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Questioning the Legality of the Federal “Spending Power”

Burton H. Kellock & Sylvia LeRoy

Contents

<i>Executive Summary</i>	3
<i>Introduction</i>	5
1 <i>Canada’s Constitutional Origins: Founding Principles</i>	5
2 <i>The Powers of Government</i>	8
3 <i>Policing the Division of Powers: Early Jurisprudence</i>	13
4 <i>Modern Interpretations of the Spending Power</i>	16
<i>Conclusion</i>	23
<i>References</i>	23
<i>About the Authors & Acknowledgments</i>	26

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- † Development Department, The Fraser Institute, Fourth Floor, 1770 Burrard Street
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Executive summary

The federal “spending power” refers the alleged “power of Parliament to make payments to people or institutions or governments for purposes on which it (Parliament) does not necessarily have power to legislate.” Despite general legal and scholarly consensus that spending power rests on uncertain legal grounds, it is currently used to justify a complex tax-and-transfer system now worth upwards of \$42 billion per year. This publication examines the case for and against the federal spending power, evaluating its legality in the context of Canada’s founding debates, constitutional text, and binding judicial precedents.

1 Canada’s Constitutional Origins: Founding Principles

These debates provide cogent evidence about the principles upon which Canada was founded. While Canada’s first Prime Minister, Sir John A. Macdonald, may have strongly favoured a legislative union with strong central powers, he was only one member of a broader coalition that put the constitution together. Canada’s founders recognized that federalism would reinforce the principle of responsible government which, in the British Parliamentary tradition, requires that the government must be accountable or responsible to a majority of the democratically elected legislature. Dividing taxation powers would reinforce the principle of responsible government by holding each order of government, federal and provincial, to account directly for any expenditure its legislation authorizes.

By adopting a “Constitution similar in Principle to that of the United Kingdom,” Canada also inherited the long-standing principle of legality or the rule of law. The rule of law dictates that the principal elements of the machinery of government and the powers and duties that belong to it are defined by law, and that its form and course can be altered only by a change in law. In a federal system where the powers of Parliament and provincial legislatures are separate and distinct, disputes as to whether a particular subject matter lies within federal or provincial jurisdiction must be resolved by the courts.

2 The Powers of Government

A federal state comprises two classes or orders of government that are not subservient one to the other. Each order of government exercises original and exclusive powers that emanate from sections 91 to 93 of the *British North America Act, 1867*, Canada’s founding Constitution. The exclusivity of these divided jurisdictions is as essential to Canada’s original structure as a federal state in 2007 as it was in 1867.

There is only one provision of the Constitution that provides an exception to the stipulation that only the provinces may raise revenue for provincial purposes. Sections 118 and 119 of the *BNA Act* required the federal government to pay the provinces fixed subsidies on an annual basis. The clear language and fixed limits of these subsidies suggests that, while Canada’s founding fathers accepted that particular circumstances surrounding the entry of some provinces into Confederation justified the transfer of federal tax revenues for provincial spending, they expected these grants would be in “full Settlement of all future Demands on Canada” (*BNA Act, 1867*).

While the subsidies were increased by constitutional amendment in 1907, the precise schedule of payments enumerated in this revision emphasizes the framers’ intent to restrict the scope of this federal spending power to the specific terms and conditions that were written into the amendment. Notwithstanding these constitutional limits, federal spending within provincial jurisdiction has steadily grown. This has resulted in a profound redistribution of legislative power in Canada.

3 Policing the Division of Powers

For years, Canada’s courts were careful to guard against this *de facto* redistribution of power. These early judicial decisions reinforced the enumerated limits on federal powers to tax and spend. Specifically, the courts determined that the federal government could not exercise its lawful taxing powers if the purpose of those tax dollars were directed towards provincial purposes. In addition, federal taxing and spending need not have the effect of regulating provincial subjects to run afoul of the constitution. Rather, federal legislation is unconstitutional so long

as its “pith and substance” can be characterized as falling “in relation” to subjects within provincial jurisdiction.

These constitutional limits on the federal spending power were definitely recognized in the 1937 Unemployment Insurance Case, which considered the validity of federal legislation to enact an unemployment scheme. While the federal government argued that the compulsory contributions required by the scheme fell within the scope of their powers of taxation, appropriations, and public property, the Privy Council concluded that, even if the compulsory contributions required by the unemployment insurance scheme were considered a valid, federal tax, Parliament could not dispose of those funds any way they saw fit. Unless reversed by the Supreme Court of Canada or by an amendment to the Canadian Constitution, this statement of law is an insuperable barrier to the argument that the *BNA Act* contains an implied federal spending power that justifies fiscal transfer payments from the federal government to the provincial governments.

4 Modern Interpretations of the Spending Power

Legal scholars are agreed that an explicit federal spending power is not provided by any constitutional text or judicial decision; indeed, it runs contrary to early decisions of Canada’s highest court of appeal. Within this apparent legal vacuum, over the past 50 years, legal scholars have developed complex legal arguments that suggested that a federal “spending power” can be inferred from other classes of federal power, specifically the federal government’s powers to tax, its responsibilities for appropriating funds, and jurisdiction over public debt and property. The most prominent amongst these arguments is the “gift theory” of federal spending that asserts ownership of public funds gives government the right to spend these funds as it sees fit. This theory ignores the fact that government can only “give” money that it has already collected through compulsory taxes, a peculiarly governmental authority. In addition, governments do not spend money as an end in itself; rather, they spend money to further specified objectives. Insofar as these federal objectives relate to matters assigned to the provinces by the Constitution, the legislation authorizing those payments is illegal. While other theorists have traced the

federal spending power to the royal prerogative or the federal government’s residual powers to make laws for the peace, order, and good government of Canada, both powers must be read in the context of the same exhaustive division of legislative authority as the specifically enumerated sections 91 and 92 of the *BNA Act*.

While the validity of the federal spending power may be the subject of much academic debate, it has only been alluded to by the Supreme Court of Canada, never fully debated or examined. While some federal legislation authorizing social spending (i.e., family allowances, Medicare, and job-creation programs) has been reviewed by the courts, no court has ever defined the constitutional sources, scope, or limitations of the federal spending power.

Conclusion

The constitutional limitations of the spending power are not only of academic significance to politicians, lawyers, and scholars. Ordinary citizens should also be concerned about how the spending power redistributes legislative power, distorting their local policy preferences in favour of the priorities of national majorities. As federal and provincial politicians negotiate fiscal transfers amongst themselves, power is transferred away from the electorate to elites. Rather than shifting political responsibility from one order of government to the other, the federal spending power blurs the line of accountability of both orders, and contributes to a lack of confidence in Canada’s democratic institutions.

The rebalancing of federal-provincial powers through the exercise of the federal spending power is considered one of Canada’s great constitutional oddities, an opinion shared by those judges and legal academics who applaud it and those who do not. The use of the federal spending power contradicts the intentions of Canada’s founding fathers, the written word of the Constitution, and the definitive precedents of the Privy Council. Parliament should withdraw from areas of provincial jurisdiction or seek a constitutional amendment, as it did after the federal Unemployment Insurance schemes was judged illegal in 1937, that would bring current political practices in line with Canada’s foundational law and principles.

Introduction

It has been 70 years since Canada's highest court of appeal struck down key features of Prime Minister R.B. Bennett's "New Deal" of progressive social-welfare legislation, thereby placing strict limits on Parliament's ability to redistribute federal tax revenues by spending in relation to matters within provincial jurisdiction. Notwithstanding this judgment, successive federal governments have continued to fund programs in relation to nearly every provincial or local matter allocated to the provinces by Canada's founding constitution. This paper will investigate the legality of the federal "spending power," which is used to justify a complex tax-and-transfer system now worth upwards of \$42 billion per year.¹

This "spending power" refers to the alleged "power of Parliament to make payments to people or institutions or governments for purposes on which it (Parliament) does not necessarily have power to legislate" (Canada, 1969: 4). While this power is not explicitly provided for in any constitutional document, proponents argue it can be inferred from the federal government's powers over taxation, public debt and property, the royal prerogative, or the residuary power to make laws for the "peace, order and good government of Canada" (POGG). This paper will carefully examine the case for and against the federal spending power, evaluating its legality in the context of Canada's founding debates, constitutional text, and binding judicial precedents.

¹ Nearly half of this total spending (\$20.3 billion) is earmarked for provincial health-care programs and another quarter (\$10.9 billion) is redistributed through an unconditional system of "equalization grants" that is based on the wealth (tax base) of individual provinces. See Clemens et al., 2007.

