Working paper
2007-06-26

Fiscal federalism and the future of Canada: Can section 94 of the Constitution Act, 1867 be an alternative to the spending power?

By Marc-Antoine Adam[1]

Introduction

25 years after the coming into force of the *Constitution Act, 1982*, we can now appreciate how much the Canadian *Charter of Rights and Freedoms* has profoundly influenced Canada's constitutional evolution, both as regards the functioning of the State and the development of Canadian identity. Ironically, as the Charter pushed the principles of limitation on sovereignty, judicial review, constitutionalism and the rule of law to a level never seen before in a British parliamentary system, those very same principles were all but abandoned as regards federalism. In other words, while the idea that the Charter should set strict and enforceable limits to all aspects of government action has sunk deep in the Canadian psyche, relativism seems to have nearly completely overcome federalism.[2]

This inconsistency in our relationship with constitutional rules and the weakening of federalism

Over the last decade, academics have devoted much attention to "what works and what might work better" with respect to Canadian fiscal federalism (to borrow from one of the Institute of Intergovernmental Relations' publications)[3]. The criticisms relating to fiscal federalism are numerous and often longstanding. To be sure, it is credited with great successes. But those achievements seem to belong to a now distant past. There is in the literature a perception that while the system might have been working relatively smoothly up until the late seventies – when money was flowing – this has not been so much the case since. Hence, complaints of potential misspending and lack of transparency and accountability traditionally associated with fiscal federalism were more recently joined by other perceived shortcomings such as the lack of binding effect of intergovernmental agreements, the absence of dispute settlement mechanisms, the political tension and constant conflicts over jurisdiction and more generally the absence of rules, the lack of process and the lack of collaboration (Lazar 2000; Telford, Meekison and Lazar 2004; Papillon and Simeon 2004; Leslie, Neumann and Robinson, 2004, Noël, 2005).

Although there seems to be a growing consensus over these weaknesses, at least in the academe, and no shortage of ideas to create new structures to address them (e.g. Burelle, 1995; Courchene, 1997; Frank, 2004; Cameron, 2004; Lazar, 2005; Leclair, 2005), fiscal federalism and Canada's social union appear forever impossible to regulate. This paper puts forward the idea that maybe our existing institutions are more adequate than we think in this respect; maybe the problem is that we disregard them.

Indeed, what is striking with Canadian federalism is that we try to govern this country without the assistance of a legal framework, i.e. the Constitution. With respect to federal-provincial issues, the conventional wisdom is, firstly, that our constitution is outdated and cannot provide satisfactory answers to the needs of today and, secondly, that it cannot be amended. Leaving aside the second of these two perceptions for a moment, let us challenge the first one.

For many, Canada's Constitution, at least those sections dealing with federalism, is a liability. Its rigidity is an obstacle to Canadian nation building. It is considered to be divisive and focusing too much on it might even pose a threat to Canadian unity. Hence, the very term constitution has become a bad word in our vocabulary. Conversely, these same people are convinced that our ingenuity to skirt around the Constitution, or to "muddle through", as some put it, has made Canada a stronger country. Maybe… but then, maybe not. It has been said that federalism is a "learning process of negotiation and conflict resolution" and that a "certain creative tension" is inherent in the federal system[4]. That we should constantly be negotiating is perhaps normal, that there should be no permanent agreed upon rules to govern our negotiations and what we negotiate is more troublesome. But this is what a constitution is meant to provide: a set of fundamental rules or a framework within which the day to day political process can take place. Lack of agreement on day to day political issues is normal and healthy. Lack of agreement on the fundamental rules is a different matter. In fact, one could

In November 2004, the Québec Government put forward five principles that ought to govern us to meet the challenges facing the Canadian federation.

safeguard for sound case law. Incidentally, it was also the conclusion reached by the Québec Commission on fiscal imbalance led by Yves Séguin which investigated this matter in 2002 (*The "Federal Spending Power"* Report - Supporting document 2, 2002; see also Lajoie, 2006)[11].

