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IRPP Working Paper Series
no. 2008-01

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Reflections on the Federal Spending Power: Practices, Principles, Perspectives *

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I: INTRODUCTION AND OVERVIEW[1]

The federal spending power (FSP) has returned to centre stage in public policy debates, in large part due to Stephen Harper's call for "open federalism" replete with a commitment to respect the constitutional division of powers on the one hand and the subsequent Parliamentary proclamation that "the Québécois form a nation within a united Canada" on the other. Watts (1999,1) defines the spending power as "the power of Parliament to make payments to people, institutions or provincial governments for purposes on which Parliament does not necessarily have the power to legislate, for example, in areas of exclusive provincial jurisdiction." However, for the purposes of this paper the exercise of the federal spending power will be viewed more broadly and will encompass areas like federal regulation that can also affect the division of powers. In any event, the key issue here is that for Prime Minister Harper's commitment to respect the constitutional division of powers to be credible it follows that the exercise of the federal spending power in selected areas must somehow be circumscribed. Not surprisingly, therefore, the October 2007 Speech from the Throne contained the following undertaking with respect to the narrower conception of the spending power:

> ...guided by our federalism of openness, our Government will introduce legislation to place formal limits on the use of the federal spending power for new shared-cost programs in areas of exclusive

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* This paper was prepared for the January 2008 symposium "Open Federalism and the Spending Power," sponsored by Queen's Law School and Queen's Institute of Intergovernmental Relations. A revised version of this paper will appear in the *Queen's Law Journal*.
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provincial jurisdiction. This legislation will allow provinces and territories to opt out with reasonable compensation if they offer compatible programs.

While this focus on new shared-cost programs is a typical concern associated with the exercise of the federal spending power, in the ensuing analysis the spending power issue will be viewed as having two related yet distinct components. The first is the one referred to in the above quotation, namely that any legislation relating to the spending power should provide the provinces with protection against arbitrary and unwanted federal intrusion in areas of exclusive provincial jurisdiction. The second is that any reworking of the spending power principles should also be flexible enough to allow for federal-provincial co-determination or collaboration on matters in provincial jurisdiction in order to build pan-Canadian programs where desired, including the possibility of delegating provincial powers upward and perhaps even federal powers downward.

With this as context, the paper proceeds by i) tracing the evolution of Canadian *practices* as these relate to the interaction between the federal spending power and selected elements of provincial constitutional powers, ii) focussing on the various *principles* that have been developed in terms of how one might institutionalize or constitutionalize the exercise of the federal spending power, and iii) assessing alternative *perspectives* for addressing the spending power issue in the larger national and global contexts. To anticipate the ensuing analysis somewhat, over the years Canada and Canadians have proven to be masters at the "art" of federalism. Via alterations in the magnitude of and incentives within federal-provincial transfers, via "opting in" and/or "opting out," via downward delegation (e.g. Quebec collecting the Goods and Services Tax), via creative arrangements/agreements to secure the internal social and economic unions, via *de facto* asymmetry within *de jure* symmetry, etc., we Canadians have been able to alter the effective division of powers in response to internal and external forces, and all of this without changing the written constitution

In more detail, Part II, (*The Spending Power and Canadian Policies/Practices*) begins with Quebec's decision in 1954 to adopt its own personal income tax (PIT) and the many spending-power ramifications that flowed from this decision. This is followed by an elaboration (in more or less chronological order) of a series

of specific spending power initiatives: the shared-cost programs; UI/EI; the tax-collection agreements; the CPP/QPP; the 1995 federal budget and the Canada Heath and Social Transfer; the Council of the Federation and the pharmacare proposal; the 2004 First Ministers' healthcare agreement, among several others. Among other purposes, this litany will serve to highlight some of the many roles that the spending power has played in the evolution of socio-economic policy, e.g., creating national versions of provincially administered social programs; creating a decentralized yet harmonized income tax system (with important recent steps in sales tax harmonization as well); preserving and promoting the Canadian economic union; creatively experimenting with "concurrency with provincial paramountcy" as an approach to the spending power; embracing "opting out with compensation" as an approach to "deux-nations asymmetry," and so on. To an important degree, these can be summarized by noting that Canadians and their governments have shown themselves to be masters of the art of managing a federal system in that most of the above accomplishments have been achieved without much, if any, alteration in the written constitutional word.

Part III (*The Spending Power and Institutional/Constitutional Principles/Proposals*) presents a comparable survey of formal principles or proposals relating to the spending power -- Section 94 of the Constitution; pre-Patriation spending-power proposals; the *Constitution Act, 1982* (including equalization and s.92A relating to resources); Meech; Charlottetown; the Calgary Declaration, again among several others. The message here is quite similar to that of Part II: we Canadians are a creative bunch and over the years we have found a rich and diversified set of principles by which to accommodate and/or inhibit aspects of the exercise of the federal spending power, writ large.

The role of Part IV (*Rethinking the Spending Power: Perspectives and Options*) is, first, to place the preceding analysis within a broader context, one that reflects the evolving nature of decision making in our increasingly integrated societies. For example, the "network" has emerged as the pre-eminent and pervasive organizational form in the Information Age (Castells, 2004), and networking does not sit well with open federalism's respect for the existing division of powers. Attention is then directed to a series of options for limiting the exercise of the federal spending power. The analysis concludes with two observations. The first

relates to Quebec. While recognizing the substantive and symbolic importance to Quebec of finding formal approaches to limiting the federal spending power, the demonstrated and quite dramatic achievements of Quebec's use of the political route in this regard suggests that the province must ensure that a legislated approach to the FSP will not end up reducing its considerable *existing* room to manoeuvre. The second relates to the emerging Canadian reality on the FSP front, namely, that the spending power issue will soon become centre-stage in the already problematical Ottawa-Alberta energy-environment nexus.

By way of a final introductory comment, while the ensuing analysis will make reference to various constitutional provisions and even some court cases, this paper takes a public policy approach to the spending power, not a constitutional law approach. Hopefully, however, it will serve to complement the more legal/constitutional perspectives, such as those referenced herein -- Adam (2008), Hogg (1985), Kellock and Leroy (2007), and Petter (1989).

II: THE SPENDING POWER AND CANADIAN POLICIES/PRACTICES

A: The 1954 Quebec Personal Income Tax

Under the provisions of the 1942-47[2] *Wartime Tax Agreements*) the provinces "rented" their personal income taxes to the federal government. In the post-war period Ottawa, infused with the spirit of Keynesian stabilization, desired to retain control of the personal income tax (PIT). Accordingly, at the 1945 Conference on Reconstruction, the federal government offered various further rental options to the provinces, which eventually became the 1947-52 *Tax Rental Agreements.* While all provinces signed on to this arrangement in 1945, by 1947 Ontario and Quebec had established their own corporate income tax (CIT) systems. More problematic for Ottawa was Ontario's announcement in 1950 that it intended to introduce a 5% PIT. In response, the federal government "sweetened" the provincial rental options under the 1952-57 arrangements. In addition to the earlier options, Ottawa added a fourth -- the yield of the PIT at 5 per cent of the federal rates, plus the yield of 8.5 per cent of corporate profits earned in the province, plus the average-per-capita revenues from succession duties, plus the existing 1948 statuary subsidies. Ontario signed on to these

enriched agreements and abandoned its CIT as well as its intention to implement a PIT. Quebec refused to sign.

All of this is preamble to one of the watershed moments in Canadian fiscal and political federalism, specifically the introduction in 1954 of Quebec's PIT, with its 15% marginal tax rate. From the perspective of 2008, Quebec's PIT, along with its CIT and its more recent Goods and Services Tax collection mechanism, are appropriately viewed as the cornerstones of its taxation autonomy and its nationhood aspirations within the Canadian institutional/constitutional frameworks. However, from the perspective of 1953, when Premier Duplessis constituted the Royal Commission on Fiscal Relations (headed by Thomas Tremblay and henceforth referred to as the Tremblay Commission) with the intent of buttressing Quebec's PIT intentions, the rationale had everything to do with creating a source of taxation revenues in order *to thwart the exercise of the federal spending power* and, in particular, to provide a revenue source to compensate Quebec universities for the province's prohibition from accepting federal grants to higher education institutions. Drawing from an excellent paper by Claude Forget (1984), I penned (as chair of the former Ontario Economic Council) the following perspective on the introduction of the Quebec PIT (Ontario Economic Council, 1983, 30):

> There can be little doubt that Quebec's move in 1954 to establish its own PIT was the outcome of a power struggle between Quebec and Ottawa. However, as our background research [by Claude Forget] makes clear, and as is also very evident from the report of the influential Tremblay Commission, what was at stake was not only the power to tax but also the power to spend for provincial purposes. By implementing its own autonomous PIT, Quebec was in effect challenging Ottawa's implicit claim, based on superior financial resources, that it had the right to determine areas of provincial jurisdiction where the national interest required that more monies be spent. Quebec saw the constitutional authority to levy direct taxes as the foremost symbol of fiscal autonomy at the provincial level. To be kept on a tight fiscal leash by Ottawa was, in the province's view, equivalent to subordination to the federal government across the entire fiscal front. Thus, as the background study suggests, to the extent that a provincial PIT was a symbol, *it was initially less a symbol of fiscal autonomy in the field of taxation than a symbol of autonomy in the field of public expenditure.* [Emphasis added]

The longer term implications of Quebec's PIT turned out to be dramatic and wide-ranging. First, Quebec's PIT effectively asserted (perhaps reasserted is better since the provinces had versions of the PIT

prior to World War II) the principle that a province can implement in the context of a separate PIT whatever tax rate and structure it deems appropriate. Second, Quebec's PIT system forced radical changes in the fiscal arrangements. In 1957, the tax rental arrangements were replaced by the *Tax Sharing Arrangements* (1957-62), whereby the provinces were given the option of levying their own taxes and receiving an abatement or deduction of federal taxes equal to 10% of the federal PIT, 9% of the federal CIT and 50% of succession duties, with the federal government agreeing to collect the provincial taxes free of charge. However, because these revenues were allocated to the provinces on the basis of the derivation principle (i.e., on the basis of what was actually raised in the province), they generated very different equal-per-capita revenues across provinces. The obvious solution here was to introduce an equalization program to compensate for these per-capita tax revenue differences. Introduced in 1957, Canada's formal equalization program clearly finds its origins and rationale in accommodating the Quebec PIT.

