they are not great. Yet the limitations on the spending power proposed by the Meech Lake Accord provide some cause to question this assessment. Even if the Accord fails to attract the unanimous provincial approval that it requires, the support it has already received from the federal Parliament and from the legislatures of more than two-thirds of the provinces is significant. This support demonstrates that a substantial number of politicians across Canada are now prepared to acknowledge a problem with the spending power, and to entertain proposals for constitutional reform. Moreover, it is a measure of support that, while insufficient to implement the Accord, would be sufficient to enact a constitutional amendment limited in scope to the spending power.⁷⁵

V. Constitutional Reform

The Meech Lake Accord marks the first concerted effort by Canadian governments to place explicit constitutional limitations on the federal spending power. Clause 7 of the Meech Lake Accord would amend the Constitution Act, 1867 by adding the following section:

106A. (1) The Government of Canada shall provide reasonable compensation to the government of a province that chooses not to participate in a national shared-cost program that is established by the Government of Canada after the coming into force of this section in an area of exclusive provincial jurisdiction, if the province carries on a program or initiative that is compatible with the national objectives.

(2) Nothing in this section extends the legislative powers of the Parliament of Canada or of the legislatures of the provinces.

What this section does, in essence, is to guarantee a provincial government "reasonable compensation" for opting out of future national shared-cost programs, provided the government in question establishes provincial programs that conform to "the national objectives". In this way, the

welfare expenditures in *Winterhaven Stables Inc. v. Attorney-General of Canada*, *supra*, footnote 34, and by the subsequent decision of the Supreme Court of Canada to refuse leave to appeal in that case: Supreme Court of Canada, Bulletin of Proceedings, April 14, 1989, p. 905.

⁷⁵ An amendment limited to restricting the use of the spending power would require the support of the federal Parliament and of the legislatures of two-thirds of the provinces representing at least fifty per cent of the population: Constitution Act, 1982, s. 38(1).

Accord seeks to limit the power of Ottawa to use conditional grants as a mechanism for dictating the details of programs that fall within provincial legislative jurisdiction.

The problem with the proposal is that it does not go nearly far enough. First, it applies only to future shared-cost programs, not to existing ones. Second, while purporting to guarantee a measure of provincial control over the details of such programs, section 106A would not impede the ability of the federal government to set spending priorities or to dictate general program objectives. Indeed, by formally recognizing Ottawa's power to set "national objectives", the section could actually encourage the federal government to tighten the conditions it imposes on existing shared-cost programs.⁷⁶ Third, section 106A would do nothing to curb federal spending outside the context of shared-cost programs. Thus if Ottawa wished to avoid the new limits on shared-cost programs, it could establish spending programs of its own. Alternatively, it could use the device of tax expenditures in an effort to avoid limitations imposed upon it by the proposed amendment.⁷⁷

At best, therefore, section 106A might marginally enhance provincial autonomy over policies falling within provincial legislative jurisdiction. At the same time, it would do little if anything to strengthen political accountability. By leaving political responsibility diffused between two orders of government, the Accord would continue to leave voters in doubt as to whether the deficiencies of a shared-cost program—even one initiated by a province—lie in the provincial or federal aspect of its design and implementation.

What is needed is a more radical and comprehensive approach. First, conditional transfers between governments should be constitutionally prohibited, and the tax room currently required to fund such transfers given over to the government with legislative jurisdiction. Second, federal and provincial governments should commit themselves to a joint initiative aimed at eliminating the use of other conditional grants, loans and tax expenditures for the promotion of policies that fall outside their respective legislative jurisdictions. Third, the federal government's commitment to regional equalization of tax revenues should be spelled out more specifically in the Constitution. Finally, formal procedures for constitutional amendment should be made more flexible.

⁷⁶ An example of this tendency is provided by a *Globe and Mail* editorial which relied upon the wording of s. 106A to argue that Ottawa ought to attach specific conditions to the block funding it currently provides provinces for post-secondary education: Editorial, *The Globe and Mail*, Toronto, November 5, 1987, p. A6.

⁷⁷ The section does not make clear whether tax deductions and credits that come out of federal and provincial coffers fall within the definition of "national shared-cost" programs. If they do not, the federal government would be able to propose a jointly funded tax credit to promote a particular policy that fell within provincial jurisdiction. Any province that refused to participate in the credit would not be entitled to compensation.

Let us consider each of these proposals in turn. The first is directed at eliminating the spending mechanism that is most destructive of provincial autonomy and political accountability: the conditional transfer from the federal to provincial governments. Conditional transfers are particularly pernicious because they do not use federal spending to address social conditions directly; rather, they use it to influence the exercise of regulatory authority by the other level of government. The disruptive potential of eliminating these transfers would be great if not accompanied by specific guarantees ensuring the continuity of the programs that they fund. However, this danger would be substantially reduced if the federal government were required to turn over to the provinces the tax room it currently occupies to fund such transfers. As a further hedge against political disruption, provinces should be required to continue programs in accordance with federal conditions until after a provincial election. This would ensure electors an opportunity to express their views before any provincial government decided to abandon or substantially alter an existing program.

The second proposal seeks to place some political limits on the use of other conditional spending programs. It would entail the establishment of an intergovernmental agency with powers to prevent federal and provincial governments from employing such programs to influence policies beyond their respective legislative jurisdictions. Such an agency, for example, would require the phasing out of federal student loans and provincial foreign aid. Again, to minimize political disruption, the funding government would be obliged to transfer the necessary tax room to the government with legislative jurisdiction. In return, the latter would be required to assume responsibility for the program and to continue it in its present form until after a general election.