1 Canada's Constitutional Origins: Founding Principles

The *British North America Act, 1867 (BNA Act)*² was enacted by the British Parliament in order to bring together as one country the provinces of New Brunswick, Nova Scotia and Canada, which at the time were British colonies.³ The preamble to the *BNA Act* recites that these colonies had "expressed their desire to be federally united into one dominion under the crown of the United Kingdom of Great Britain and Northern Ireland with a Constitution similar in principle to that of the United Kingdom." The *BNA Act* was preceded by resolutions passed at meetings of the Fathers of Confederation at Quebec in October 1864 and London in 1866.

Federalism

The provisions of the *BNA Act* divided all governmental power between the new central government (Canada) and the provincial governments, closely following the resolutions agreed to by the provinces in Quebec and London.⁴ The questions as to whether Canada should be created, and the nature of the rules that should govern it, were debated in the legislative assemblies of the uniting provinces. These debates provide cogent evidence about the principles upon which Canada was founded.

While Canada's first Prime Minister, Sir John A. Macdonald, may have favoured a legislative union with strong central powers, "[h]e was not the only Father of Confederation" (Russell, Knopff and Morton, 1993: 17). Rather, Macdonald was only one member of a broader coalition

² This statute was renamed the *Constitution Act, 1867*, when the constitution was repatriated with the *Constitution Act, 1982*. The term "*BNA Act*" will henceforth be used interchangeably with the *Constitution Act, 1867*.

³ The province of Canada was formed in 1840 by combining Upper Canada (Ontario) and Lower Canada (Quebec) into one province, the province of Canada.

⁴ The full text of these resolutions is available online at <http://www.solon.org/Constitutions/Canada/English/Misc/lr_1866.html>.

that put the constitution together. Also included were political leaders from the Maritimes and Quebec, who hoped that strong provincial governments with a significant role in the economy would develop under the new constitution. The need to accommodate these diverse regional interests resulted in the compromise embodied in the *BNA Act*, Canada's founding Constitution.

Macdonald was well aware that his dream of a centralized legislative union would not be achieved. As he explained in the Confederation debates of February 6, 1865,

it would not meet the assent of the people of Lower Canada, because they felt that in their peculiar position—being in a minority, with a different language, nationality and religion from the majority—in case of a junction with the other provinces, their institutions and their laws might be assailed, and their ancestral associations, on which they prided themselves, attacked and prejudiced ... We found too ... there was as great a disinclination on the part of the various Maritime Provinces to lose their individuality, as separate political organizations, as we observed in the case of Lower Canada herself. (Waite, 1963: 40–41)

Accordingly, the advocates of Confederation, including Macdonald, made the case for a federal union that would respect the autonomy of the provinces. The exclusivity of each jurisdiction's power to legislate within their respective fields of autonomy featured prominently in the rhetoric of these advocates, both in Upper Canada (Ontario) and Lower Canada (Quebec) (Vipond, 1991: 35; see also Silver, 1982: 50).

Responsible Government

This federal principle was not only designed to win the support of Quebec, whose delegates (George-Étienne Cartier chief among them) had strong cultural and linguistic reasons for safeguarding their distinctiveness in the new union. Rather, it was also seen as reinforcing the principle of responsible government. In the British Parliamentary tradition, responsible government requires that the executive (Prime Minister and Cabinet) must be accountable or responsible to the majority in the legislature.

As the population of Lower Canada exceeded that of Upper Canada within a decade of the 1840 Act of Union,⁵ Upper Canadian reformers such as George Brown saw Confederation as the opportunity to reassert the principles of responsible government so that the citizens of Upper Canada could be “masters in their own house” (see Romney, 1999). By the 1860s, Upper Canada paid nearly three quarters of the revenues appropriated by the Union government, yet had no interest in the local purposes these taxes funded in Lower Canada. The federal principle, Brown argued, would remedy this under-representation. As he explained: “All local matters are to be banished from the general legislature; local governments are to have control over local affairs, and if our friends in Lower Canada choose to be extravagant they will have to bear the burden of it themselves” (Ajzenstat et al., 1999: 287–88).

The concern for local autonomy and responsible government provided clear justification for dividing taxation powers between two levels of government, giving provinces powers to use direct taxes to fund local needs. Accordingly, the division of powers would reinforce the principle of responsible government by holding each government—both federal and provincial—to account directly for any expenditure its legislation authorizes. As Alexander Tilloch Galt, Canada's Finance Minister, explained it back in 1865:

one of the wisest provisions in the proposed Constitution ... is to be found in the fact that those people will feel, when they resort to direct taxation, that a solemn responsibility rests upon them, and that that responsibility will be exacted by the people in the most peremptory manner ... If the men in power find that they are required, by means of direct taxation, to procure funds necessary to administer local affairs, for which abundant provision is made in this scheme, they will pause before they enter upon any career of extravagance. (Waite, 1963: 54)

This logic is no less true in 2007 than it was in 1867. Any power that purports to transfer federal tax revenues to provincial governments for spending on matters falling beyond

⁵ The 1840 *Act of Union* united the two Canada's into the United Provinces of Canada.

the federal Parliament's regulation or control breaks the clear line of accountability that supports Canada's system of responsible government. Thus, in agreeing to unite under a common Constitution, the Fathers of Confederation thus agreed that Parliament and the legislatures of each province would each have "exclusive" power to legislate, tax, and spend, in their respective spheres of jurisdiction.

The Rule of Law

By adopting a "Constitution similar in Principle to that of the United Kingdom," Canada also inherited the long-standing principle of legality (or the rule of law). This rule holds that the existence or non-existence of a power or duty is a matter of law and not of fact, and so must be determined by reference to the law. In Canada, as in England, governmental power must be found in at least one of three sources: statutes, the royal prerogative, or what has been called the "property power."⁶ It is for the courts to determine, as a matter of law, whether or not a particular power or duty exists, to define its ambit, and to provide an effective remedy for unlawful action. Since the principal elements of the machinery of government and the powers and duties that belong to it are defined by law, its form and course can be altered only by a change in law (Halsbury, 8(2): para. 6).

The Role of the Courts

An independent judiciary is essential to the rule of law. In a federal system where the powers of Parliament and provincial legislatures are separate and distinct, disputes as to whether a particular subject matter lies within federal or provincial jurisdiction must be resolved by the

⁶ The royal prerogative refers to the common-law powers unique to the Crown, e.g., summoning Parliament or exercising the prerogative of mercy. The "property power" is also known as the "third source of authority for government action," understood as "the freedom which government has to do anything that is not prohibited by law." Examples include the distribution of written information and the entering into of contracts. See Harris, 1992, 2007.

courts. In Canada, the courts hold the power to strike down or declare invalid laws enacted by either level of government that fall *ultra vires* or "beyond the powers" of Parliament or the legislatures as defined primarily in sections 91 and 92 of the *BNA Act, 1867*. The Judicial Committee of the Privy Council (JCPC), based in Westminster, acted as the final arbiter of disputes between federal and provincial jurisdictions until 1949.

Neither the executive branch of government nor the judicial branch may change the law. The role of the judge is to apply existing law to individual cases, thereby establishing precedent that provides certainty and order for individual conduct and the continued development of legal rules. A precedent is drawn from the underlying reasons or principles upon which a case or question is decided, divorced from the particular circumstances that may have given rise to that case or question (see Halsbury, 37: para. 1237). The general rules or principles that forms the basis of a precedent is known as the *ratio decidendi* of the case.

In sharp contrast, are statements or remarks made in passing by a judge, known as *obiter dicta*. *Obiter* statements, which opine on matters that extend beyond the question of law put before the court, should not be construed as part of the reasons for judgment. While judges deciding cases in the future may consider *obiter dicta*, these statements are not binding on lower courts. As the Supreme Court of Canada recently noted in *R. v. Henry* [2005], "there will be commentary, examples or exposition that are intended to be helpful and may be persuasive, but are certainly not 'binding'" (at para. 57).⁷ In other words, "judge-made" law does not mean "judge-made up." According to the editors of Halsbury (widely respected as the definitive encyclopedic treatise on the laws of England), in applying the law a judge must look to the words of the legislation in question, but may refer to reports of Parliamentary debates as an aid to construction in cases "where there is ambiguity or obscurity" (Halsbury, 37: para. 1238)

⁷ See also *Provincial Judges Reference* [1997] at para. 168. These decisions specifically overrode the so-called "*Sellers* principle," that purported *obiter dicta* could be used to precipitate a successful appeal (*Sellers v. The Queen* [1980]). Thanks to an anonymous reviewer for clarifying this jurisprudence.