Two other spending-power implications of Quebec's PIT merit highlight. The first is that the introduction of the Quebec PIT in order to have a revenue base to counter the federal spending-power initiatives emphasizes an obvious, but oft-unstated, reality, namely, that the spending power issue is, in large measure, a fiscal imbalance issue. Without the existence of superior revenue access, Ottawa would have much less incentive to use its scarce resources to spend in areas of provincial jurisdiction. Along these lines, Quebec's launching of the Séguin Commission on fiscal imbalance in 2003 and the Commission's subsequent recommendation that the provinces take over the Goods and Services Tax are also inherently about the fiscal vulnerability of the provinces to Ottawa's exercise of the spending power in the wake of the 1995 federal budget's slashing of cash transfers to the provinces.

The second influence was more immediate and had a more far-reaching impact on the evolution of the federal spending power let alone the federation, as Forget (1984, 194) noted:

> In the years before 1954, Ottawa made a long series of important decisions that brought about spending programs entirely financed, regulated, and administered by the federal government in areas of provincial jurisdiction. These programs were unemployment insurance, family allowances, and old age pensions. Two of the programs required constitutional amendments to which Quebec (in one case under Duplessis) consented. After 1954 came even more significant spending

> programs: hospital insurance, medicare, and social assistance. *All of these later programs were to be cost-shared with the provinces, but provincially administered*. [Emphasis added]

Arguably, therefore, this shift from federally funded, regulated and administered programs to shared-cost programs under provincial design and administration is also part of the legacy of the Quebec PIT. To be sure, there is a fascinating irony here: federal shared-cost programs in this era served as a bulwark against federal *takeovers* on social programs in provincial jurisdiction, whereas in the fullness of time these shared-cost programs are themselves typically now viewed as having the potential for trampling on areas of provincial jurisdiction.

By way of some final comments, Quebec's revealed preference for own-source taxes over federal cash transfers led the province in the 1960s to demand and receive 16.5 additional tax-points of the federal PIT instead of an equivalent amount of cash transfers.[3] The other provinces were also offered the same opportunity, but there were no takers. This would not happen today, which is no doubt why Ottawa's offer has never returned to the table. Forget's (1984, 208) observations are appropriate in terms of a "what-if" conclusion to this fascinating episode:

> Had the federal government continued in the early 1950s to spend only for its own purposes, the provincial PIT would probably never have seen the light of day, since it was by no means likely that the Quebec government could have obtained an offset for its [15%] tax from the federal government beyond the 5 per cent that was already on offer [from the 1952-57 *Tax Rental Arrangements*]...At any rate, it should be clear that the Quebec PIT was a defensive reaction to the federal [spending power] initiative and not a forerunner of some separatist drive.

Prior to focussing on the spending-power-driven shared cost programs and the resulting development of much of the Canadian welfare state, we direct attention to the two programs that were, via constitutional amendment, transferred to the federal government -- UI/EI in 1940 and the contributory public pension plan in 1964.

B: Unemployment Insurance

In the 1937 *Unemployment Insurance Reference*, the Judicial Committee of the Privy Council ruled that unemployment insurance fell under "property and civil rights" and, therefore, outside of the competency of the federal Parliament. Indeed, as Kellock and Leroy (2007,15) recount, Lord Atkin concluded that even if the compulsory contributions required by UI were to be considered a valid federal tax, Parliament could not disperse those funds as it saw fit because this would afford an easy federal passage into the provincial domain. All in all, a landmark decision and a strong defence of provincial jurisdiction against the exercise of the federal spending power.

As noted by Forget above, until the advent of cost sharing in the wake of the Quebec PIT, constitutional amendment (i.e., passing s.92 powers upward) was the only way to make Ottawa a key social-envelope player. For unemployment insurance this occurred very quickly: As a result of a 1940 amendment to the Constitution, unemployment insurance became a federal head of power. Therefore, Ottawa's UI/EI program, *per se*, does not constitute an exercise of the federal spending power of the sort contemplated in this paper, since UI/EI was now a federal responsibility. However, what may well still fall under the rubric of the generalized spending power is Ottawa's use of UI/EI to venture into areas such as training and maternal/parental leave, which may well go beyond the strict definition of unemployment insurance and are, arguably, in areas of provincial jurisdiction. But the 2005 Supreme Court decision supported Ottawa by ruling that maternity benefits "are consistent with the essence of the federal jurisdiction over unemployment insurance," and went on to say the same thing about parental benefits.

Nonetheless, as DiGiacomo (2008) has noted, prior to this decision Ottawa entered into a deal with Quebec that devolved the maternity- and parental-benefits components of EI to the province. This Canada/Quebec agreement will result in the federal EI premiums falling by an amount essentially equivalent to what these benefits were costing Ottawa in Quebec. This deal was designed to come into force irrespective of the eventual decision of the Supreme Court. Obviously, Quebec felt that Ottawa was using the EI program to regulate/spend in areas that Quebec believed remained in the province's jurisdiction. Presumably, other provinces can follow in Quebec's footsteps.

By way of a final observation that runs in the opposite direction, one might note that a majority of Canadians probably are in favour of EI embodying maternal and parental leave, since these initiatives represent advances in the ambit of our welfare state and may have been unlikely to have been put in place by the provinces. This may be yet another role for the federal spending power, namely, to utilize programs within federal jurisdiction to initiate new social programs in areas of provincial jurisdiction which, once established, may eventually be transferred back to the provinces.

C: Canada Pension Plan/Quebec Pension Plan

Section 94A of the Constitution (added by the *Constitution Act, 1964*) reads as follows:

> The Parliament of Canada may make laws in relation to old age pensions and supplementary benefits, including survivors' and disability benefits irrespective of age, but no law shall affect the operation of any law present or future of a provincial legislature in relation to any such matter.

In constitutional jargon, the responsibility relating to dd age pensions is "concurrent with provincial paramountcy" (CWPP). What transpired in 1966 was that Quebec exercised its paramountcy and established its own separate Quebec Pension Plan (QPP) while the rest of the provinces signed on to the Canada Pension Plan (CPP).

The reason why the CPP/QPP is so interesting is that CWPP represents one way of addressing the federal-spending-power concern. Suppose (only for illustrative purposes) that CWPP were to characterize all of the programs comprising Canada's social envelope. Ottawa would then be free to legislate with respect to these programs, but the provinces could trump this by passing their own legislation. And if the opting-out provinces were provided compensation, then concurrency with provincial paramountcy would be, at least in principle, one way to circumscribe the exercise of the federal spending power. Obviously, however, the federal government would be loath to engage in this process unless it was confident that all or almost all of the provinces would remain on side.

As will also become clear, the CPP/QPP process is quite similar to the amending procedure explicit in s.94 of the Constitution which, as elaborated later, would allow the common law provinces (all except Quebec) to transfer to Ottawa areas that fall under s.92(13), i.e., "Property and Civil Rights in the Province". This is exactly what happened with the CPP/QPP. (Given that the numerical section for this amending procedure is s.94, it is certainly appropriate that the numerical section for the pension amendment is s.94A.)

D: The Shared-Cost Programs (Established Programs and Canada Assistance Plan)

While hospital insurance (introduced in 1958), post-secondary education (1967), and Medicare (1968) were all 50% shared-cost programs, the actual sharing differed markedly across each program. For post-secondary education, Ottawa offered to share operating expenses dollar-for-dollar with each province. However, three Atlantic provinces (all except Nova Scotia) accepted the alternative $15-per-capita option. For hospital insurance, each province received 25% of the per capita insurable hospital expenses in the province and 25% of the Canada-wide average per capita insurance expenses. And for Medicare, Ottawa calculated the total costs of the program of all provinces combined and then distributed 50% of these costs to the provinces on an equal per capita basis.

Because of the cost-sharing formats, the financing for these three so-called "established programs" was open ended, so that Ottawa's spending on them was essentially determined by the collective decisions made in the provincial capitals. By way of an aside, might one say that since it was the provinces that were triggering the increases in the federal spending, it was also the provinces that were triggering increases in the exercise of the federal spending power? In any event it should come as no surprise that Ottawa took advantage of the 1977 *Fiscal Arrangements Act* to "block fund" these established programs. The financing for the three programs was henceforth to be evenly split between cash transfers and tax-point transfers, where a tax point is 1% of the relevant federal tax. The number of tax points to be transferred was determined to be 13.5 for the PIT and 1 for the CIT. Since the provinces were already in receipt of 1 CIT tax point and 4.357 PIT points, the net tax point transfer amounted to 9.143 PIT tax points. The transfer was implemented by a reduction in the federal PIT tax rates and an equivalent (in terms of revenue yield) increase in the provincial

PIT rates. By way of example, Ontario's pre-block-funding tax rate was 30.5% of the federal tax rate. Post block funding, it rose to 44%.[4]

The Canada Assistance Plan (CAP) was established in 1966 as a 50-50 shared-cost program. While the CAP eligibility criterion is "needs," regardless of cause, provincial welfare levels differ markedly in terms of how this criterion is implemented and in levels of income support. Because one of the conditions of Ottawa's 50% funding share is that the provinces cannot impose residency requirements for eligibility, these independent provincial programs become linked together in a national grid, as it were.

Prior to turning to the further evolution of these social programs in the wake of the 1995 federal budget, some perspective on the relationship between the exercise of the federal spending power and our social envelope is appropriate. In particular, the following observations seem apt:

- The genius inherent in the exercise of the federal spending power in these areas was that it allowed the provinces to administer these programs which, with federal co-funding and Canadian economic union-related conditions, effectively became national programs;
- Over time many of the initial conditions were relaxed (e.g., the move from shared-cost to block-funded programs) so that the provinces progressively became responsible for the design as well as the delivery/administration of these programs.
- In terms of how governments reacted to these joint programs, the provinces could complain that spending 50-cent dollars on social programs, but 100-cent dollars elsewhere in their budget, tilted spending toward the social programs. For its part, Ottawa was presumably pleased with this leverage, but not too happy about the fact that most of the credit associated with these programs was showered on the provinces.
- In spite of the presence of federal funding for the social programs (whether cash or tax-point transfers), what allowed these programs to provide reasonably comparable public goods and services to all Canadians (and what allowed these programs to remain in provincial jurisdiction) was the presence of the generous equalization program. However, it is important to note that the benefits of equalization went beyond the "have-not" provinces: this is so because the decentralization of the CIT and PIT would never have progressed as far as it has without the presence of an equalization program that allowed the poorer provinces to share in the returns from devolving taxation to the provinces.
- Finally, from a provincial vantage point and even from a states' rights perspective, the exercise of the FSP might well be celebrated. This is so because, as Forget's earlier-referenced comments indicated, without the shared-cost approach these programs might have ended up in the federal

domain as did family allowances and UI/EI. In contrast, the provinces are able increasingly to exercise full control over these programs.