In fact, as some authors have pointed out in recent years (Yudin 2002; Telford, 2003), the only authoritative case that dealt with the federal spending power is the 1937 decision of the Judicial Committee of the Privy Council rendered in the *Unemployment Insurance Reference* (before the Constitution was amended to transfer unemployment insurance to the federal Parliament). In that case, the federal government was attempting to defend the validity of its legislation by construing it as taxation on the one hand and disposition of federal property on the other hand, and then by arguing that in disposing of such property, it was not constitutionally limited to federal objects. The Privy Council was not convinced by the federal characterization of the statute, but even supposing such characterization to be correct, it rejected the federal claim that its power to dispose of federal property was not limited by the distribution of powers (*A. –G. Can* v. *A. –G. Ont*, 1937)[12].

What is striking about this case is the resilience of the unlimited spending power thesis despite its clear rejection by the Privy Council[13]. Clearly, what allowed the thesis to survive is the continuing and expanding practice of federal interventions in areas of provincial jurisdiction that came with the advent of the Welfare State. In the legal literature, this led to some interesting intellectual gymnastics, first to skirt around the decision of the Privy Council[14] and second to skirt around the distribution of powers[15]. This is how State spending, and the legislation authorizing it, came to be differentiated from “compulsory regulation” and portrayed as a gift that could be made freely, irrespective of the assignment of responsibilities provided for in the Constitution (Hogg, 1997, chapter 6). To achieve this result, first, words were read into sections 91 and 92 of the Constitution Act, 1867. Hence, these sections, effecting the distribution of powers, no longer covered all legislation relating to the matters listed, as is written and as the courts have taught us: they would only cover the legislation actively “regulating” these matters[16]. Second, it was argued that conditions attached to spending, however demanding and inescapable, are not “regulation”, even if it admittedly indirectly achieves the same outcome. Lastly, we were told that the purpose of the spending is not to be taken into account even though purpose has always been a central element to determine the validity of legislation in disputes about the distribution of power[17].

The underlying rationale provided for the unlimited spending power thesis was that we should distinguish situations when the State acts as a “public power”, i.e. in a “compulsory” manner, from when it acts as a “private actor” such as when spending, lending and contracting. In the latter cases, it was argued, the State should be no more constrained by the Constitution than would a private individual (Hogg, Ibid). Strangely, no one has ever seriously attempted a similar public/private distinction to argue that the Charter ought not to apply to a government spending program. Obviously, there is a double standard here[18].

Taken to its logical conclusion, the unlimited spending power thesis would imply that the provision of public services of any kind would largely be excluded from the purview of the distribution of powers, for it is essentially spending. The fact that “compulsory” taxation

provides the means for these services seems irrelevant to the proponents of this thesis, as does the fact that the provision of public services is now the core mission of the modern State. Moreover, little explanation is provided to account for the presence of many items in sections 91 and 92 which actually take the trouble of allocating exclusive public services/spending responsibilities between the federal and the provincial legislatures[19]. Nor are we told why exactly we needed to amend the Constitution to allow the federal government to take on unemployment insurance and old age pension[20].

As we can see, the unlimited spending power thesis is at odds with many constitutional provisions and principles[21]. It should therefore come as no surprise that it is also sometimes seen by non-lawyers as defying common sense as Donald Smiley once so eloquently put: “Although it is not within my competence to]2t2 Tw[(eo)]TJ1tional

concept have sought in one way or another to prescribe proper limits surrounding the use of the federal spending power[24]. In retrospect, that this course was chosen instead of an outright constitutional challenge may have been a mistake, for we all know what happened with the constitutional file. After the failure of the Charlottetown Accord, the same endeavor was again attempted through the administrative route with the disappointing and toothless Social Union Framework Agreement as a result[25]. Somehow, it seems that the incentive to find an effective, permanent and sustainable mechanism that would allow the federal government to play a constructive and collaborative role in areas of provincial jurisdictions has never been sufficiently strong, longwinded or shared to bear fruits. The temptations of unilateralism stirred up by the unlimited spending power thesis have always prevailed.

Yet, what many Canadians seem to be seeking is, first and foremost, collaboration between the two orders of government in the management of what they perceive as pan Canadian issues. However, the problem with satisfying this desire is twofold. First, as mentioned, often it is not equally shared by Quebecers. To be sure, there have been some instances of opting out which have succeeded in smoothing over this difficulty, but these were ad hoc arrangements and only came after hard fought political battles[26]. And this leads to the second difficulty, which is the lack of a legal framework to sustain this vision of federalism in the Constitution, or so it seems.