2 The Powers of Government

The Federal State

A federal state differs from a unitary state such as Great Britain, whose constitution Canada's was to resemble "in principle." In a unitary state, all power is vested in one national Parliament, which may then delegate law-making power to subordinate local authorities, or to the Cabinet. A laws made by Cabinet is called an "order-in-council" or regulation. Regulations may also be made by other bodies providing that Parliament has bestowed on those bodies the authority so to do. Orders-in-council and Regulations are termed delegated or subordinate legislation. The power to enact subordinate legislation can be altered or withdrawn by Parliament at any time, without notice, and for any or no reason.

A federal state, on the other hand, comprises two classes or orders of government that are not subservient one to the other. While these two classes of legislative powers are often described as two "levels" of government, this is inaccurate. In federal states, federal and provincial governments are not subordinate one to the other, as is the case with municipal governments, which are created by the province in which they are located and can be absolutely controlled and indeed abolished at the discretion of the provincial government. Neither the federal government nor the provincial governments owe their existence or powers to the federal or other provincial governments. In Canada, both orders of government (federal and provincial) are entitled to authorize other bodies to enact subordinate legislation, but such subordinate legislation *must* also observe the constitutional division of power provided for in the *BNA Act*.

Canada, whose Constitution expresses the desire of the provinces to be "federally united into one dominion," is such a federal state. Neither the federal government in Ottawa nor any provincial government derives its powers from the other. Each order of government exercises original and exclusive powers that emanate from the Constitution, specifically the sections in Part VI under the heading "Distribution of Legislative Powers," which divides all government power between Ottawa and the provinces.

Canada's Constitutional Division of Powers

Section 91 of the *BNA Act* authorizes Parliament to make laws "in relation to all matters not coming within the classes of subjects by this *Act* assigned exclusively to the legislatures of the provinces"; for greater certainty, it lists specific matters that are to fall within federal jurisdiction. In all, 29 classes of subjects are listed, including "the public debt and property" (91(1A)), "the regulation of trade and commerce" (91(2)), and "the raising of money by any mode or system of taxation" (91(3)).⁸

While these federal powers of taxation may seem broad, there are clear limits to the purposes towards which these tax revenues may be directed. All expenditures (federal or provincial) require legislative authority,⁹ and the *BNA Act* stipulates that "in each Province the Legislature may *exclusively* make Laws in relation to Matters coming within the Classes of Subjects" enumerated in section 92 (emphasis added). This section of the constitution gives provinces exclusive jurisdiction to use direct taxes to raise "revenue for provincial purposes" (92(2)), which include "the establishment, maintenance, and management of hospitals" (92(7)), "property and civil rights in the province" (92(13)), "generally all matters of a merely local or private nature in the province" (92(16)), as well as the exploration, development, conservation, management, and taxation of "non-renewable natural resources, forestry resources and electrical energy (92A)." By section 93, the provinces are given the exclusive authority to make laws in relation to education.

In 1937, Canada's highest court of appeal aptly described this exclusivity of federal and provincial jurisdiction as "water-tight compartments," essential to Canada's original structure as a federal state notwithstanding the immense social and economic changes

⁸ For the complete list of enumerated grounds, see the text of the *Constitution Act, 1867*, available online at <<http://lois.justice.gc.ca/en/const/index.html>>.

⁹ See sections 53, 54, and 106 of the *Constitution Act, 1867*. This principle can be traced back to the 1688 *Bill of Rights*, which sought to ensure not merely that the executive branch of government was subject to the rule of law but also that the executive branch would have to call the legislative branch into session both to raise taxes and to distribute appropriations.

that had transpired since Confederation (*Labour Conventions Case* [1937]). Twenty years later, at the onset of another period of rapid social and economic transformation, Pierre Trudeau reiterated the importance of this federal principle to Canada's constitutional foundations. Writing about a proposed system of federal grants to universities he said:

if Ottawa regularly subsidized the construction of schools in all provinces on the pretext that the provinces did not pay sufficient attention to education, these governments would be attacking the very foundation of the federal system ... which does not give any government the right to meddle in the affairs of others" (Trudeau, 1957: 81).¹⁰

Trudeau clearly changed his mind about Ottawa's power to spend on matters within provincial jurisdiction after assuming federal office and power (see Canada, 1969). Nevertheless, his 1982 package of constitutional amendments gave Canada a *Charter of Rights and Freedoms* and a new amending formula but otherwise did nothing to alter the exclusivity of the powers assigned to the federal and provincial governments. The *BNA Act*, including the distribution of legislative powers in Part VI, remains an essential part of Canada's Constitution and can only be changed by lawful amendment.

Uniformity of Laws: Section 94

One other provision of the *BNA Act* is relevant to our interpretation of the legislative autonomy protected by Canada's constitutional division of powers. Section 94 of Canada's founding constitution stipulates that:

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 the Power 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.

Historically, this clause has been given scant attention by either political actors or academics. Two notable exceptions are Scott (1942) and La Forest (1975), who read section 94 as a potential source of federal authority to legislate national standards in the common-law provinces outside Quebec. In recent years, scholars and politicians have invoked section 94 variously to justify "asymmetrical federalism" recognizing the distinct society of Quebec (Pelletier, 2005; Laforest 2005; Adam, 2007), and to limit the federal power by giving all provinces equal opportunity to "opt in" to federal social programs (Courchene, 2006; Brock, 2007). As Kathy Brock, Associate Professor in the School of Policy Studies at Queen's University concludes:

Section 94 empowers and sustains the provinces. It is not a sign of the compliance of the common law provinces with the federal government or their desire for uniformity but rather an affirmation of their ability to stave off unwanted federal intrusion into provincial jurisdiction. (Brock, 2007: 15)

The stipulation that any federal law passed in relation to the property and civil rights of the provinces must be supported by independent provincial legislation, Brock notes, could give the provision the effect of a veto on federal initiatives.¹¹ As she explains, "provinces may nullify

¹⁰ The same principle, he argued, applied to equalization grants. In Trudeau's words, "I believe in equalization grants so long as they relate to that part of the general welfare that is under federal jurisdiction" (Trudeau, 1957: 82).

¹¹ Brock compares this stipulation to the federal disallowance power. This federal power of disallowance, authorized under sections 55–57 and 90 of the *BNA Act* was used a total of 112 times to veto provincial legislation before 1943. After considerable opposition from the provinces, this federal power fell into disuse and is now considered obsolete.

any federal law in relation to property and civil rights and court procedures, simply by not adopting it” (2007: 15). Far from providing constitutional authority to the federal spending power, section 94 could be invoked as a constitutional barrier against it.

Provincial Subsidies

There is only one provision of the Constitution that provides an exception to the stipulation that only the provinces may raise revenue for provincial purposes. Section 118 of the *BNA Act* required the federal government to pay the provinces (Ontario, Quebec, Nova Scotia, and New Brunswick) fixed amounts of money on an annual basis. For example, Ontario was entitled to receive \$80,000 per year, Quebec would receive \$70,000, Nova Scotia, \$60,000, and New Brunswick, \$50,000. In addition, the federal government was required to pay an annual “grant in aid” to each province “equal to eighty cents per head of the population as ascertained by the census of 1861.”

Notably, the Fathers of Confederation agreed on this limited scheme of equal, per-capita grants even though each province was projected to bear different costs upon entering into Confederation. After extensive debate amongst delegates to the Quebec Conference in 1864, a needs-based schedule of payments that would correct for federal-provincial imbalance was rejected as unnecessary and undesirable (Davenport, 1982: 113).¹² The resulting schedule of fixed payments is thus distinguished from modern-day equalization payments, which are based on a complex formula related to each province’s specific economic situation. An exception was nevertheless made for the province of New Brunswick, which would have faced a disproportionately high deficit within the federal union. Reflecting Resolution 65 of the Quebec Conference, section 119 provided another carefully defined grant to the province of New Brunswick.¹³

¹² Section 118 of the *BNA Act* reflects Resolution 64 of the Quebec Conference. The complete resolutions can be reviewed online at <http://www.solon.org/Constitutions/Canada/English/Misc/qr_1864.html>.

¹³ Finally, section 120 elaborated on the form the payment of the grants defined in section 118-119 should take.

The precise language used to authorize the transfer payments in section 118 of the *BNA Act* suggests two key points. First, Canada’s founding fathers accepted that particular circumstances surrounding the entry of some provinces into Confederation justified the transfer of federal tax revenues for provincial spending, notwithstanding the strict division of powers enumerated in sections 91 and 92 of the Constitution. Second, Canada’s founding fathers intended that the grants of section 118 would be in “full Settlement of all future Demands on Canada” (*BNA Act*, 1867), using clear language that would eliminate the possibility that the terms and conditions of these grants would be ambiguous enough to allow for contrary interpretation. No authorization was provided for the federal government to incur new financial obligations to the provinces beyond the explicit terms of sections 118 and 119 of the *BNA Act*.