The provincial counter-argument here would run along the lines that Ottawa was anything but a reliable partner on this sharing. Specifically, once the programs became "established" (i.e., embraced by citizens) the federal government could, and did, withdraw funds unilaterally and arbitrarily. The best examples of this are the early 1990s cap on the Canada Assistance Plan and the freezes on the health and post-secondary education transfers. The most arbitrary and punitive of all, however, was the cuts unleashed by the 1995 federal budget, on which more later.

Thus far, the selection of policies in this survey of Canadian practice as it relates to the spending power has proceeded in more or less chronological order. At this juncture, we interrupt this approach to focus in turn on the Canadian economic union and on tax harmonization and the ways in which these interact with the spending power. We shall then return to the historical approach, starting with the 1995 federal budget and continuing through to Harper's "open federalism."

E: The Canadian Economic Union (CEU) and the Spending Power

One often hears that there are more barriers to the movement of goods and people across provincial boundaries in Canada than there are across national boundaries in the EU. To the extent that this is true, it is because the EU is at base an economic union subject to EU administrative law processes whereas Canada is a political union monitored in the first instance by political processes. There are, of course, constitutional provisions that can be drawn upon to secure the CEU, e.g., the federal trade and commerce power (s.91(2)), the internal free-trade provision (s.121), the mobility provisions of the Charter. But these are constrained by the existence of the exclusive provincial powers embodied in s.92. In sharp contrast, the Australian and US economic union provisions, especially their interstate commerce clauses, do not have a s.92 equivalent to run up against and, therefore, have been given a much more expansive interpretation by their courts so that governments (both sub-national and national) in these countries have, in principle at least, fewer opportunities to mount internal barriers.

Intriguingly, what this means is that the "threat" on Ottawa's part to promote the CEU can be viewed by the provinces as an attempt to pare back their powers, i.e., a regulatory approach to exercising the spending power, as it were. This was certainly the case in the 1980-82 constitutional negotiations when the CEU was introduced as a means of curtailing provincial demands. Simeon (1984, 367-68) merits quotation in this regard:

> ...the [1980-82] focus on barriers to free trade has an open-ended quality. Almost by definition, any government action interferes with the free movement of goods, services, people, or capital. Virtually every policy difference between provinces -- and federalism is presumably designed to encourage such differences -- may cause impediments to free movement. Indeed, it could be argued that the sudden prominence of the "economic union" issue arose from the conjunction of Ottawa's search for a political means to assert its status, limit that of the provinces, and promote "national" values and a growing neo-conservative preference for market forces over any kind of government intervention ... The answer, however, is not to eliminate all interregional barriers to trade. To do that would be to argue for a unitary state.

In the current context, the Harper Conservatives' might be viewed as engaging in a similar ploy by playing off the promise made in Mr. Harper's December 2005 Quebec City speech to limit the federal spending power with a potentially counter promise in the October 2007 Speech from the Throne to resort to the trade and commerce power (s.91(2)) to promote the CEU. Since Ottawa cannot be bound by its own power, this would call into question any and all provincial barriers but leave untouched the egregious federal barriers such as the regional components of EI.

These comments aside, there is a need to preserve and especially to promote aspects of Canada's socio-economic union. As noted, the exercise of the federal spending power in the context of our shared-cost programs as well as the adoption of the Canada Health Act principles have contributed to the social union. Securing the economic union has been more problematical. The formal approaches to the economic union, namely, the 1994 Agreement on Internal Trade (AIT) and the mutual recognition of provincial accreditation under the Social Union Framework Agreement, have some common defects. The agreements were not binding and in any event the private sector (citizens and businesses) was not allowed to directly access their provisions. Yet the presumed rationale for such agreements is to provide citizens with an

inherent right to free and unencumbered access the domestic market. As Lincoln might have said, federalism that is only of the governments, by the governments and for the governments should perish from the scene.

Thankfully, the BC-Alberta Trade, Investment and Labour Mobility Agreement (TILMA) may be the beginnings of the solution. Among the agreed-upon provisions designed to give workers and businesses seamless access to a single market is the commitment to "create a clear, comprehensive and enforceable dispute avoidance and dispute resolution mechanism." As important, TILMA is open to other provinces willing to abide by its provisions. The Council of the Federation (COF) is actively involved in trying to extend TILMA nation-wide and efforts are also underway to replicate a version of TILMA in Atlantic Canada.

The unwritten message here is that Canadians want (and deserve) full access to the Canadian market. If the provinces, with or without the COF, will not or cannot deliver this, then Canadians will insist that Ottawa step in. The provinces may choose to view this as a spending-power-like intrusion into their jurisdiction, but the reality is that there are certain key aspects of a CEU that must be inherent in Canadian citizenship. If the provinces can deliver the CEU, then this will obviate the need for Ottawa to step in.

F: Tax Harmonization and the Spending Power

Canada's approach to income taxation has long been a model for decentralized federations.[5] The original shared PIT system had Ottawa determining the definitions of income, the amounts of deductions and the overall progressivity of the PIT, with the provinces allowed to apply a single tax rate to federal taxes. Moreover, provided the provinces adhered to the so-called "MacEachen guidelines,"[6] they would be allowed to mount their own set of tax credits/surcharges/reductions. Finally, and here is where the spending power comes in, Ottawa would collect the provinces' taxes free of charge and would oversee/collect the credits/surcharges for a modest fee. More recently, Ottawa has bowed to provincial pressure and converted the original tax-on-tax approach to a tax-on-income approach where the provinces now have tax-rate and tax-

bracket freedom, but with the MacEachen guidelines still in place. Failure to have provided this increased provincial flexibility may well have precipitated the creation of several separate provincial PIT systems.

On the corporate taxation front, seven provinces piggy-back on the federal corporate income tax (similar to the personal income tax). However, all provinces have agreed to a common method of allocating corporate profits (of multi-province corporations) across provinces. The allocation for a province equals 50 percent of the province's share of the corporation's Canadian payroll plus 50 percent of the province's share of the corporation's Canadian sales. Since corporate income taxes enter the equalization formula, this facilitates the acceptance of the formula, at least for the poorer provinces. This is so because underestimating a province's true share of corporate revenues will lead to a compensatory increase in equalization, and vice versa. In any event, the CIT provisions serve to ensure that there is no zero taxation or double taxation of corporate profits, something that the US cannot claim.

In terms of provincial sales taxes (PST), the situation is unfortunately very mixed. On the plus side, Ottawa facilitated (via a $1 billion transfer and free tax collection) the creation of a Harmonized Sales Tax for three Atlantic provinces (Newfoundland and Labrador, New Brunswick and Nova Scotia). The federal government also enticed Quebec to harmonize its PST with the Goods and Services Tax (GST) by allowing Quebec to collect the combined Ottawa-Quebec GST in the province and then to transfer the relevant share to Ottawa. Setting aside Alberta which has no provincial sales tax, the PSTs in the remaining five provinces remain non-harmonized with the federal GST, and do so at considerable economic cost since most PSTs end up taxing production inputs which then get embedded in the prices of exported goods. Converting these PSTs to a GST format would allow tax rebates on exports. Some federal incentives may be in order to bring the outlying provinces into the GST fold, especially since as already noted financial incentives were given to those four provinces that have now adopted the GST format.

With the exception of this on-going PST challenge, Ottawa has successfully employed the spending power in the service of enhancing the Canadian tax union, while simultaneously enhancing provincial tax flexibility and tax autonomy. Plaudits all around.

The analysis now turns to the landmark 1995 federal budget.

G: The 1995 Federal Budget and the Federal "Savings Power"

Over the late 1980s and early 1990s, Ottawa introduced a series of arbitrary caps and freezes to several components of the cash transfers to the provinces. Then came the deficit-taming 1995 federal budget, where Established Programs Financing and the Canada Assistance Plan were rolled into the Canada Health and Social Transfer, which was then slated to be cut in absolute terms by some $6 billion over the next few years. In a paper concerned with the federal spending power, this dramatic chopping of cash transfers to the provinces (or deficit-shifting to the provinces) is probably best viewed as an exercise of the federal savings power! (By way of an aside, many of the provinces, and no doubt a majority of Canadians, would very much prefer the exercise of the federal spending power to this exercise of the federal savings power.) This 1995 budget also merits the designation of a watershed in the evolution of Canadian fiscal federalism. This is so because the federal deficit downloading to the provinces, in tandem with various other budget tightening and process measures, led to a remarkable turnaround in federal fiscal fortunes, with Ottawa now nearing a dozen years of consecutive budget surpluses. On the provincial fiscal front, the short-term consequence was that monies had to be transferred from here, there and everywhere order to satisfy the health-care demands, the consequence of which was that the non-health-care areas were being fiscally starved. The end result was hardly surprising: the intergovernmental fiscal balance turned quickly and sharply in Ottawa's favour. Fiscally, therefore, Ottawa was now more than able to employ the spending power in areas of provincial jurisdiction and for their part the cash-strapped provinces were more than willing to accept this federal largesse. This would eventually set the stage for the rather spectacular spending power binge (much of it in the form of bilateral deals with the provinces) orchestrated by Prime Minister Paul Martin -- e.g., for cities, day care, infrastructure, health, and equalization.