Indeed unlike other federations, such as Germany for instance, Canada's constitutional architecture was not built around the model of intra-state federalism. It is rather a classic example of inter-state federalism. Accordingly, little seems to be provided in the way of legal principles to address the requirements of interdependence. We have just seen that the unlimited spending power thesis is not very helpful in this regard, for it essentially amounts to suggesting there is a huge legal vacuum at the heart of Canada's federal system, which, in turn, is hardly conducive to genuine principled collaboration. And without a sound legal basis, fiscal federalism and the management of Canada's social union are condemned to remain in the lawless realm of raw politics.

The constitution inside the Constitution

In a speech he delivered in February 2004 at the law faculty of the University of Toronto questioning the legal foundation of the federal spending power, Québec's minister for

accord with its Québec addendum and the Premiers' proposal for a federal pharmacare program excluding Québec provide a good illustration of this (Milne, 2005; Courchene, 2006).

There is very little to be found in the legal literature about section 94[33]. In 1942, F.R. Scott devoted an important article to it as he was seeking to find ways that would allow the federal government to play a leading role in building the Welfare State following the decisions rendered by the Privy Council about the distribution of powers in this area, including the *Unemployment Insurance Reference* (Scott, 1942). In 1975, former justice Gerard La Forest also wrote about section 94. In the introduction to his paper, he noted how the interest in this area of the law had vanished and pointed at the spending power as a possible explanation (La Forest, 1975). To be sure, both Scott and La Forest themselves became supporters of the unlimited spending power thesis (Scott, 1955; La Forest, 1981). But maybe section 94 was the more promising idea. Maybe the appealing magic of the unlimited spending power thesis has detracted us from more constructive and solid avenues.

If we were to rethink fiscal federalism and Canada's social union using section 94, rather than basing it on the unlimited spending power thesis, here are some of the potential benefits that could follow:

- we could stop pretending that public spending and legislating are two different things so that parliamentarians could reclaim their rightful place in our system, with the greater transparency and accountability that come with it.

- federal interventions could go beyond mere spending and involve "compulsory regulation" thus allowing more effective, comprehensive and sound public policy.

- outcomes would be legally binding and the law courts could settle potential disputes.

- the implicit acknowledgement that we are dealing with provincial jurisdiction and the constitutional requirement for provincial consent would eliminate federal unilateralism and shift the focus on to the merits of the public policy at stake rather than on jurisdictional disputes.

- the federal government could move forward with its interventions in some provinces without having to secure beforehand cross-Canada consent each time.

- this could possibly go a long way toward easing relations with Québec, without changing the Constitution, without giving Québec more powers, and without even preventing other provinces, if they so wish, from opting out as well.

Some issues for consideration

Section 94 does raise a number of questions to which attention should be devoted if it were to be considered as a potential legal foundation for Canada's social union. Its wording dates from

another period and is not always clear. Unlike other provisions of the Constitution, it has not benefited from successive judicial restatements carrying its meaning through to the 21st century. The following paragraphs are an attempt to briefly explore some of these questions and provide suggestions as to how they could be addressed. While this exercise may sometimes require us to move beyond the mere words of section 94, it is contended that it nevertheless constitutes a much more straightforward account of Canada's Constitution than that provided by the unlimited spending power thesis.

The issue of financial compensation for non participating provinces is one such question. Having been written in the 19th century with the liberal model in mind, section 94 is silent on this. In the context of today's social union, the absence of a right to compensation under section 94 would leave the door open to the same financial coercion presently associated with the unlimited spending power that plagues fiscal federalism. This in turn would hardly be faithful to the principle requiring individual provincial consent embedded in section 94. Hence, it is argued that a right to compensation should and could now be inferred from section 94 on federalism and equitable grounds, particularly if read together with section 36 of the Constitution Act, 1982.

Indeed, under the liberal conception of the role of the State prevailing in 1867, where social

Another complex issue with section 94 is the question of reve

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." (pp. 366-367). Interestingly, this case has more or less disappeared from much of the contemporary literature supporting the unlimited spending power thesis and has never been discussed, let alone overturned, in the subsequent judicial decisions which are alleged by many as having "recognized" such a power.

[15] For an early articulation of the unlimited spending power thesis, see Scott, 1955. The most complete contemporary articulation is probably provided by Hogg (1997, chapter 6). Accordingly, it acts as the backdrop for the discussion set out in this paper.

[16] This narrow interpretation of the scope of the distribution of powers effected under ss. 91-92

Framework Agreement in 1999 was based on this position. For an analysis of this episode see Tremblay, 2000b.