“Better Terms”

When the federal government of John A. MacDonald tried to exercise his Prime Ministerial discretion by unilaterally offering “better terms” (i.e., increased subsidies) to Nova Scotia shortly after Confederation, the opposition pointed to the clear terms laid out in section 118 and argued it would take a formal constitutional amendment to alter the terms of the deal made in 1867 (Vipond, 1991: 41–44).¹⁴ As MP Edward Blake explained to the House of Commons on June 11, 1869, “this Parliament had no right to devote, from the service of Canada, for the support of the local governments, any sums of money whatever, except those (constitutionally) specified sums” (quoted in Vipond, 1991: 43).

While MacDonald’s “better terms” resolution ultimately passed handily in the House of Commons, Parliament would later recognize the need for formal constitutional amendment to end what Blake rightly predicted would be “a general scramble for more money and increased sub-

¹⁴ MacDonald’s offer of “better terms” for Nova Scotia were prompted by the strong anti-Confederation movement, which claimed 36 of 38 seats in the provincial assembly and 18 out of 19 federal constituencies in the elections of 1867 (Vipond, 1991: 41).

sides by the other Provinces.” Consequently, in 1907 the Canadian Speaker of the Senate and the Speaker of the House of Commons petitioned the King to amend the Constitution to authorize a “final and unalterable settlement” (Skelton, 1935).¹⁵ As Dr. O.D. Skelton, then Under-Secretary of State for External Affairs would observe in the Special Committee of the House of Commons on the *BNA Act* in 1935: “the Dominion recognized the desirability ... of preventing any further provincial demands, and sought by consultation with the provinces and by utilizing the formal method of amendment, to give some degree of permanence to the arrangement” (Skelton, 1935).

To emphasize this permanence, then-Prime Minister Sir Wilfred Laurier sought to have the words “final and unalterable settlement” included in the 1907 amendment to section 118 of the *BNA Act*. While the words “final and unalterable settlement” were omitted from the final amendment, as it stands today, the amendment established a new formula for grants by the federal government to provinces outside the division of powers in sections 91 and 92. The transfer payments were set at between \$100,000 and \$250,000 dollars, depending on provincial population, with an additional \$100,000 granted to the province of British Columbia for a fixed 10-year period.

Once again, the precise schedule of payments enumerated in this amendment emphasizes the framers’ intent to restrict the scope of this federal spending power to the specific terms and conditions that were written into the Constitution. Having expressly provided for federal grants to the provinces in section 118 of the *BNA Act*, Canada’s founding fathers intended that subject matter to be exhausted. The amendment of 1907 reflects the express desire of the democratically elected government to alter these original terms of settlement, but to do so only according to a carefully prescribed formula.

The fixed limits of the federal government’s power to initiate new transfers to provinces are not compromised by section 1(7) of the Constitution Act, 1907,

¹⁵ While Canada and other British colonies achieved full legislative sovereignty under the *Statute of Westminster* in 1931, until the passage of the *Canada Act* in 1982, Canada’s Constitution could only be amended by an act of British Parliament.

which provides that: “Nothing in this Act shall affect the obligation of the Government of Canada to pay to any province any grant which is payable to that province, other than the *existing* grant for which the grant under this Act is substituted” (emphasis added). “Any grant which is payable to any province” would have to be authorized by valid federal legislation that conforms to the Constitution’s original division of powers, and the specific terms of payment laid out in the *BNA Act*’s amended section 118. The “existing grant” referred to in this section, meanwhile was carefully limited to a schedule of payments that left little room for interpretation. Far from suggesting a broad spending power, the additional grants implied by this section logically refer to the grant to New Brunswick explicitly authorized by section 119 of the *BNA Act*, or any constitutionally specified grants the federal government might have been, at the time, in default of.

These strict limits are still a binding part of the “Constitution of Canada,” which is the “the supreme law of Canada” and includes the *BNA Act, 1867* and the *Constitution Act, 1907* as part of a schedule of Acts, orders, and amendments appended to the *Constitution Act, 1982*.¹⁶ Within this schedule of Acts and orders, only the *Constitution Act, 1907* provides a clear authority for federal grants to the provinces. Additional grants may be made, but only pursuant to a constitutional amendment that explicitly provides for them notwithstanding the division of powers in sections 91 and 92 of the *BNA Act*. That is, federal grants can only be made in relation to the classes of subjects assigned to the federal government by the Constitution.

All in all, between 1867 and 1982 there were some 25 amendments to the *BNA Act, 1867*, not including the amendments authorized by enactment of the *Canada*

¹⁶ *Constitution Act, 1982*, section 52. The complete schedule of Acts, orders and amendments can be reviewed at <http://lois.justice.gc.ca/en/const/sched_e.html>. Included in this schedule is the *Constitution Act, 1940*, which gave the federal government jurisdiction over Unemployment Insurance, and the *Constitution Act, 1951*, which gave the federal government the power to administer and operate its own old-age pension plan. The federal government’s jurisdiction over pensions, survivor, and disability benefits was later expanded by the *Constitution Act, 1964*.

Act in 1982, which added the *Constitution Act, 1982* and the *Canadian Charter of Rights and Freedoms*. As a result of the Privy Council's decision in 1937 (in the *Unemployment Insurance* case) to the effect that the Parliament of Canada did not have authority to establish an unemployment insurance scheme, the British Parliament amended the *BNA Act* to include as section 91(2A) "Unemployment Insurance," thus providing Parliament with the jurisdiction to enact an unemployment insurance scheme. In 1951, the *BNA Act* was amended to give Parliament jurisdiction to legislate in relation to "Old Age Pensions," an area of jurisdiction that was expanded by another constitutional amendment to cover survivor and disability benefits in 1964. These amendments clearly reflect a political awareness, buttressed by binding legal precedent, of constitutional limits to intergovernmental fiscal transfers. Notwithstanding this awareness, no constitutional provision to recognize or legitimize an open-ended federal spending power explicitly was ever introduced, let alone enacted.

This stands in sharp contrast to provisions debated and then entrenched in the constitutions of other British Commonwealth countries such as Australia and India in the first half of the twentieth century. For instance, the strict limits on the federal grants to provinces entrenched in the *Constitution Act, 1907* (the former section 118 of the *BNA Act*) stands in sharp contrast to the explicit spending power granted Australia's federal Parliament in section 96 of the *Commonwealth of Australia Constitution Act, 1900*, adopted by the British Parliament just a few years earlier. According to section 96:

During a period of ten years after the establishment of the Commonwealth and thereafter until Parliament otherwise provides, *the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.* (For discussion, see Quebec, Commission on Fiscal Imbalance, 2002: 24, f.n. 79; emphasis added).

A similar spending power is enumerated in section 282 of the Constitution of India: "The Union or a State may make any grants for any public purpose, notwithstanding that the purpose is not one with respect to which Parliament or the Legislature of the State, as the case may

be, may make laws (see Telford, 2003).¹⁷ This provision, came into effect in 1950, the year before the Government of Canada amended the *BNA Act* to allow federal spending on old-age pensions. No power of the scope imagined by sections 96 or 282 of the Australian or Indian Constitutions was granted to any federal or provincial authority under the *BNA Act, 1867* or any of the subsequent amendments to Canada's founding Constitution.

The Political Origins of the Alleged Spending Power

Notwithstanding its intended finality, the 1907 amendment to the "grant in aid" provisions of the *BNA Act* did little to stop the political development of a federal spending power. For instance, Skelton observed that by 1935 "revision of the terms then granted [had] proceeded apace without formal amendments and without incidentally the consent of all of the provinces" (Skelton, 1935: 79–82). Skelton recounts the observations of Mr. J.A. Maxwell that

in the 60 odd years since 1869 there have been three general revisions scaling up the grants given to all the provinces and more than a score of special revisions affecting every one. Despite heavy withdrawals from capital account (i.e. debt allowances) the four original provinces in 1928-1929 drew more than three and one half times as much from the federal treasury as had been promised in the *BNA Act*. (Skelton, 1935: 82).

While the introduction of federal unemployment and pension plans may have waited for constitutional amendment, countless other spending programs have been introduced by Ottawa notwithstanding their relation to matters of provincial jurisdiction. These federal spending initiatives include family allowances (1944), federal grants to universities (1951), hospital insurance (1957), to name but a few. Petter (1989) calculates that conditional transfers from Ottawa to the provinces grew from less

¹⁷ Telford notes that section 282, inserted into the Indian Constitution "to meet an unforeseen contingency," has become the subject of considerable abuse and is now the primary means by which funds are allocated to the states.

than 1% of federal budgetary expenditures in 1945, to over 13% of federal expenditures in 1965, and almost 20% of federal expenditures a decade later.