H: The Report to Premiers and the Annual Premiers' Conferences

But this is getting too far ahead of the storyline. As part of the 1995 federal budget, Ottawa requested that the provinces work with the federal government in developing mutual-consent principles to underpin social Canada. The provinces responded by revitalizing the Annual Premiers' Conferences (APCs) and by commissioning the impressive *Report to Premiers* (Ministerial Council ...,1996) which, among other roles, began investigating whether the provinces, acting collectively, could make progress in the direction of designing, delivering and setting standards for what might be called pan-Canadian social programs. This was in response to the earlier-noted reality (mentioned under the Canadian economic union heading) that if the provinces did not move in the direction of harmonizing their social programs then Ottawa would do it for them.

The *Report to Premiers* also made the case for federal-provincial cooperation in launching a nationwide child-tax benefit. The result was Ottawa's introduction of the Canada Child Tax Benefit (CCTB) in the 1997 federal budget. Apart from being a welcome social policy innovation, one that currently pays $3,500 and $3,250 for children under 7 years and over 7 years respectively,[7] this was also a "federalism friendly" program in that the provinces were allowed, if they wished, to reduce their spending on welfare benefits to families with children by the value of the CCTB provided that they re-directed these savings to other programs that also focussed on low-income families with children. As will be noted in Part III, this *Report to Premiers* and the CCTB eventually led to 1999 Social Union Framework Agreement (SUFA), which circumscribed the exercise of the federal spending power in areas of exclusive provincial jurisdiction.

In the present context, three further observations appear warranted. The first is that while the CCTB can be viewed as a welfare program, it is delivered via the federal personal income tax and, therefore, falls under Ottawa's jurisdiction. Second, with the CCTB and subsequent enrichments there appears to be a *de facto* re-arrangement or re-allocation of responsibilities in the social policy arena -- Ottawa is now largely responsible for the children and the elderly, leaving the provinces largely responsible for working-age adults

(especially since Ottawa, in the aftermath of the 1995 Quebec referendum, devolved aspects of training to the provinces). The third observation is that there appears to be a trend for Ottawa to pull back on its transfers to and/or through the provinces in favour of dealing directly with citizens, a trend continued with the Harper Conservatives (with daycare, for example). More on this development later.

While Quebec was not a formal participant in the APC process (it had observer status) and was not a signatory of SUFA, it was nonetheless active along roughly similar lines. Specifically, the province launched the earlier-noted *Commission on Fiscal Imbalance*, headed by Yves Séguin. The newly elected (2003) Jean Charest government, with Yves Séguin as the Minister of Finance, proposed that the Annual Premiers' Conferences be folded into a new organization, the Council of the Federation, with membership restricted to provincial and territorial premiers. All provinces agreed and the Council was created in December 2003, with its initial mandate directed toward restoring fiscal balance in the federation.

I: The Council of the Federation and the 2004 Pharmacare Proposal

At the (post-federal-election) June 2004, meeting of the Council of the Federation (COF) at Niagara-on-the-Lake, the provinces and territories proposed to transfer responsibility for pharmacare upward to the federal government. Intriguingly, the COF was also unanimous that the province Quebec would be opting out (with compensation) of this pharmacare plan. From the COF Press Release: **"**It is understood that Quebec will maintain its own program and will receive a comparable compensation for the program put in place by the federal government." This proposal corresponds closely to the wording and spirit of the s.94 amending formula which (as will be elaborated later) allows all common-law provinces to transfer aspects of **"**property and civil rights in the province" (which would obviously include pharmacare) upward to the federal government, while civil-law Quebec would retain its existing program. Compensation is not mentioned in s.94. While Ottawa did not agree to take up the provinces' offer, this pharmacare proposal is nonetheless noteworthy in the evolution of all three of practices, principles and prospects relating to the federal spending power.

J: The 2004 First Ministers' Meeting and the Healthcare Agreement

At the First Ministers' Meeting in September of 2004, Prime Minister Paul Martin and the provinces signed a 10-year, $41 billion healthcare agreement. Apart from the importance of this deal in terms of restoring much of the provincial fiscal shortfall arising from the 1995 federal budget, it also embraced and formally recognized Quebec's specificity. While Quebec agreed to work in collaboration with Ottawa and the provinces, Quebec's own policies would be determined "in accordance with the objectives, standards, and criteria established by the relevant Quebec authorities," cited from *Asymmetric Federalism that Respects Quebec's Jurisdiction*, a Canada-Quebec addendum to the healthcare agreement.

In effect, this addendum can be viewed as the federal counterpart to the provinces' recognition of Quebec's distinctiveness contained in the above pharmacare proposal. However, this addresses the reigning-in of the spending power only to the extent that the issue relates to Quebec. This is not likely to be viewed as an acceptable approach to the spending power by the other provinces. Indeed, apparently in the final countdown to the September 2004 healthcare deal, Ottawa verbally agreed that Alberta and British Columbia (and by extension, one would presume, all the provinces) could have the same deal as that offered to Quebec. Since the other provinces have not acted on this option, what transpired may best be described as *de jure* symmetry but *de facto* asymmetry. However, the reality that Quebec could be finessed by an asymmetric side deal served to open the way for Prime Minister Paul Martin's relentless exercise of the federal spending power during the remainder of his tenure.

K: Paul Martin's Fiscal Cafeteria

With the Quebec issue thus finessed, the Martin Liberals went about devoting much of their remaining time in office to a seemingly unrestrained exercise of the federal spending power in terms of one-off (time-limited) bilateral deals across a bewildering array of policy areas, a process that I have elsewhere (2006) referred to as *bilateral* or *contractual* federalism. As noted earlier this should not be all that surprising since, in the wake of the 1995 federal budget, Ottawa was fiscally flush and the provinces were cash-starved. *The Economist* likened this spending spree to operating a "fiscal cafeteria" for the provinces.

This period merits further attention. Were the provinces so cash-strapped that they signed any and every federal deal available, or were we witnessing the rest of Canada (ROC) expressing a desire to work much more closely with Ottawa to create national programs? To the extent that the latter cannot be ruled out, this suggests that the rethinking/reworking of the federal spending power must recognize that the ability of consenting provinces to pass powers upward (e.g., pharmacare) may be as important as constraining Ottawa's power to intervene in exclusive provincial jurisdictions.

L: Stephen Harper's Open Federalism

While there were plenty of issues that separated the Conservatives from the Liberals in the 2006 election, the battle was ultimately decided in Quebec, where Stephen Harper's promise of "une Charte du fédéralisme d'ouverture" garnered enough seats in the context of a Liberal collapse to give the Harper Conservatives a minority government.

"Open federalism," as reflected in Harper's now-famous Quebec City speech [December 19, 2005], represented much more than a swing back to the middle in that it was a sharp move in the direction of classical federalism. *Inter alia,* open federalism embraced the following: a recognition and a respect for the constitutional division of powers; a recognition that there exists a fiscal imbalance in the federation; a commitment to redress this vertical fiscal imbalance; a related commitment to rein in the federal spending power in areas of exclusive provincial jurisdiction; and, finally, a commitment to work with the Council of the Federation to improve the management and workings of the Canadian federation. And all of this was cast within the political rhetoric of bringing a halt to the "domineering and paternalistic federalism of the Chrétien-Martin Liberals."

M: Summary

By way of a brief conclusion to this overview of the policies/practices relating to the exercise of the federal spending power, it is important to note that Quebec's concerns are often centre-stage. In this regard, there is an important observation that also needs to be emphasized. That is, that Canadians are prone to

saying that Quebec has opted out of the personal income tax, Quebec has opted out of the CPP, Quebec has opted out of some cash transfers in favour of additional tax transfers, Quebec has effectively opted out of the 2004 healthcare accord, and Quebec was to be permitted to opt out of the proposed pharmacare program. However, by this point in the analysis it should be clear that there is something quite wrong with this terminology. These are all areas of Quebec's jurisdiction (some exclusive, some concurrent). *It is not opting out to operate a program that is within one's own constitutional jurisdiction*. The institutional/constitutional reality is that the rest of the provinces are "opting in" to federally run (or jointly run) programs. There is more than mere semantics involved here, since there is a negative connotation to opting out, one that portrays Quebec as forever pleading for special treatment when the opposite is closer to the truth. Indeed, this "opting in" (or transferring upward of aspects of property and civil rights) by the common-law provinces is exactly what Sir John A. anticipated when he inserted s.94 into the original *BNA Act.* This reference to s.94 is an ideal segue into the focus on the evolution of selected *principles* associated with the exercise of the federal spending power.

III: PRINCIPLES UNDERPINNING THE EXERCISE OF THE SPENDING POWER

With the evolution of Canadian practice with respect to the spending power as backdrop, attention now turns to a comparable evolution of selective spending power principles as reflected in various federal, provincial and federal-provincial agreements and declarations. Because the line between what might best be interpreted to fall in the domain of "practices" as distinct from "principles" is obviously a matter of judgement, readers may well have allocated the various events/accords differently between the practices of Part II and the principles that follow.

A: The *Constitution Act, 1867*: s.94

In terms of the "passing powers up" or "opting in" aspect of reworking the spending power, s.94 of the *Constitution Act, 1867* is an oft-overlooked provision that may have considerable potential. Entitled "Uniformity of Laws in Ontario, Nova Scotia and New Brunswick," s.94 reads as follows:

> *Notwithstanding anything in this Act, the Parliament of Canada may make Provision for the Uniformity of all or any of the Laws relative to Property and Civil Rights in Ontario, Nova Scotia, and New Brunswick, and of the Procedure of all or any of the Courts in those Three Provinces, and from and after the passing of any Act in that Behalf of the Parliament of Canada to make Laws in relation to any Matter comprised in any such Act shall, notwithstanding anything in this Act, be unrestricted; but any Act of the Parliament of Canada making Provision for such Uniformity shall not have effect in any Province unless and until it is adopted and enacted as Law by the Legislature thereof.*

More detail on the potential role of s.94 in terms of the spending power issue appears in Adam (2008). For present purposes we note that the late Frank Scott (1977, 114) suggested that the Fathers of Confederation, unable to obtain a unitary state, included this clause so that an easy way would be available for the provinces other than Quebec to pursue a more uniform and unified future. Samuel LaSelva (1983) suggests that one reason why section 94 has received so little attention, both from the courts and from constitutional experts, has to do with its misleading label: rather than "Uniformity of Laws ..." it should have been entitled "Transferring Constitutional Jurisdiction," to make it clear that it is in fact an amending procedure. Although s.94 mentions only three provinces, it would presumably apply to all non-Quebec provinces.[8]

Therefore, section 94 is designed to allow the non-Quebec provinces to transfer selected powers pursuant to property and civil rights to Ottawa, *without* the consent of Quebec. In an important sense, the earlier-referenced 2004 health care deal can be viewed as a non-constitutional way to accomplish a similar goal. It allows the nine provinces to opt into a more uniform and unified approach to the Canada Health Act, while at the same time allowing for asymmetric (essentially status quo) treatment for Quebec. And the pharmacare proposal is an even better example since, on the one hand, it explicitly transfers to Ottawa aspects of property and civil rights for all provinces except Quebec and, on the other, it assumes that Quebec will maintain its existing program replete with federal compensation. This reference to compensation could be viewed as "updating" s.94 to reflect the reality of the 21st century. Attention will be directed back to s.94 in Part IV, dealing with options for addressing the spending power.