[23] Although it is safe to conclude that the federal government has always had the upper hand, historically, federal spending measures in areas of provincial jurisdiction have generally been the subject of federal-provincial discussions, if not negotiations. This was the case for the initial cost-shared programs in health care, post-secondary ed

assimilation of the notion of “property and civil rights” to the field of “private law”, as opposed to “public law”, may be historically inaccurate. Aside from criminal law, there certainly were principles of English public law that were meant to continue to rule the inhabitants of Québec, not necessarily because such principles, by definition, fell outside the scope of the expression “property and civil rights”; but rather because section VIII of the Quebec Act specified that the right of Quebecers “to hold and enjoy their Property and Possessions, together with all Customs and Usages relative thereto, and all their other Civil Rights […] [as] determined [by] the Laws of Canada [i.e. old French Law]“ had to be exercised in a manner consistent “with their Allegiance to his Majesty, and Subjection to the Crown and Parliament of Great Britain”. In other words, it is, one could say, only to the extent of an actual inconsistency with their duty of loyalty toward their new Sovereign, or otherwise in face of some threat to English sovereignty, that Quebecers were to be governed by English Law as opposed to their own Laws. The relatively narrow scope of this restriction was evidenced in a judgment rendered by the Judicial Committee of the Privy Council in 1835 with respect to a litigation arising out of Québec where, in summary, it was held that by virtue of the Quebec Act, “the Prerogative of the Crown with regard to aliens [in this case the *droit d’aubaine*], must be determined by the laws of [Canada, i.e. old French law] and not by the law of England, which is only to be looked at in order to determine who are, and who are not, aliens.“(*Donegani*, 1835).

30 There are obviously many items other than s. 92(13) which deal with property and civil rights, for example, provincial undertaking (s. 92(10)), incorporation of companies with provincial objects (s. 92(11)), solemnization of marriage, etc. See Brun and Tremblay, 1990, p. 426. In fact, the

adequate services (at the average Canadian standard) without excessive taxation (on the average Canadian basis) the freedom of action of a province is in no way impaired. If a province chooses to provide inferior services and impose lower taxation it is free to do so, or it may provide better services than the average if its people are willing to be taxed accordingly, or it may, for example, starve its roads and improve its education, or starve its education and improve its roads – exactly as it may do today." (Ibid, p. 84).

[35] The possibility that the term "unrestricted" would both mean an irreversible grant of power to the federal Parliament, akin to a constitutional amendment, and the unlimited federal capacity thereafter to modify the law at will should be ruled out as it would be tantamount to granting the federal Parliament a tool to change the distribution of power at will in respect of property and civil rights: a proposition hardly compatible with federalism and the economy of s. 94, requiring provincial consent each time recourse is had to this section.

[36] The word "unrestricted" did not appear in article 29(33) of the Quebec Resolution of 1865, the predecessor of s. 94, which ended as follows: "but any Statute for this purpose shall have no force or authority in any Province until sanctioned by the Legislature thereof." In a subsequent text prepared for the London Conference the following phrase was added: "et, après cette sanction, le Parlement aura seul la faculté d'abroger, d'amender ou de modifier ces lois" (O'Connor, 1939, p. 138) which in the final version of the B.N.A. Act would be replaced by the current notion of "unrestricted" power. Another reason to dismiss the interpretation of s. 94 as an "amending formula" based on historical text is the fact that the B.N.A. Act did in fact contain a provision expressly allowing provinces to effect "Amendment from Time to Time, notwithstanding anything in this Act, of the Constitution of the Province, except as regards the Office of the

Cameron, D. 2004. “Inter-Legislative Federalism” in *Canada: The State of the Federation 1999-2000: Toward a New Mission Statement for Canadian Fiscal Federalism*, edited by H. Lazar, McGill-Queen’s University Press.

Chaoulli c. *Québec*, [2005] 1 S.C.R. 791.

Chevrette, F. and Marx, H. 1982, *Droit constitutionnel, notes et jurisprudence*, Montréal, PUL.

Choudrhry, S. 2002. “Recasting Social Canada: A Reconsideration of Federal Jurisdiction Over Social Policy”, (2002) 52 *U. of T. L. J.* 163

Commission on Fiscal Imbalance. 2002. *The "Federal Spending Power" Report - Supporting document 2*, Québec.