Administrative Federalism

Andrew Petter, Dean of the University of Victoria's Law School, has described these developments as ushering in a new era of "administrative federalism" or extra-legal federalism. In sharp contrast to the clear-cut division of powers envisioned by "classical" or "coordinate" federalism, administrative federalism blurs the financial and policy independence of the two orders of government (Petter, 1989; see also Black, 1975; Cooper, 2004). As a result of these political developments, the federal government currently operates under a host of statutes it itself has enacted to exercise its alleged spending power; these include the *Federal-Provincial Fiscal Arrangements Act*, the *Canada Health Act*, the *Provincial Subsidies Act*, and many more. Through a host of conditional and unconditional grants, Parliament has used its "spending power" to fund provincial programs and services relating to matters outside their proper jurisdiction.

Professor Gerald La Forest, later appointed to the Supreme Court of Canada, points out that "[s]uch activity, of course, effected a profound reorientation of power in the Canadian federation in favour of the central authority" (La Forest, 1981: 30). Thomas Courchene, one of the country's foremost economists, makes a similar observation, noting that "the magnitude and nature of intergovernmental cash and tax transfers [are] essentially de facto redistributions of power under the Constitution" (Courchene, 1985; see also Hogg, at ch. 6.7). Professor Hogg puts it this way: "often a legislative body will find a way to do indirectly what it cannot do directly." Far from justifying the legality of the alleged spending power, these statements demonstrate its illegitimacy. The remainder of this paper will evaluate this legality, considering both the alleged sources of the spending power, and its treatment by the courts.

3 Policing the Division of Powers: Early Jurisprudence

Canada's constitutional division of powers was intended to prevent the federal government, on the one hand, and the legislatures of the provinces, on the other, from trespassing on areas of jurisdiction assigned to the others. Any federal tax, treaty, or expenditure authorized by legislation "in relation" to matters that fall within the scope of subjects enumerated in section 92 or section 93 necessarily conflicts with the higher law of the Constitution. The fact that the law may be in relation to taxation or in relation to spending is "incidental" and is not part of the analysis required in order to determine the law's constitutional validity.

In the vast majority of federalism cases that came before the Privy Council, the question at law was whether the legislation under review was or was not in relation to the subject matters listed in sections 91 and 92. There were, of course, occasions when the Privy Council found that sections 91 and 92 would authorize both Parliament and the provincial legislatures to enact valid legislation covering the same ground but obviously enacted in relation to a different subject matter. But in every case in which the validity of a federal statute was impugned, the legislation was upheld only because it was found to be legislation in relation to a federal head of power.¹⁸

Constitutional Limits on the Spending Power: Early Jurisprudence

Two decades after Confederation it was clear that in law the legislatures of the provinces, and only the legislatures of the provinces, had the right to levy direct taxes "for provincial purposes." In *Citizens Insurance Co. v. Parsons* [1881], the Privy Council held that sections 91 and 92 must be read together so that broad and general subjects did not cancel out or absorb specific subjects. In the words used by the Privy Council (Sir Montague-Smith):

¹⁸ Under the rule of paramountcy, valid federal legislation takes precedence over valid provincial legislation,

so the raising of money by any mode or system of taxation ... though the description is sufficiently large and general to include “direct taxation within the province in order to the raising of a revenue for provincial purposes” ... it obviously could not have been intended that, in this instance, also, the general power should over-ride the particular one.

In other words, the power to raise money by direct taxation within a province for provincial purposes was exclusively a provincial power and not a power that could be encroached upon, or exercised in any way, by the federal government.

The Privy Council reiterated their opinion that Parliament could not levy direct taxes to raise revenue for provincial purposes in *Caron v. The King* [1924]. In considering whether the federal government had the authority to enact the *Income War Tax Act, 1917*, the Privy Council speaking through Lord Phillimore, said:

Both sections of the Act of Parliament [sections 91(3) and 92(2)] must be construed together ... The only occasion on which it could be necessary to consider which of these two principles was to guide, would be in the not very probable event of the Parliament of Canada desiring to raise money for provincial purposes by indirect taxation. (at 1003–04).

Consequently, an express federal power to impose direct taxes for provincial purposes in light of the conferral of that power exclusively upon the provincial Legislatures by section 92(2) cannot exist.

The Privy Council revisited the matter in 1932 when it ruled that a federal tax on property insurance premiums amounted to the regulation of the insurance business and as such was *ultra vires* of Parliament: “Now as to the power of the Dominion of Parliament to impose taxation there is no doubt. But if the tax as imposed is linked up with an object which is illegal, the tax for that purpose must fall” (*Insurance Act Reference*, [1932]).

The Privy Council drew support from their 1924 decision in the *Reciprocal Insurers* case, where it was said that:

[I]t is no longer open to dispute that the Parliament of Canada cannot by purporting to create penal sanc-

tions under section 91 head 27, appropriate to itself exclusively a field of jurisdiction in which, apart from such a procedure, it could exert no legal authority, and that if, when examined as a whole, legislation which is in form criminal is found, in aspects and for purposes exclusively within the provincial sphere, to deal with matters committed to the provinces, it cannot be upheld as valid.

In the 1932 case, the Privy Council said that if, instead of the words “create penal sanctions under section 91 head 27,” one substitutes the words “exercise taxation powers under section 91 head 3” and, for the word “criminal,” one substitutes the word “taxing,” the sentence expresses precisely their Lordships’ views. The same logic holds true if one substitutes “conditional grant” for “penal sanctions” and “spending” for “criminal.” That is, even if the spending power was sanctioned as a separate class of activity within federal competence, if the full effect of that spending was ultimately determinative of policy in relation to matters of provincial jurisdiction (as conditional grants necessarily are), such a purported exercise of the “spending power” would have to be held to be invalid.

The latter example illustrates how federal spending might be construed as regulation of provincial matters, but this ignores an even bigger problem. Federal spending, like federal taxation, need not have the effect of *regulating* provincial subjects to run afoul the constitution. Rather, it’s legality is in question so long as the taxing or spending can be characterized as being “in relation” to subjects within provincial jurisdiction.

In the absence of any provision of the *BNA Act* explicitly authorizing federal taxation of any kind for “provincial purposes” it would seem logical to conclude that the federal government was not, and is not, authorized to collect money from all the taxpayers of Canada and then turn around and give it to the provinces to be spent for “provincial purposes.” It is even less logical to contemplate that federal taxes that are handed over to the provinces subject to the stipulation that they be spent for provincial purposes, could be authorized by the *BNA Act*.

Neither the power to tax nor the power to spend revenues placed in the consolidated revenue fund is constitutional without specific legislative authority. This

point is crucial. As Viscount Haldane wrote, delivering the judgment of the Privy Council in *Auckland Harbour Board v. The King*:

It has been a principle of the British Constitution now for more than two centuries ... that no money can be taken out of the consolidated fund into which the revenues of the state have been paid excepting under a distinct authorization from Parliament itself. The days are long gone by in which the Crown or its servants, apart from Parliament could give such an authorization or ratify an improper payment. Any payment of the consolidated fund made without Parliamentary authority is simply illegal and *ultra vires* [beyond the power] and may be recovered by the government if it can, as here, be traced. ([1924] at 326).

Binding Precedent: The Unemployment Insurance Case

The Privy Council and the Supreme Court of Canada have spoken definitely on the legality of the federal government's use of its taxation and spending powers to fund programs in relation to subjects within provincial jurisdiction. In 1935, the federal Parliament enacted a number of statutes modeled after US President Franklin Delano Roosevelt's "New Deal" of unemployment insurance and closer regulation of working conditions, including limitations to hours worked and mandatory minimum wages. The *Unemployment Insurance* case, decided by the Privy Council in 1937, considered the validity of federal legislation to enact an unemployment scheme.

The federal government argued before the Supreme Court and, subsequently, the Privy Council that compulsory contributions required by the scheme fell within scope of their powers of taxation, appropriations, and public property. Lord Atkin delivered the Privy Council's reasons for judgment, concluding that even if the compulsory contributions required by the unemployment insurance scheme were considered a valid, federal tax, Parliament could not dispose of those funds in any way they saw fit:

If on the true view of the legislation it is found that in reality in pith and substance the legislation invades civil rights within the Province, or in respect of other classes of subjects otherwise encroaches upon the provincial field, the legislation will be invalid. To do otherwise would afford the Dominion an easy passage into the provincial domain. (Unemployment Insurance case [1937]).