B: Treaties and the Division of Powers: The 1937 *Labour Conventions* Case

Can the signing of international treaties serve to undermine the constitutional division of powers? Or, as University of Melbourne's Greg Craven (1993,11) put it: "Can the central [federal] government, simply through the exercise of its capacity in the field of foreign relations, significantly alter what otherwise would be the constitutional balance of power?" For Australia, Craven's answer is clearly yes: "the federal balance achieved by the Constitution is now at the mercy of the treaty making power of the federal executive" (1993,22). This also appears to apply to other federations, such as the Swiss and the American, where the federal governments have relatively free reign to manoeuvre and in the process force compliance of sub-national governments. Any countervail tends to be political, not constitutional.

However, Canada is a clear exception, since prevailing constitutional precedent points in the other direction. Specifically, in the *Labour Conventions* case (1937.A.C. 326 (P.C.)), the Judicial Committee of the Privy Council decided that Canada's signature to the International Labour Organization Convention did not give Parliament the power to implement those aspects of the Convention relating to matters coming under provincial constitutional responsibility. By way of an aside relevant to the overall spending power issue, it was in this case that Lord Atkin penned his famous "watertight compartments" metaphor: "while the ship of

state now sails on larger ventures and into foreign waters she still retains the watertight compartments which are an essential part of her original structure."

Kellock and Leroy (2007) argue that *Labour Convention's* reasoning ought to extend to the spending power issue:

> …governments do not spend money as an end in itself, just as governments do not implement treaties as an end itself (Petter, 1989). As Lord Atkin explained in the 1937 *Labour Conventions Case*: "there is no such thing as treaty legislation as such. The distribution [of legislative, TJC] powers is based on classes of subjects; and as a treaty deals with classes of subjects so will the legislative power of performing it be ascertained."

In contrast, Hogg (1985,253) suggests that *Labour Conventions* "is a poorly reasoned decision," although he adds that it may not be undesirable as a matter of policy within a federation such as Canada.

My hunch is the environment is likely to trigger a challenge to *Labour Conventions.* The reality that markets are progressively global, that social-policy and labour-policy "riders" are increasingly attached to trade agreements, and that the environmental challenge knows no jurisdictional boundaries means that we are almost certain to find ourselves in a federal-provincial jurisdictional tug-of war which could easily involve revisiting *Labour Conventions.* This is not meant to downplay its importance, past, present and even future, in terms of the exercise of federal policies -- regulatory or spending -- in areas of provincial jurisdiction. Rather, it is to note that environmental federalism may at base best be viewed more as an inherently international issue than a federal-provincial issue.

C: Trudeau and the Spending Power

Faced with provincial concerns about the exercise of the federal spending power, initially by Quebec (following on from Jean Lesage's opting for the QPP and for additional tax points in lieu of cash transfers), but gradually spreading to other provinces, Prime Minister Trudeau tabled a set of spending power principles/guidelines at the 1969 First Ministers' Conference. These guidelines were (reproduced from Watts 1999,2):

- the federal spending power should formally be entrenched in the constitution;
- Parliament should have an unrestricted power to make conditional grants to provincial governments for the purpose of supporting their programs and public services; and
- Parliament's power to initiate cost-shared programs involving conditional grants in areas of provincial jurisdiction should require both a broad national consensus ... and a per capita reimbursement of the people (not the government) of a province whose legislature decided not to participate.

This would come close to importing the Australian approach to its spending power. Specifically, s.95 of the Australian constitution states that Parliament "may grant financial assistance to any State on such terms and conditions as Parliament thinks fit." Since Quebec has never accepted the constitutionality of the federal spending power (Telford, 2003, 4), there is no chance that formal recognition, let alone entrenchment, of the federal spending power will ever find acceptance.

A more acceptable approach from the Trudeau government emerged a decade later in the context of the 1978-79 constitutional discussions with the provinces. Again from Watts (1999,2):

> ... the exercise of the federal spending power would have been made subject to a provincial consent mechanism (to a majority of provinces with a majority of the population), with unconditional compensation for non-participating provinces (though there was no agreement on whether compensation was to be paid to non-participating provincial governments or directly to their residents).

While enshrining this version would also create problems for Quebec, one should note that this was part of a "best efforts draft" relating to overall constitutional change that was much more "province-friendly" than what resulted, post-Referendum, from Trudeau's promise to Quebecers of a "renewed federalism."

D: The *Constitution Act 1982* and Equalization (s. 36)

As part of the 1980-82 constitutional negotiations, the "gang of eight" (all provinces except Ontario and New Brunswick) proposed that the overall patriation package include a provision whereby a province would be able to opt out from federal programs with full compensation. Although this proposal fell by the wayside, the concept of "opting out with full compensation" would resurface on several later occasions. What did become enshrined were the s.36 equalization principles:

> **36.** (1) Without altering the legislative authority of Parliament or of the provincial legislatures, or the rights of any of them with respect to the exercise of their legislative authority, Parliament and the legislatures, together with the government of Canada and the provincial governments, are committed to
>
> *(a)* promoting equal opportunities for the well-being of Canadians;
> *(b)* furthering economic development to reduce disparity in opportunities; and
> *(c)* providing essential public services of reasonable quality to all Canadians.
>
> (2) Parliament and the government of Canada are committed 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.

While the generally accepted view is that s.36 is non-justiciable, it nonetheless does provide constitutional underpinning for the exercise of the spending power to achieve interprovincial fiscal equity (s.36(2)) and for the promotion of equality of opportunity and of access to public services for individual Canadians (s.36(1)). More on this latter role in the later reference to SUFA and to the recent contribution by Tom Kent (2008).

E: The National Energy Program and s. 92A

If Quebec felt betrayed by the 1980-82 patriation process, the same can be said with respect to Alberta and the 1980 National Energy Program (NEP). On the tax front, the following initiatives were part of the NEP: the Natural Gas and Gas Liquids Tax; the Petroleum and Gas Revenue Tax; the Petroleum Compensation Charge (on consumers); and a Canadian Ownership Charge for purposes of financing an increase in public ownership of the energy sector. Beyond these taxation measures, depletion allowances were to be phased out and replaced by the Petroleum Incentive Program grants, which Canadian-owned companies operating on Canada Lands (as distinct from provincial lands) could access. Finally, the NEP included two "nationalization" provisions: the federal government reserved for itself (or a federal crown corporation) a 25% interest in all existing and future petroleum rights on Canada Lands (i.e., the controversial "back-in provision"), and it also signalled its intention to purchase several large foreign-owned oil and gas firms.

Not surprisingly, the reaction from the energy patch, and particularly from Alberta, ranged from negative to outright hostile. The NEP was viewed as a frontal attack on the energy sector which the provinces asserted was beyond Ottawa's jurisdiction, an exercise of the federal regulatory power, as it were, in areas of exclusive provincial jurisdiction. The ongoing patriation process offered the energy provinces an opportunity to push for a confirmation of provincial powers over resources in return for their support of the overall constitution package. As a result, in 1982, s.92A was added to the *Constitution Act, 1867.* Beyond granting (or re-affirming) the provinces exclusive legislative authority over development, conservation and management of natural resources, s.92 also includes the provision that the provinces can make laws in relation to the raising of money by any mode of taxation in respect of natural resources and electricity generation.

Overall, therefore, the NEP was a policy with ramifications that transcended the energy patch and the West to profoundly influence Canada's political, constitutional and federal evolution as well as to play a catalytic role in the introduction of the Canada-US Free Trade Agreement (FTA) (because the energy pricing provisions of the FTA make it difficult for Canada to ever unload another NEP on the energy patch). However, given the energy-environment nexus in the context of global climate change, it seems clear that an Ottawa-Alberta confrontation is inevitable, with the exercise of the federal regulatory (and perhaps spending) power surely to assume centre-stage.

F: The Meech Lake Accord (1987-90)

At the 1986 Mont Gabriel conference "Rebuilding the Relationship: Quebec and its Confederation Partners" (co-sponsored by Queen's Institute of Intergovernmental Relations and its then Director, Peter Leslie), Quebec's Minister for Canadian Intergovernmental Affairs Gil Rémillard advanced five conditions that needed to be met before the province would sign on to the 1982 constitutional amendments. Included among these five points was the "limitation of the federal spending power." This speech became the catalyst for federal-provincial agreement on the *1987 Meech Lake Accord*. The *Accord,* requiring unanimous ratification by Ottawa and the provinces within three years, was intended to become enshrined in a

Constitution Act, 1987. As Telford (2003,38) notes, this represented the first attempt to limit the federal spending power constitutionally. Section 106A was to read as follows:

> 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.

Telford (2003,37-8) also points out that Premier Robert Bourassa was comfortable with this wording because (quoting Bourassa) "the new section 106A is drafted so that it speaks solely of the right to opt out, without either recognition or defining the federal spending power ... so Quebec keeps the right to contest before the courts any unconstitutional use of the spending power." This way of finessing the spending power concern will be revisited later in this paper. The *Meech Lake Accord* failed when Manitoba and Newfoundland withheld their legislative support, thereby allowing the three-year ratification period to expire without achieving unanimous provincial ratification.