Why should this agency be political rather than judicial? The answer lies in the complexity of current fiscal arrangements and in the difficulty of distinguishing between spending that is aimed at a legitimate federal or provincial purpose and that which is not. Unlike conditional transfers, which invariably flow from the federal government and which relate to a discrete group of policy initiatives, other conditional spending initiatives comprise a complex web of federal and provincial grants, loans and tax expenditures. The task of disentangling this web requires political sensitivity and skill. It is a job that must be given to a body that is capable of comprehending the complexity of the task and that possesses the means to respond in a constructive and sophisticated fashion. Moreover, while programs funded by means of conditional transfers have been generally recognized as falling under provincial legislative jurisdiction, the jurisdictional pedigree of many other spending initiatives is problematic. This is especially true of tax expenditures. Is a particular expenditure aimed at promoting tax equity or a social policy that falls within provincial jurisdiction—or is it aimed at both? In many cases, the

answer will turn on questions of political judgment. To leave determinations such as these to a detached adjudicative agency with limited remedial powers would be to invite ongoing political instability and disruption. The only practical solution is to entrust these determinations to a body that fully understands the practical implications of its actions and has the capacity to make decisions and recommendations that will produce jurisdictional disentanglement at the least political cost.

The third proposal is designed to ensure that the elimination of conditional transfers and other conditional spending programs does not diminish the federal government's commitment to equalizing tax revenues on a regional basis. It would require the inclusion in the Constitution of a specific formula guaranteeing that current levels of regional equalization, including those embodied within existing conditional grant programs, be maintained or enhanced. This requirement could be met by means of unconditional transfers to the provinces or other initiatives whose effect would be to equalize revenues on a regional basis.

These three proposals would go a long way to restoring provincial autonomy and political accountability to Canadian federalism while protecting the principle of regional equalization. But there is more to be done. If governments are to be deprived of spending as an informal means of constitutional adjustment, it is essential that formal amendment procedures be made more flexible. In this respect, the Meech Lake Accord marks a step backwards. First, it would impose a unanimity requirement on certain constitutional amendments affecting national institutions and on amendments providing for the creation of new provinces.⁷⁸ Second, by providing greater compensation to provinces that opt out of other amendments, the Accord would make it more difficult to obtain the required measure of provincial consent under the general amendment formula.⁷⁹ The inevitable impact of embracing such constitutional rigidity would be to increase the pressure upon governments to resort to spending and other expedients to overcome jurisdictional barriers.

⁷⁸ Clause 9 of the Accord would amend ss. 41 and 42 of the Constitution Act, 1982 to require unanimous provincial consent for amendments relating to: the principle of proportionate representation of the provinces in the House of Commons; the powers of the Senate and the method of selecting Senators; the Supreme Court of Canada; and the establishment of new provinces. Under current arrangements, such amendments require only two-thirds of the provinces representing fifty per cent of the population.

⁷⁹ Clause 9 of the Accord would amend section 40 of the Constitution Act, 1982 to require the federal government to provide "reasonable compensation" to provinces that opt out of constitutional amendments that transfer legislative powers from provincial legislatures to the Parliament of Canada. Such compensation is currently required only with respect to amendments "relating to education or other cultural matters".

Conclusion

This article has examined the doctrinal, theoretical and political justifications for the federal spending power and the regime of administrative federalism to which it has given rise. I have argued that the spending power not only lacks doctrinal foundation, but that it serves to undermine provincial autonomy and political accountability, thereby weakening the federal and the democratic character of the Canadian state. I have also tried to show that the political claims of those who defend the spending power as being necessary to preserve equalization, to fund existing programs and to promote social progress do not withstand close scrutiny.

At the same time, I have acknowledged that it would be a mistake to look to the courts to curtail the spending power. Forty years of constitutional development cannot be undone by judicial decree. Reform of the spending power must come, if at all, in the political arena. The prospects of such reform, admittedly, are not great; yet the Meech Lake Accord provides a glimmer of hope. While the limitations it proposes are minor, the Accord at least demonstrates that a substantial number of politicians across Canada are capable of acknowledging a constitutional problem with the spending power. The question that remains is whether they are capable of doing more. If so, the Meech Lake initiative may yet serve as an important milestone along the road to more meaningful change. If not, that initiative, even if successful, could do more to legitimize the spending power than to curb its exercise.

Postscript

On June 8, 1989, the Supreme Court of Canada rendered judgment in *Brown v. YMHA Jewish Community Centre of Winnipeg Inc.*⁸⁰ At issue in the case was whether provincial wage laws applied to workers participating in a federally funded job creation programme. In the course of deciding that such workers were subject to provincial wage laws, the court held that the power of the federal government to establish job creation programmes "is derived from the federal spending power".⁸¹

L'Heureux-Dubé J., writing on behalf of a seven member bench, noted that the "scope and extent of this power has been the subject of some speculation".⁸² After quoting Professor Hogg's discussion of the constitutional basis of the power, she stated:⁸³

There has been some debate over the extent to which the exercise of the federal spending power can justify incursions into what would otherwise be areas of

⁸⁰ [1989] 4 W.W.R. 673 (S.C.C.)

⁸¹ *Ibid.*, at p. 686.

⁸² *Ibid.*

⁸³ *Ibid.*

provincial legislative jurisdiction. In *The Allocation of Taxing Power Under the Canadian Constitution*, 2nd ed. (1981), at p. 45, Dr. G. V. La Forest, now a Justice of this court, expressed the view that the federal spending power can be exercised so long as it is not in substance legislation on a provincial matter. Thus, the federal government could spend money to create jobs in the private sector, or in areas not directly under its competence.

While this reasoning is scanty and obscure, it provides strong support for the view expressed in this paper that Canadian courts lack the institutional capacity to curtail the federal spending power. At the same time, the formal recognition now given to the spending power by the Supreme Court of Canada will inevitably enhance the constitutional legitimacy of that power, making the prospects for its political reform even more remote.