The judgment of the Privy Council in the Unemployment Insurance case contains a statement of the law. Unless reversed by the Supreme Court of Canada or by an amendment to the Canadian Constitution, this statement of law is an insuperable barrier to the argument that the *BNA Act* contains an implied federal spending power that justifies federal-provincial fiscal transfer payments.

As a result of this judgment, a constitutional amendment (now section 91(2A) of the Constitution) was required before Parliament could proceed with its plan to establish unemployment insurance. This amendment would not have been necessary if statutes enabling federal taxes to be used for provincial purposes were valid. According to this test, any other federal-provincial transfer program and its enabling legislation that use federal tax revenues for provincial purposes—including equalization, health, and social transfers now granted under the *Federal-Provincial Fiscal Arrangements Act*—should be held illegal unless and until the Canadian Constitution is amended to provide for them.

Section 36, added to the *Constitution Act, 1982*, does not constitute such an amendment. While section 36 is a statement to the effect that Parliament is "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," it is widely regarded as non-justiciable. In addition, section 36 stipulates that Canada's commitment to equalization will be filled without altering "the legislative authority of Parliament or the provincial legislatures." The federal spending power clearly represents a redistribution of this legislative authority. (For further discussion, see Kellock and LeRoy, 2006).

4 Modern Interpretations of the Spending Power

Before reviewing more recent judicial interpretations of the federal spending power, it is important to emphasize the general consensus among legal academics that there is no such thing as an explicit federal “spending power” in the Canadian Constitution. Until recently, there had been no explicit mention of this power in any judicial decision either. As E.A. Dreiger, emeritus law professor at the University of Ottawa, observed in 1981, “I have been unable to find the expression ‘spending power’ in any Canadian judicial decision or statute” (Dreiger, 1981: 124). Lending support to our earlier discussion of provincial subsidies, Ken Hanssen wrote in the *Manitoba Law Journal* some 50 years ago, “The only explicit provisions of the constitution that confer upon the federal government power to transfer money to the provinces are the sections providing for what are known as the statutory subsidies which were unconditional grants to the provinces” (Hanssen, 1966/1967: 195). Even more recent observers have noted the federal spending power “essentially amounts to a huge legal vacuum at the heart of Canada’s federal system” (Adam, 2007: 32).

If the so-called spending power is not mentioned in any constitutional text, what is the authority for it? Over the past 50 years, legal scholars have developed complex legal arguments that suggested that a federal “spending power” can be inferred from other classes of federal power (Hogg, 2000: ch. 6.8; see also Barker, 1990: 112). We will begin by considering the two most frequently cited sources of constitutional authority: the federal government’s power to raise money by “any mode or system of taxation,” and its powers to appropriate funds and make laws in relation to debt and public property.

Federal Powers to Tax and Spend

The primary source of authority that proponents of the spending power look to is section 91(3) of the *BNA Act*, seemingly unlimited power to raise money by “any mode or system of taxation.” When read in isolation, this taxing

power may appear unlimited. In the context of the constitutional division of legislative powers, however, this power is in fact subject to justiciable limits. These limits were laid down as binding precedents by a series of early Privy Council cases. Specifically, the federal Parliament may not make laws in relation to a subject that has been assigned by the *BNA Act* to the exclusive legislative jurisdiction of the provinces under the guise that those laws are in relation to taxation, as if “taxation” were a discreet subject matter of federal constitutional jurisdiction.

It follows that, if the federal government had an unlimited power to collect taxes, it would also have an unlimited power to dispose of those monies. Like the federal taxing power, however, the federal power to spend is not without limits. Section 91(1A) empowers the federal government to make laws in relation to the public debt and property. By sections 102 and 106 of the *BNA Act*, it is a requirement of Canada’s Constitution that all federal revenues be deposited into one consolidated revenue fund and expended for the public service of Canada and for no other purpose. By virtue of section 126, the same rules apply to provincial revenue, which must be spent for the public service of the province.

If Canada’s founders had intended the federal power over appropriations to override the general division of powers so crucial to the federal compromise of Confederation, they would have said so. Andrew Petter (1989) emphasizes this point by drawing a comparison with the Australia. While the Australian constitution contains nearly identical provisions to Canada’s section 102 and 106, it still explicitly provides for a federal spending power under a separate head of power.¹⁹ Canada’s Constitution does not.

“Gift Theory”

Nevertheless, academics have articulated a popular “gift theory” of federal spending, which asserts ownership of public funds gives government the right to spend these funds as it sees fit, including by imposing special condi-

¹⁹ Section 96 of the Australian Constitution authorizes federal Parliament to “grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.”

tions (Scott, 1955: 6–7; Hogg, 2000: ch. 6.8). When government spends, these theorists argue, it is not exercising compulsory authority but rather it is acting as a “natural person.” F.R. Scott, the foremost proponent of this theory, explains:

All public monies that fall into the Consolidated Revenue Funds of the federal and provincial government belong to the Crown. The Crown is a person capable of making gifts or contracts like any other person, to whomever it chooses to benefit. The recipient may be another government, or private individuals. The only constitutional requirement for Crown gifts is that they must have the approval of Parliament or a legislature ... Generosity in Canada is not unconstitutional (Scott, 1955: 6–7).

Generosity may not be unconstitutional but it is a private, voluntary act. Government can only spend what resources it has collected, through its power to tax, which is a peculiarly governmental and coercive state power.

This contradiction poses a serious problem for those who argue that government spending is “benevolent and voluntary” and, thus, a unique power, exempt from the constitutional constraints that limit other types of activities. Peter Hogg explains the argument as follows.

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

There are several problems with this line of reasoning. First, as discussed above, the compulsory collection of tax revenues from citizens by a government is most definitely the exercise of a “peculiarly governmental authority over its subjects.” This is so even if a provincial government has the option of “opting out” or declining

the “gift” of federally collected tax revenues. Citizens of the province opting out are ultimately forced to make a “gift” of their tax revenues to fund local matters in other provinces. As Petter (1989) notes, a government’s spending function cannot be divorced from the taxing function, which rather is “part and parcel of a single redistributive activity.”

Second, because virtually every governmental function of the modern welfare state involves the expenditure of public funds, the “gift theory” suggests that huge areas of government activity are virtually without constitutional limits. This highlights an irony observed by Marc-Antoine Adam in a recent issue of *Policy Options*. If government spending on social welfare programs was truly the actions of a private or “natural person,” the Charter would not apply. “Strangely,” Adam observes, “no one has seriously attempted a similar public/private distinction to argue that the Charter ought not to apply to a government spending program” (Adam, 2007: 31).

Finally, 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 is based on classes of subjects; and as a treaty deals with a particular class of subjects so will the legislative power of performing it be ascertained.”²⁰ The same holds true of spending.

Royal Prerogative

Similar problems can be found in attempts to place the source of the federal spending power in the royal prerogative. D.V. Smiley, for instance, cites Prime Minister Louis Saint Laurent as speaking of “the authority of the federal government to spend moneys on subjects within the legislative jurisdiction of the province as an exercise of the royal prerogative to apply public funds to matters that would be of value to the national development or to the welfare of the nation as a whole” (Smiley, 1963: 23). However, the royal prerogative, whether legislative or

²⁰ See also *Amax Potash Ltd. v. The Government of Saskatchewan* [1977].

executive, is subject to the same exhaustive division of powers as the specifically enumerated sections 91 and 92 of the *BNA Act*.²¹ Perhaps the clearest statement of the exhaustive division of powers incorporated in the *BNA Act* was made by Lord Watson in *The Liquidators of the Maritime Bank v. Receiver General of New Brunswick*, [1892]. It had been argued that a prerogative right could be exercised only by the Crown in right of Canada and not by the Crown in right of New Brunswick. According to Watson, however, Canadian federalism

was accomplished by distributing between the Dominion and the provinces, *all powers Executive and legislative, and all public property and revenues* which had previously belonged to the provinces; so that the Dominion government should be vested with such of these powers, *property and revenues as were necessary for the due performance of its constitutional functions and that the remainder should be retained by the provinces for the purposes of provincial government.* (emphasis added)

Consequently, whether the source of the alleged power to make fiscal transfers to the provinces is a legislative, executive, prerogative, or “natural person” power, it remains a governmental power and the authority for it must be found in the provisions of the *BNA Act* conferring power on the federal government. It follows that Ottawa has no power over public property or revenues that are not necessary for the due performance of the federal government’s constitutional functions.