G: The Charlottetown Agreement

The failure of Meech triggered yet another round of constitutional activity. The resulting federal constitutional proposals, in *Shaping Canada's Future Together* (Government of Canada, 1991), included spending power provisions which, after negotiations with the provinces, were then included in the 1992 *Charlottetown Agreement*:

> A provision should be added to the Constitution stipulating that the Government of Canada must provide reasonable compensation to the government of a province that chooses not to participate in a new Canada-wide shared-cost program that is established by the federal government in an area of exclusive provincial jurisdiction, if that province carries on a program or initiative that is compatible with the national objectives.
>
> A framework should be developed to guide the use of the federal spending power in all areas of exclusive provincial jurisdiction. Once developed, the framework could become a multilateral agreement that would receive constitutional protection. The framework should ensure that when the federal spending power is used in areas of exclusive provincial jurisdiction, it should:
> (a) contribute to the pursuit of national objectives;

(b) reduce overlap and duplication;
(c) not distort and should respect provincial priorities; and
(d) ensure equality of treatment of the provinces, while recognizing their different needs and circumstances.

The *Charlottetown Agreement* went down to defeat in a national referendum (54.3% vs. to 46.7%), and with 6 of the provinces also rejecting the *Agreement* (the four westernmost provinces plus Quebec and Nova Scotia).

H: From the 1995 Quebec Referendum to the Calgary Declaration

On October 30, 1995 the federalist forces won a razor-thin (50.58% vs. 49.42%) victory in the Quebec independence referendum. This led to olive-branch initiatives on the part of both Ottawa and the provinces. At the federal level, the Jean Chrétien Liberals, obviously reeling from the referendum near-miss, included a reference to the spending power in their 1996 *Speech From the Throne*. Specifically, the government declared that it would only create new shared-cost programs once it obtained an agreement from a majority of the provinces. In addition, it promised to allow provinces to opt out of such programs with compensation if they set up an equivalent program.

The provinces' approach to reaching out to Quebec after the 1995 Referendum took the form of the under-appreciated *Calgary Declaration*. This *Declaration* was orchestrated by Premier Ralph Klein in his role as Chair of the Annual Premiers' Conference and was signed by all provinces (except Quebec, in large measure because this was to be a response on the part of the other provinces to Quebec's concern over its role in the federation). The *Calgary Declaration* was then taken back to each of the nine provinces for further consultation and discussion and was eventually (1998) given assent in all nine provincial legislatures, in several cases with considerable fanfare. Of the 7 articles of the *Declaration*, three are of importance for present purposes:

5. In Canada's federal system, where respect for diversity and equality underlies unity, the unique character of Quebec society, including its French speaking majority, its culture and its tradition of civil law, is fundamental to the well being of Canada. Consequently, the legislature and Government of Quebec have a role to protect and develop the unique character of Quebec society within Canada.

6. If any future constitutional amendment confers powers on one province, these powers must be available to all provinces.

7. Canada is a federal system where federal, provincial, and territorial governments work in partnership while respecting each other's jurisdictions. Canadians want their governments to work cooperatively and with flexibility to ensure the efficiency and effectiveness of the federation. Canadians want their governments to work together particularly in the delivery of their social programs. Provinces and territories renew their commitment to work in partnership with the Government of Canada to best serve the needs of Canadians.

Article 5 represents a formal recognition on the part of the provinces that Quebec is a distinct society. Moreover it is entirely fitting that this proclamation of Quebec's specificity took place in Calgary, the erstwhile capital of "symmetric federalism." Article 6 allows Ottawa to make bilateral deals with any province (but clearly this was written with Quebec in mind) which could then become multilateral should the provinces so wish. Ron Watts (1999,4-5) notes that Article 7 has "acknowledged the interdependence of governments and called for more cooperation between the different orders of government in their respective jurisdictions, pointing implicitly to the significance of the federal spending power." Care must be taken in interpreting this quotation. Specifically, while the nine signatory provinces are speaking about and to Quebec in articles 5 and 6, they are obviously *not speaking for Quebec in article 7* since Quebec is not a signatory.

From my perspective, the *Calgary Declaration* is more significant than is generally assumed. First, it is wholly consistent with the spirit of s.94. This is so because i) from article 7, the common law provinces want to work more closely with Ottawa, ii) from article 5 Quebec is distinct in terms of its language, culture and legal traditions and it may need to go its own way in terms of "national" programs in order to promote its distinctiveness; and iii) from article 6, Ottawa can make special bilateral deals with Quebec, with the other provinces coming on board if they wish. Second, a good case can be made that the 2004 COF pharmacare proposal took its principles/conception from the Calgary Declaration. And arguably so did Ottawa's bilateral asymmetric side deal for Quebec in the 2004 First Ministers' healthcare agreement, where the provinces apparently have the right to have the side-deal apply to them (along the lines of article 6), but are probably not interested in doing so. As already noted, this is a clever compromise -- *de jure* symmetry, but *de facto*

asymmetry. Finally, and here I am probably going way too far, the fact that all common-law provinces agreed to article 5 may have emboldened the Harper Conservatives to go the further step within the open federalism framework of declaring that the Québécois form a nation within a united Canada.

I: Pan-Canadian Provincialism and National Programs

In roughly the same time frame as the *Calgary Declaration*, the Annual Premiers' Conferences were wrestling with possibility of having the provinces collectively play a more important role in designing and monitoring pan-Canadian principles and standards for Canada's social envelope. The motivating factor here was the arbitrary and unilateral federal actions that characterized the dramatic 1995 cuts in transfers to the provinces. It was in this context that the province of Ontario commissioned my 1996 ACCESS paper (Courchene, 1996) which fed directly, albeit controversially, into the 1996 Jasper Premiers' conference as well as the 1997 conference in St. Andrews. Part of the ACCESS analysis had to do with whether and how interprovincial agreements (e.g., mutual recognition across provinces of provincial credentials) or federal-provincial agreements (e.g., the Agreement on Internal Trade) could be made binding on the parties. As pointed out in ACCESS, the Australian federation has found a solution to this problem. This is because their Constitution contains a provision for delegating powers upward. Specifically, s.51 (xxxvii) of the Australian Constitution reads:

> 51. The Parliament shall, subject to the Constitution, have power to make laws for the peace, order and good government of the Commonwealth with respect to
> ...
> (xxxvii) Matters referred to the Parliament of the Commonwealth by the Parliament or Parliaments or any State or States, but so that the law shall extend only to States by whose Parliaments the matter is referred, or which afterwards adopt the law.

The best example of the workings of this provision relates to the early 1990s Mutual Recognition Agreement among the Australian states pertaining to regulations and standards with respect to cross-border sales of goods and services and the transferability of credentials. The states designed the appropriate legislation, but then realized that it might be difficult to make the agreement binding on themselves. The solution took the form of requesting that the Commonwealth also pass the identical template legislation, after which the

individual states would follow suit. Because of the federal paramountcy provision in the Australian Constitution, the agreement became binding on the states -- in effect, constitutionalized.

Sturgess (1993,10) elaborates on this process as follows:

> ... the Commonwealth is obtaining no power from the States under this very limited reference, other than to pass a single Act of Parliament once-for-all. It cannot pass further legislation in the same area, nor can it establish a bureaucracy through which to regulate the States. In that sense, there is no reference to *powers* at all.
>
> In effect, the States are using the Commonwealth to jointly make an amendment to each of their constitutions ... In practice, what the States are doing is ceding sovereignty to each other [and not to the Commonwealth government -- TJC].

Unfortunately, Canada does not have access to this sort of option under its constitution, although one of the rationales for the paper by Adam (2008) is to ascertain whether s.94 could be re-activated to serve this purpose, among others. In the interim, one fall-back position might be to draw in part from Australian practice and combine this with "manner and form" legislation. Specifically, the governments would design the accord or convention to their liking. Template legislation would then be drafted and passed in the legislatures of all signing parties. Embedded in this legislation would be manner and form requirements for amendment procedures relating both to the legislation itself and any future amendments. This may not be constitutionally binding, but derogations from it would become very difficult, particularly if the convention itself embodied citizen rights. The Alberta-BC Trade, Investment and Labour Mobility Agreement (see Part II) is a variant of this approach, including passage in the legislatures of the participating governments.

The rationale for including the foregoing analysis under the umbrella of the spending power is that if the provinces can find ways to make binding pan-Canadian agreements the door is then open for enhancing their policy manoeuvrability in the federation. For example, any future cash transfers from Ottawa could presumably be more unconditional since the provinces themselves will now be able to ensure the preservation and promotion of the economic and social unions. Alternatively, Canadians would arguably be

more willing for the provinces to embark on creative programs if the provinces will be bound by pan-Canadian principles.

J: The Social Union Framework Agreement

The 1999 Social Union Framework Agreement (SUFA) was a natural follow up to the *Report to Premiers* and the flexible approach to the implementation of the Canada Child Tax Benefit. While SUFA is a wide-ranging document that has implications for many aspects of the social union, the focus here will only be on the two sections that are directly relevant to the spending power issue. The first of these relates to new Canada-wide programs involving federal-provincial cash transfers and the second focusses on the federal spending power at it relates to individuals and organizations. From SUFA:

> *New Canada-wide initiatives supported by transfers to Provinces and Territories*
>
> With respect to any new Canada-wide initiatives in health care, post-secondary education, social assistance and social services that are funded through the intergovernmental transfers, whether block-funded or cost-shared, the Government of Canada will:
> 36. Work collaboratively with all provincial and territorial governments to identify Canada-wide priorities and objectives.
> 37. Not introduce such new initiatives without the agreement of a majority of provincial governments.
> 38. Each provincial and territorial government will determine the detailed program design and mix best suited to its own needs and circumstances to meet the agreed objectives.
> 39. A provincial/territorial government which, because of its existing programming, does not require the total transfer to fulfill the agreed objectives would be able to reinvest any funds not required for those objectives in the same or a related priority area.
> 40. The Government of Canada and the provincial/territorial governments will agree on an accountability framework for such new social initiatives and investments.
> 41. All provincial and territorial governments that meet or commit to meet the agreed Canada-wide objectives and agree to respect the accountability framework will receive their share of available funding.
>
> *Direct federal spending*
> 42.a. Another use of the federal spending power is making transfers to individuals and to organizations in order to promote equality of opportunity, mobility, and other Canada-wide objectives.
> 42.b. When the federal government introduces new Canada-wide initiatives funded through direct transfers to individuals or organizations for health care, post-secondary education, social assistance and social services, it will, prior to implementation, give at least three months'

> notice and offer to consult. Governments participating in these consultations will have the opportunity to identify potential duplication and to propose alternative approaches to achieve flexible and effective implementation.