Commission royale d’enquête sur les problèmes constitutionnels (Commission Tremblay). 1956. *Rapport*, Québec.

Courchene, T. 1984. *Equalization Payments: Past, Present and Future*, Special research report, Ontario Economic Council.

- Courchene, T. 1997. “ACCESS : A Convention on the Canadian Economic and Social Systems” in *Assessing ACCESS : Towards a New Social Union*, Institute of Intergovernmental Realtions.

- Courchene, T. 2006. “Variation on the federalism theme” in *Policy Options/Options politique*, September, 2006

Dicey, V. H. 1961. Law of the Constitution, 10th edn. London: MacMillan & Co Ltd.

Donegani v. *Donegani*, (1835) 12 E.R. 571 (P.C.).

Dupont, J. 1967 “Le pouvoir de dépenser du gouvernement fédéral: ‘A Dead Issue?’ “, (1967) *U.B.C.L.R./C. de D.*, 69.

Eldridge v. *B.-C. (A.G.)*, [1997] 3 S.C.R. 624

Frank, C. E. S. 2004. “A Continuing Canadian Conundrum: The Role of Parliement in Questions of National Unity and Processes of Amending the Constitution” in *Canada : The State of the Federation (2002): Reconsidering the Institutions of Canadian Federalism*, edited by J. P. Meekison, H. Telford and H. Lazar, McGill-Queen’s University Press.

Gaudreault-Desbiens, J.-F. 2006. “The Irreducible Federal Necessity of Jurisdictional Autonomy, and the Irreducibility of Federalims to Jurisdictional Autonomy” in *Dilemmas of Solidarity: Rethinking Redistribution in the Canadian Federation*, edited by S. Choudhry, J.-F. Gaudreault-Desbiens and L. Sossin, University of Toronto Press.

Hanssen, K. 1966. “The Constitutionality of Conditional Grant Legislation”, (1966-1967) 2 *Man. L. J.* 191.

Hogg, P. W. 1997. *Constitutional Law of Canada*, loose leaf ed. Toronto, Carswell.

Hurley, J. R. 1996. *Amending Canada’s Constitution: History, Processes, Problems and Prospects*, Canada.

Kelly, J. B. 2004. "Guarding the constitution," in *Canada : The State of the Federation (2002): Reconsidering the Institutions of Canadian Federalism*, edited by J. P. Meekison, H. Telford and H. Lazar, McGill-Queen’s University Press.

Keith, A. B. 1937. “A comment from Great Britain”, (1937) 6 *C. B. Review*, 428.

Kennedy, W. P. M. 1944 “The Interpretation of the British North America Act”, (1944) 8 *Cambridge L. J.* 146.

KitKatla Band v. *B. C.* [2002] 2 S.C.R. 146

La Forest, G. V. 1975. “Delegation of Legislative Power in Canada” (1975) 21 *McGill L. J.* 131.

- La Forest, G. V. 1981. *The Allocation of Taxing Power Under the Canadian Constitution* (2nd edn.), Toronto, Association canadienne d’études fiscales, 1981.

Laforest, G. 2005. “The Historicial and Legal Origins of Asymmetrical Federalism in Canada's Founding Debates: A Brief Interpretive Note” in *2005 Special Series on Asymmetric Federalism*, Working papers edited by Havey Lazar, Institute of Intergovernmental Relations
http://www.iigr.ca/iigr.php/site/browse_publications?section=43

Lajoie, A. 2006. “The Federal Spending Power and Fiscal Imbalance in Canada” in *Dilemmas of Solidarity: Rethinking Redistribution in the Canadian Federation*, edited by S. Choudhry, J.-F. Gaudreault-Desbiens and L. Sossin, University of Toronto Press.

Ryan, E. F. and Slutsky B. V. 1964 “Canada Students Loan Act – Ultra Vires?”,

- Tremblay, A. 2000b. "Federal Spending Power" in *The Canadian Social Union Without Québec: 8 Critical Essays*, edited by A.-G. Gagnon and H. Segal, Montreal, Institute for Research on Public Policy, pp. 155-186.

YMHA Jewish Community Centre of Winnipeg Inc. v. *Brown*, [1989] 1 S.C.R. 1532

Yudin, D. S. 2002. “The Federal Spending Power in Canada, Australia and the United States”, (2002) 13 *N.J.C.L.* 437