To put it somewhat differently, Executive power in Canada—including the royal prerogative—is split between Ottawa and the provinces in the same manner as legislative power. As political scientist David E. Smith has observed: “Had provinces only had legislative authority over certain matters in s. 92 of the Constitution Act, but not royal prerogative in those same areas,

their ability to develop social policies that involved extensive administrative regulation would have been severely hampered” (Smith, 1995: 635). That means that all governmental power, including the royal prerogative and any other source of authority said to be exercisable by government as a “natural person” is divided between the federal government and the provincial governments on the basis of the division of powers enumerated in the Constitution.

Peace, Order, and Good Government

Yet another inferred source of the spending power is the federal government’s residuary powers under section 91 to make laws for the “peace, order and good government” (Strayer, 1956; La Forest, 1981). The argument that a broad federal spending power is authorized by the federal government’s powers to foster peace, order, and good government (POGG) draws support from a popular founding myth that reads the POGG clause as a conscious reversal of the US federal model. According to this interpretation of Canada’s constitutional origins, the Fathers of Confederation wanted to create a more centralized federal union that would protect the new country from the regional strife that had devolved into civil war in the United States. Thus while the US Constitution granted all unenumerated (“residual”) powers to the constituent states, in Canada the residual power would rest with the Crown in right of Canada.

The founding debates do indeed make clear that Canada’s constitutional drafters sought to avoid the civil strife that had afflicted their southern neighbour. However, as historian Paul Romney states, the Fathers of Confederation did not intend to assign residuary powers to the central government. Rather they divided powers between the orders, enumerating a list of assigned powers for each order of government, and rounding each list off with a catch-all category. “In short,” Romney explains, “‘general’ powers were assigned to both legislatures” (Romney, 1999: 99). Thus, the residuary powers in the preamble to the *BNA Act* must be contrasted with the residuary powers granted to the provinces. Just as the general Parliament was given “general” powers “respecting all matters of general character, not especially and

²¹ Some scholars have cited a “third source of authority for government action,” in addition to statutory law and the royal prerogative (see Harris, 1992). In the context of Canada’s federal constitution, however, this source of authority would similarly be subject to the exhaustive division of powers between federal and provincial governments.

exclusively reserved for the Local Governments and Legislatures,” so too were provincial legislatures given “general” jurisdiction over “all matters of a private or local nature, not assigned to the General Parliament.”

As such, the *BNA Act* remedied the weakness of American system by defining powers of both general (i.e., federal) and local (i.e., provincial) legislatures—not by making local legislatures subordinate to the central government (see also Ajzenstat, 2007: 96). As Russell points out, “It would have been ridiculous for the Fathers of Confederation to go to all the trouble of negotiating two lists of powers if all along they intended that some of the powers in the provincial list were ‘not for real’ but were intended to absorbed into federal powers” (Russell, 1986: 533).²²

Fragile Constitutionality

While the validity of the federal spending power may have been the subject of much academic comment, it has only been alluded to by the Supreme Court of Canada in cases past 1937; the question has never been fully debated or examined in that, or any, court. A key reason for this is that the provinces (with the notable exception of Quebec)²³ have seldom objected to—and indeed, frequently encouraged—the use of the federal spending power to increase transfers for education, health and other social programs: “the provincial governments ... do not want to challenge it. Federal spending supports so much of the established political, social and economic structure that prudent men hesitate to take steps that might wipe it out” (Smiley, 1963: 23). Banting notes both levels of government have avoided legal certainty, preferring to negotiate politically than to risk a judicial decision that could alter the status quo: “The negotiated has always seemed safer than the litigated” (Banting, 1988: S84).

²² Russell cites French Canadian newspapers showing how Macdonald’s Quebec colleagues assured French Canadians they would retain significant economic powers.

²³ See Quebec, Secrétariat des Affaires intergouvernementales canadiennes, Directions des politiques institutionnelles et constitutionnelles, Ministère du Conseil exécutif, 1998 for a thorough review of Quebec’s historical objections to the spending power from 1944 to 1998.

While perhaps politically safer, scholars are agreed that the spending power rests on shaky legal grounds. What is, in the words of La Forest “odd,” is that the centralization of power in Ottawa as a result of the exercise of its spending power “was accomplished with little additional judicial support” (LaForest, 1981: 30). In fact, he writes,

[t]he validity of these [redistributive] schemes have never been tested; thus far neither the federal government nor the provinces have demonstrated any inclination to refer them to the courts, and until recently a private individual would probably not have been given standing to question them. (La Forest, 1981: 50)

Thus, in its 1981 submission to the Parliamentary Task Force on the Federal and Provincial Fiscal Arrangements, the Canadian Bar Association described the legality of the federal spending power as “uncertain” (cited in Telford, 2003). Similarly, in one of the few modern judicial decisions to skirt around the question, Justice Lambert of the BC Court of Appeal spoke of the “fragile constitutionality” of the spending power (*Reference re Canada Assistance Plan* (1990)). This “fragile constitutionality” becomes clear in the small number of judicial decisions that have referred to, though not ruled, on the legality of the federal spending power in the post-Privy-Council era.

Challenging the Federal Income Tax Act

One case that addressed, obliquely, the limits of the federal spending power in the post-war era was launched by a private citizen, not a provincial government. In 1988, a taxpayer initiated a challenge to the constitutionality of the *Federal Income Tax Act* (*Winterhaven Stables Ltd. v. The Attorney General of Canada*, (1988)). The reason for the taxpayer’s complaint was that a portion of the monies extracted from him under the *Income Tax Act* were being transferred under federal statutes to the provinces to fund provincial programs in health, welfare, and post-secondary education, all matters within provincial legislative jurisdiction.

There seems to have been no dispute about the facts and the trial judge explicitly found that the federal government was raising money through federal taxes which

was then used for provincial purposes. Nevertheless, the Alberta Court of Appeal upheld the legality of the federal grants to the provinces at issue, concluding that the impugned legislation (i.e., the *Income Tax Act* and the federal statutes authorizing the grants) did not constitute legislation regulating provincial matters:

Parliament ... is entitled to spend the money that it raises through proper exercise of its taxing power in the manner that it chooses to authorize. It can impose conditions on such disposition as long as the conditions do not amount to a regulation or control of a matter outside of federal authority.

This decision appears to contradict binding precedents of the Privy Council that determined federal legislation passed “in relation” to provincial matters was as unconstitutional as legislation actively “regulating these matters” (see discussion of the *Reciprocal Insurer’s* case [1924], above). Nevertheless, the taxpayers’ case was refused leave to appeal to the Supreme Court of Canada,²⁴ leaving the matter open to future challenge. Indeed, reviewing this case, Quebec’s Commission on Fiscal Imbalance concluded: “The federal spending power ... is still not part of this Constitution, unless more weight is given to a decision of the Court of Appeal of Alberta than to all the precedents of the Privy Council and of the Supreme Court” (Quebec, Commission on Fiscal Imbalance, 2002: 16).

References in *Obiter*

While the Supreme Court of Canada has never been directly asked to consider the constitutionality of the federal spending power *per se*, there have been a series of judgments where the Court has considered related matters. One of the most notable cases was a reference initiated by the province of British Columbia to chal-

²⁴ The Supreme Court exercises broad discretionary power to set its own agenda and determine the cases it wishes to hear. Refusal of leave to appeal does not mean that the Supreme Court approves of the result in the case for which appeal is sought.

lenge the constitutionality of cuts to federal transfers for provincial social spending made under the 1966 *Canada Assistance Plan* (CAP) (CAP Reference [1991]).

As part of a broad expenditure reduction plan intended to reduce the federal budget deficit, Parliament enacted a statute that amended the CAP, thereby reducing the amounts payable by the federal government to provinces not eligible for equalization payments.²⁵ Without challenging the prior validity of the federal power to issue grants under CAP, British Columbia charged that the spending legislation had itself given rise to a “legitimate expectation” that CAP payments would continue without amendment. The province of Manitoba, intervening in the case, made an additional argument, suggesting that in order to protect the “overriding principle of federalism” and protect the autonomy of the provinces, the Court had a duty to supervise the federal government’s exercise of its spending power.

The Supreme Court of Canada upheld the federal “cap on CAP” on the the long-standing principle of Parliamentary sovereignty. According to Justice Sopinka writing on behalf of an unanimous Court, no one, including Parliament itself, could prevent Parliament from repealing or amending legislation it itself had enacted.²⁶

With the legal question resolved, Sopinka dismissed Manitoba’s argument about the spending power outright. According to Sopinka:

The Court should not, under the “overriding principle of federalism,” supervise the federal government’s exercise of its spending power in order to protect

²⁵ At the time, these provinces were British Columbia, Alberta, and Ontario. CAP (a federal statute) was repealed in 1995 and replaced by *The Federal Provincial Fiscal Arrangements Act*, the statute under which equalizations payments as well as the Canada Health and Social Transfers (CHT and CST) are now made.