Focussing first on the traditional spending power area (Sections 36-41), these are very flexible and province-friendly principles at virtually every stage of the process -- initiation, design and delivery, opting out with compensation, accountability, etc. However, some social policy analysts have raised concerns with respect to section 37 above. Indeed Tom Kent (2008) notes that it is likely that we will never see another major shared cost program because Ottawa would have little incentive to spend federal money on a presumed pan-Canadian program that would allow opting out by the four largest provinces. In an important sense, therefore, the SUFA approach to the traditional spending power may have gone *too far* in accommodating opting out of federal programs, especially for those provinces that are interested in working more closely with Ottawa. This is so because Ottawa, not the provinces, would balk at engaging in future shared-cost programs where provinces comprising a majority of the population could opt out with compensation.

Quite different concerns are associated with article 42 of SUFA, which relates to the exercise of what is termed "direct federal spending," i.e., federal spending going *directly* to citizens and institutions as distinct from going *indirectly* "through the provinces". At one level, this can be viewed as a rather straightforward attempt to make operational some of the spending power principles contained in s.36(1) of the *Constitution Act, 1982*. Whereas Kent (2008) has, as already noted, labelled SUFA as signalling the end of shared-cost programs, he sees it as breathing life into the spending power as it relates to individuals. And in anticipation of this he recommends new federal programs relating to family support, to human capital investment (for both training and post-secondary education), to parents for day care, and to child health. If the Millennium Scholarships are any guide, such initiatives will not sit well with Quebec. Moreover, some other provinces have reduced funding to students and/or to post-secondary education institutions in line with the scholarships. In effect, this is a roundabout way to "upload" aspects of education funding to Ottawa.

Some recapitulation is warranted. To the extent that SUFA were to hold sway, concern about the exercise of the federal spending power via shared-cost programs in areas of exclusive provincial jurisdiction may well be largely symbolic (which, nonetheless, may be very important). However, the exercise of the federal spending power as it relates to individuals is (arguably) not only constitutional as long as it lines up with s.36(1) but, as well, important electorally for Ottawa. What this means is that the principal battlefield for countering some federal spending under s.36(2) and under s.42 of SUFA will be the political arena. And here one should keep in mind that it was the exercise of this direct spending power in the form of grants to universities that triggered the Quebec personal income tax in the first place. By way of a final observation, to the extent that the counter to the exercise of the direct spending power will tend to be a political/policy response, then political documents like the Calgary Declaration may well provide the provinces (and particularly Quebec) with more room to manoeuvre on the policy front.

To round out this section on spending power principles, attention is directed to a rather dramatic political initiative that has expanded Quebec's political/policy space.

K: Open Federalism, the Spending Power, and the Québécois Nation

The major features of Prime Minister Harper's open-federalism policy were elaborated in the earlier section on Canadian policies/practices. What is appropriate to add in the present context is Harper's surprising declaration that "the Québécois form a nation within a united Canada." Harper introduced this resolution in the House of Commons on November 22, 2006 and it received unanimous House of Commons support on November 27, 2006. High politics aside for the moment, I believe that this is a most welcome initiative. Canadians have for a long time been willing to confer the "nation" designation on our first peoples. As far back as my appearance as an expert witness before Quebec's Bélanger-Campeau commission (Courchene, 1991) my expressed view was that for Quebecers, Quebec will always be their nation and Canada will always be their state. For the rest of Canadians, Canada is typically viewed as the embodiment of both nation and state. In terms of high politics, the formal recognition of this reality may be of significant help in creating an institutional, even constitutional, approach to the spending power, one that will allow both

"nations" to achieve their goals. Intriguingly, if the rest of Canada wants to work closely with Ottawa in defining the ROC nation, then Quebecers will need to be given the flexibility to define their own nation, and vice versa.

This speaks directly to the two pronged approach that the analysis adopted toward the spending power, namely that it must at the same time be flexible enough i) to provide the provinces with protection against unwarranted and unwanted intrusion in areas of exclusive provincial jurisdiction and ii) to allow for federal-provincial collaboration on matters within provincial jurisdiction (including the ability to delegate powers upward). Often the breakdown of provinces between these two will be along civil-law and common-law lines, and for legal/philosophical reasons[9] as well as political reasons. But not always, as the environment-energy issue is increasingly illustrating.

Having thus surveyed Canadian practice as it relates to the federal spending power in Part II and some of the institutional and even constitutional approaches to operationalizing its exercise in Part III, attention is now focussed on the manner in which this backdrop might inform the range of prospects, and even proposals, for addressing the spending powers. Since much of Part II and Part III have been in the nature of "backcasting" or assessing where we were, the first section of Part IV will engage in some degree of forecasting, i.e., assessing the emerging governance environment that will ultimately frame approaches to the spending power.

PART IV: PERSPECTIVES AND OPTIONS

A. Information Age Perspectives

While the foregoing analysis was framed in the context of the traditional spending power parameters (e.g., fiscal imbalances, the "watertight compartments" division of powers, the evolution of the social envelope, the variety of proposals and agreements that have conditioned the operation of the federal spending power, and so on), this approach needs to be supplemented, even augmented, from the vantage

point of the new global order, that is, from the perspective of the emergence of the Information Age. Among its generally agreed features are the following (adapted from Courchene, 2001):

- As befits this knowledge/information paradigm, human capital is taking its rightful place alongside physical and financial capital as an engine of economic prosperity;
- Accordingly, citizens are emerging the principal beneficiaries of the Information Age;
- Partly because cities (especially what are called global city regions) are the repositories of dense concentrations of human capital needed to generate growth, trade and innovation, they have become the key institutional drivers in the Information Age, even though cities are jurisdictionally constitutionless;
- The "network" has become the pre-eminent and pervasive organizational form of the Information Age.

The bottom line here is rather straightforward. The Information Age has privileged a new set of policies (human capital), a new set of players (citizens and nongovernmental organizations), a resurgent set of institutions (cities), and a new set of organizational forms (networks, including global supply chains), all of which represent dramatic shifts in the power structures of 21st century societies. But while societal power may have shifted, the division of powers remains in its 19th century structure.

1. The National-Interest/Provincial-Jurisdiction Nexus

This has given rise to the situation where, for socio-economic and electoral reasons, Ottawa has become more involved in post-secondary education, in research chairs, in Millennium Scholarships, in early childhood development, in cities, etc. Phrased differently, the Information Age has catapulted these areas to be in the *national interest*, although they remain in *provincial jurisdiction*. It is this national-interest/provincial-jurisdiction nexus that is often missing in the foregoing vertical approach to the exercise of the federal spending power. To see this, consider the role of cities and their designation as the new economic drivers of the Information Age. While there may be ways of integrating cities more fully and more formally in the operations of political and fiscal federalism without altering the formal division of powers (Courchene 2008), the Conference Board's Anne Golden argues that Ottawa should not defer focussing on cities just because

the *Constitution Act, 1867* made them the creatures of their respective provinces. In more detail (Golden, 2008):

> It would be paradoxical to expect Ottawa to restrict itself to indirect ways of helping cities out of deference to constitutional roles prescribed in 1867, an era when conditions were entirely different. All intelligent human arrangements must evolve in response to changing conditions. No observer of Canadian and global trends would today design a constitution that forbade federal government involvement in the engines of national prosperity. It is, after all, a two way street: flourishing cities help Ottawa achieve its overall economic and social objectives.

2.. Networked Federalism

A second set of considerations relates to the nature of governance in the INFORMATION AGE. In her forthcoming article "Networked Federalism," Janice Stein (2008) argues that governance in a decentralized federation is not about disentangling overlapping jurisdictions. Rather it is about accommodating and managing complexity, and for this "the model of a network embedded in a grid ... is a more useful metaphor than that of parallel lines of government neatly separated from one another." From Stein's perspective, the most serious obstacles to the renewal of federalism are the jurisdictional squabbles and silo arrangements and, more generally, "the deeply embedded political culture of rights and entitlements of both orders of government and their emphasis on control." . In a sense, "networked federalism" may well be the Information Age version of Carl Freidrich's (1968, 7) vision of federalism:

> ...federalism should not be seen only as a static pattern of design, characterized by a particular and precisely fixed division of powers between government levels. Federalism is also and perhaps primarily the process...of adopting joint policies and making joint decisions on joint problems.

These Information Age perspectives are not intended to undermine attempts, where appropriate, to circumscribe the federal spending power. However, they are intended to ensure that limiting the spending power does not serve to rigidify federal governance. Indeed, in terms of the options that follow, some fall into the "restricting" camp and some in the "enabling" camp in terms of the relationship between the spending power and jurisdictional assignment of competences.

B: Options for Limiting the Federal Spending Power

The good news from Parts II and III above has been highlighted in the introduction, namely, that that there is a wealth of Canadian practice and principle that can be drawn upon in addressing the federal spending power challenge. Moreover, over the years Canada and Canadians have proven to be masters at the "art" of federalism. Via alterations in the magnitude of and incentives within federal-provincial transfers, via "opting in" and/or "opting out," via downward delegation (Quebec GST collection), via creative arrangements/agreements to secure the internal social and economic unions, via *de facto* asymmetry within *de jure* symmetry, etc., we Canadians have been able to alter the effective division of powers in response to internal and external forces, and all of this without changing the written constitutional word. The time to call on our innate collective creativity is again at hand.

1. A Generic Approach to the Federal Spending Power and New Shared Cost Programs

Toward this end, the obvious option is to distill a workable model from the various spending power provisions that have surfaced over the years. Arguably the most acceptable of these is the wording of the Meech Lake Accord:

> The Government of Canada shall provide reasonable compensation to the government of a province that chooses not to participate in a new national shared-cost program that is established by the Government of Canada in an area of exclusive provincial jurisdiction, if the province carries on a program or initiative that is compatible with the national objectives.

This wording would satisfy the Throne Speech commitment. And it does so in a manner that is generic, i.e., it applies equally to all provinces. One would presume that it may would find acceptance in Quebec, and for the same reason that Premier Bourassa found Meech acceptable, i.e., it does not formally mention, let alone recognize, the federal spending power.

This approach could be supplemented in various ways:

- Adding a set of commitments that governments work together to determine priorities, objectives, accountability, etc;
- Allowing provinces control over the actual program design best suited to their needs;
- Bi-governmental dispute resolution procedures;
- Addressing mechanisms to ensure temporal stability of the program and its funding. This may be achieved via legislative ratification by all participating governments, i.e., a version of "manner and form" legislation alluded to earlier.

While some of these supplementary provisions may appear quite restrictive, they may be necessary because the provinces are all too aware that Ottawa has been a most unreliable financial partner given its history of arbitrary freezes and caps and cuts to federal-provincial cash transfers.

2.. A Deux-Nations Approach to New Shared-Cost Programs

Given our experience with the CPP/QPP, with the personal income tax, and more recently with the pharmacare proposal and the 2004 health accord, there appears to be a revealed preference for selected programs falling under the "property and civil rights" rubric to be pursued at the respective "national" levels, where national in this context means Quebec City for Quebec and Ottawa for the rest of the provinces. To the extent that the legislated proclamation ("... the Québécois form a nation within a united Canada") has some substantive implications, this also would seem to point in the direction of a *deux-nations* approach to shared-cost programs.

The most straightforward approach here may be to convert the earlier spending power provision into a *deux-nations* variant. For example,

> The Government of Canada shall provide reasonable compensation to the government of Quebec should it choose not to participate with the rest of the provinces in a new pan-Canadian shared-cost program that is established by the Government of Canada in an area of exclusive provincial jurisdiction, if Quebec carries on a program or initiative that is compatible with the pan-Canadian objectives.

This would be a non-constitutional version of s.94. It would allow the common-law provinces to petition Ottawa for new shared-cost programs, without the ability of Quebec to cast a veto. In turn, however, Quebec could receive compensation commensurate with the per capita value of the new program to the nine "opting-in" provinces. Moreover, in a formal (although not constitutional) manner, this recognizes the distinctiveness of Quebec.

These are duelling visions of the way to limit the federal spending power. Quebec would presumably view the generic option as falling short, substantively and symbolically, of its legislated "nation" status whereas the other provinces would not accept the *deux nations* version in isolation without the generic version. While we will return to this later, the emerging reality is that the spending power issue in the Information Age will not likely be about the "direct" spending power and not about shared-cost programs.

3. Preventing Bilateral-Federalism

The above two dual proposals coincide with the two issues identified in the foregoing analysis relating to the FPS, namely sheltering provinces from unwanted federal intrusion into areas of exclusive provincial jurisdiction in the one hand and allowing like-minded provinces to work with each other and with Ottawa to develop pan-provincial, perhaps pan-Canadian, approaches to selected areas of provincial jurisdiction on the other. Because of the free-wheeling spending of the Paul Martin government, there is another spending power issue that needs to be confronted, namely the reining-in of what was earlier referred to as "bilateral federalism." This would obviously include the problematic Nova Scotia and Newfoundland and Labrador bilateral agreements on offshore resources, but it would also include Ottawa's one-on-one provincial agreements with respect to cities and daycare, which were interrupted in mid-stride as it were by the 2006 federal election. While we are appropriately concerned about preserving and promoting the social union and the economic union, bilateral federalism threatens to undermine the "federalism union." Intriguingly, the earlier-referenced Calgary Declaration provided an effective counter to the spread of bilateral federalism. From article 6 of the Calgary Declaration (with appropriate modification for the issue at hand):

> If any future federal-provincial agreement confers powers or privileges on a province or a set of provinces, these powers or privileges must be available to all provinces.

While this is intended to prevent fragmentation of the interprovincial and provincial-federal relationships, there is also an upside to this proposal. Ottawa would be free to enter into an agreement with a given province in full knowledge that other provinces can request similar treatment. This represents an opportunity for Ottawa to work with selected provinces to introduce new policies or programs that may become pan-provincial.

4. Limiting the Direct Federal Spending Power

Assuming that Kent (2008) is correct in predicting that more intensive use of the FSP will likely be related to *direct* federal spending to individuals and institutions, might not this mean that this area also needs to be subject to some FSP limits? To be sure, s.36(1) of the *Constitution Act 1982* commits Canada's governments, inter alia, to promote equal opportunities for, and the provision of public services of reasonable quality to, all Canadians so that initiatives in these areas might not fall under exclusive provincial jurisdiction. Nonetheless, it was federal direct transfers to universities that triggered the Quebec personal income tax (and subsequent developments) and other direct FSP initiatives (Millennium Scholarships, the Canada Child Tax Benefit) embraced aspects of provincial asymmetry. If deemed necessary, the wording might be along the following lines:

> The Government of Canada shall provide reasonable compensation to the government of a province if it chooses not to participate in Canada-wide initiatives directed to individuals or institutions that are established by the Government of Canada in areas of provincial jurisdiction, if the province carries on initiatives that are compatible with the pan-Canadian objectives.

Because all provinces except Quebec were signatories to SUFA, which included its own approach to direct federal spending, this limiting of direct FSP may be primarily a Quebec issue. The deux-*nations* version of the above direct spending power proposal would replace "province" by "Quebec".

Intriguingly, these duelling visions (generic vs. *deux nations)* for both the shared-cost and direct FPS may well be simplified were the "nation" status of Quebec to be enshrined. To this we now turn.

C: Constitutionalizing the Spending Power Options

The analysis of options to this point has taken its cue from the 2007 Speech from the Throne, which refers to the commitment to "introduce *legislation* to place formal limits on the use of the federal spending power." As this is being written (March 2008), there are musings from the Harper Conservatives that "step by step" and "when the ground is fertile" open federalism will be extended to constitutionally enshrine the recognition of Quebec as a "nation." How might this affect the preceding analysis?

A case can be made that the enshrining of "the Québécois form a nation within a united Canada" will presumably serve, of and by itself, to condition the exercise of the federal spending power in Quebec's jurisdiction (section 92, 93, etc). That is, it may deliver much of what was intended under the above two *deux-nations* proposals. And it will recognize the specificity and special status of Quebec within Canada in a much more wide-ranging and symbolic way than the "distinct society" constitutional proposal of Meech.

But while this addresses Quebec's spending power concerns, it may do little for the rest of Canada. Specifically, it would be important to breathe life into a version of s.94, so that the common-law provinces have the ability to "opt-in" to pan-Canadian programs in the social envelope and beyond.

Yet even this will likely fall short, especially if some of the common law provinces want to follow the Quebec lead and run their own versions of pan-Canadian programs. So something along the Meech wording, but applying to the direct exercise of the federal-spending power as well as to new shared-cost programs, would likely be in order. Indeed, demands for asymmetry are sure to arise in the energy producing provinces in the context of the climate change challenge where, intriguingly, the designation "ROC" for energy initiatives will likely include Quebec as a member.

This aside, the essential point here is that if the status of Quebec as a nation were enshrined, provisions must be put in place to allow the rest of the provinces to work with each other and with Ottawa in networking fashion to be able to create "national" programs without Quebec. To be sure, this will likely give rise to "West Lothian" issues (i.e., whether Quebec MPs can vote on programs that will apply only to the resot of Canada), but it is instructive to remind readers that we are already finessing this issue with the "bi-national" CPP/QPP.

This leads to two concluding comments. The earlier survey of Canadian practices and principles as they relate to the federal spending power, and the social envelope more generally, clearly demonstrates that Quebec has been able to carve out for itself a remarkable degree of political and policy space, so much so

that it is the envy of sub-national governments everywhere. And for the most part, this has been accomplished through political rather than constitutional channels. While the time may well be ripe for some legislative and even constitutional approaches to limiting the exercise of the federal spending power and to increasing Quebec's power and symbolism in the federation, these initiatives must not be at the expense of the existing and creative process dimension of Canadian federalism. Indeed, the key assumption underlying the above analysis is that addressing the federal spending power will serve to increase, not decrease, the flexibility of the process (or networking) dimension of both Canadian federalism and federal-provincial relations. In other words, successfully addressing the spending power issue requires both a restraining and an enabling component.

The final comment is that the ongoing motivation for rethinking the federal spending power relates largely to Quebec. Specifically, the combination of open federalism, of recognizing and addressing the fiscal imbalance, and of proclaiming Quebec as a nation led to substantial emphasis in the foregoing analysis being placed on *deux nations* perspectives. Going forward, however, the focus will increasingly be on western Canada and the energy-environmental nexus, where these *deux nations* approaches will fall short of the mark. But the spending power issues (including the federal regulatory and treaty making powers) in the context of what might be referred to as "environmental federalism" are best left for another time.

Endnotes

1. This paper drew from ideas contained in Watts (1999), Kellock and Leroy (2007), Telford (2003) and Verelli (2008) among others.

2. Canada's fiscal arrangements agreements tend to be renegotiated every five years. Hence the reference to !942-47.

3. Of this 16.5 PIT tax points, 8.5 related to hospital insurance, 5 points related to the Canada Assistance Plan and the remaining three to the former Youth Allowance Program. Now that all of these programs have been superseded, these tax points remain as part of Quebec's PIT and are offset via a corresponding decrease in Ottawa's other cash transfers to the province. This is why Quebecer's pay considerably less in the way of federal taxes and more in the form of provincial PIT than the residents of the other provinces. Note that a tax point is 1% of federal personal income taxes at the time of the tax-point transfer.

4. For more detail on the 1977 *Fiscal Arrangements Act* see Courchene (1979).

5. This discussion abstracts from Quebec, which has its own personal income taxation and collection system.

6. The three MacEachen principles or guidelines (named after Finance Minister Allen MacEachen) were: administrative feasibility; respect for the common tax base; and respect for the efficient functioning of the Canadian economic union.

7. These dollar figures are for the first child. The payments per child decrease somewhat for families with more children, e.g., $3,275 for the 3rd and subsequent child (under 7). The CCTB is targeted to low-income families.

8. Marc-Antoine Adam (2008) notes that when it seemed possible that Prince Edward Island and Newfoundland might be part of Confederation, s.94 included these provinces in addition to the remaining three. This seems to suggest clearly that s.94 would include all non-Quebec provinces.

9. Thomas Fleiner (2008) has provided an insightful analysis with respect to the manner in which common law federations differ from civil law federations across many areas, including their approach to the division of powers.

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