²⁶ Lending further support to the principle of Parliamentary sovereignty, the Supreme Court cited section 42(1) of the *Interpretation Act*, applicable to the CAP and all federal statutes where no contrary intention appears: “Every Act shall be so construed as to reserve to Parliament the power of repealing or amending it, and of revoking, restricting or modifying any power, privilege or advantage thereby vested in or granted to any person” (CAP Reference [1991]: at 29).

the autonomy of the provinces. Supervision of the spending power is not a separate head of judicial review. If a statute is neither *ultra vires* nor contrary to the Canadian *Charter of Rights and Freedoms*, the courts have no jurisdiction to supervise the exercise of legislative power.

While this statement has been interpreted as upholding the legitimacy of the federal spending power,²⁷ Sopinka neither considers the constitutional source of the alleged power nor past precedents such as the aforementioned Privy Council decisions. Significantly, he also failed to consider the constitutional requirement for valid legislation authorizing *all* federal spending, a requirement of the *BNA Act* and the principle explained in the Auckland Harbour case. As Quebec's Commission on Fiscal Imbalance concluded, on the basis of the Sopinka's opinion in the CAP Reference, "it can hardly be concluded that the Court has confirmed the federal power to spend conditionally in spheres of provincial jurisdiction without even discussing the question which incidentally had not been raised before it" (Quebec, Commission on Fiscal Imbalance, 2002: 15).

Another case deserving mention is *Brown v. YMHA Jewish Community Centre of Winnipeg, Inc.*, [1989]. In this case, the court was asked to consider whether provincial wage laws applied to workers participating in a federal job-creation program. The court concluded that provincial minimum wages did apply. In the Court's written decision, Justice L'Heureux-Dubé noted that the federal government's power to create job-creation programs—a matter within provincial jurisdiction—was derived from the federal spending power:

²⁷ For example, after observing that hospital insurance and Medicare programs fall within the exclusive jurisdiction of the provinces in the 1997 *Eldridge* case, the Supreme Court goes on to note: "This has not prevented the federal Parliament from playing a leading role in the provision of free, universal medical care throughout the nation. It has done so by employing its inherent spending power to set national standards for provincial medicare programs ... (The constitutionality of this kind of conditional grant, I note parenthetically, was approved by this Court in *Reference Re Canada Assistance Plan (B.C.)*, [1991] 2 S.C.R. 525, at p. 567.)"

The power to establish these programmes is derived from the federal spending power, but the mere spending of federal money does not bring a matter which is otherwise provincial into federal competence. While Parliament may be free to offer grants, the decision to make a grant of money in any particular area cannot be construed as an intention to regulate all related aspects of that area.

The Court concluded, therefore, that the federal government's power to create job-creation programs was not sufficient to bring the subject into federal competence and exempt the program from valid provincial labour laws. Notably, however, L'Heureux-Dubé herself conceded that her statement was *obiter dicta*.²⁸ Since Sopinka's comment on the spending power in the CAP Reference was also *obiter* and was made in a case where the spending power was not itself the object of litigation, it lacks the binding weight of precedent under the law (see discussion of *R. v. Henry* [2005], above).²⁹

These decisions have done little to settle the "fragile constitutionality" of the federal spending power. As Justice McLachlin noted in *Finlay v. Canada* (Minister of Revenue) [1993], "I have not considered the limits, if any, on the federal spending power. That issue was not raised before us and should, in my view, be left for another day." That day may soon be before us. At least three separate cases have been commenced recently in which the court could be asked to settle long-ignored legal ambiguities about the \$42.3 billion federal tax-and-transfer system that supports Canada's health and welfare system. The government of Saskatchewan has launched a constitutional challenge to changes to the equalization formula used to transfer revenues taxed from all Canadians to

²⁸ Justice L'Heureux-Dubé conceded these remarks were *obiter* at a session of the Association of Comparative Law at McGill University in 1990 (Quebec, Commission on Fiscal Imbalance, 2002).

²⁹ *Angers v. Minister of National Revenue* [1957], in which the Court upheld the validity of the *Family Allowances Act*, and *CMHC v. Co-op College Residences* (Ont CA-1975), in which the Court upheld the validity of federal loans for student housing, are two other cases similarly lacking the weight of precedent.

governments in “have not” province.³⁰ In Ontario and Alberta, meanwhile, private citizens are using the Canadian *Charter of Rights and Freedoms* to strike down the government’s ban on private health insurance.³¹ While these cases also raise important questions about the legality of the federal government’s “spending power,” they do not challenge it directly.

Limiting the Spending Power

There is good reason for ordinary citizens to be concerned about the supraconstitutional development of the federal spending power in Canada. As Marc-Antoine Adam recently noted, “without a sound legal basis, the management of Canada’s social union is condemned to remain in the lawless realm of raw politics” (Adam, 2007: 32–33). In addition to violating the rule of law, this *de facto* redistribution of power has undermined the federal nature of Canada as a country by letting national majorities override regional majorities in dictating social and economic priorities. As Prime Minister Wilfred Laurier cautioned in 1889, “The only means of maintaining Confederation is to recognize that, within its sphere assigned to it by the Constitution, each province is independent of control by the federal Parliament as the latter is from control by the provincial legislatures” (quoted in Cairns, 1971: 323; see also Trudeau, 1957).

By trading in their fiscal and policy autonomy for greater revenue, provincial government find themselves in what Stanford University Professors Maite Careaga and Barry Weingast have called “fiscal pacts with the devil.” These pacts ultimately “benefit politicians, who gain more revenue to distribute according to political criteria, but harm citizen welfare” by favouring corruption and rent seeking over public goods that foster growth (Careaga and Weingast, 2000: 4). In this way, the *de facto* redistribution of legislative authority also has

the effect of transferring power away from the electorate to political elites. As Smiley observed over a generation ago, “we have evolved into a situation where action of the provincial and federal executives has in respect to many important matters superseded formal constitutional arrangements in delineating the respective roles of the two levels of government” (Smiley, 1965: 86).

This power makes it difficult for citizens to attribute political responsibility to one or the other level of government, thus breaking the bond of accountability required for responsible government—a founding principle of Canada’s parliamentary system. “An electorate that cannot attribute political responsibility to one order of government or the other,” notes Petter, “lacks both the ability to express its political will and the assurance that its will can be translated into action” (Petter, 1989). Rather than shifting political responsibility from one level of government to the other, the federal spending power blurs the lines of accountability of both. This breakdown of the division of legislative powers contributes to Canadian’s lack of confidence in national politics (see Ajzenstat, 2007: 99).

³⁰ Saskatchewan set out their terms of reference in June 2007.

³¹ Last spring (2007), Lindsay McCreith launched a constitutional challenge against Ontario’s government ban on private medical. Bill Murray filed his class-action lawsuit over Alberta’s ban on private medical insurance in September 2006.

Conclusion

The rebalancing of federal-provincial powers through the exercise of the federal spending power is considered one of Canada's great constitutional oddities, an opinion shared by those judges and legal academics who applaud it and those who do not. As Donald Smiley observed over a generation ago:

It is striking that federal involvement in a very great range of matters within the legislative jurisdiction of the provinces has not been accomplished by large-scale transfers of legislative power to Parliament either by constitutional amendment or changing patterns of judicial review. (Smiley, 1965: 85)

The use of the federal spending power is in direct contradiction to the intentions of Canada's founding fathers, the written word of the Constitution, and the definitive precedents of the Privy Council. Parliament should withdraw from areas of provincial jurisdiction, or seek a constitutional amendment, as it did after the federal Unemployment Insurance schemes was judged illegal in 1937, that would bring current political practices in line with Canada's foundational law and principles. The rule of law is to be observed in practice. It should not be treated as an empty slogan.

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About the Authors

Burton H. Kellock

Burton H. Kellock is a Partner Emeritus with Blake, Casels, & Graydon LLP. He completed his Bachelors degree at McMaster University in 1955 and his LL.B. at the University of Toronto in 1958. He was called to the Ontario Bar in 1960, appointed a Queen's Counsel in 1972, and certified as a Specialist in Civil Litigation in 1988. He has completed a number of major papers for organizations including the Canadian Bar Association and the Law Society of Upper Canada. He has over 40 years of civil and administrative legal experience and has appeared in every court in which he is entitled to practise in Ontario, including the Supreme Court of Canada, the Federal Court of Canada, and the Ontario Court of Appeal. He has also appeared before a number of federal and provincial administrative tribunals such as the Ontario and National Energy Boards, the Tariff Board, and the Ontario Municipal Board. Mr Kellock is currently working on a full-length book on the legality of the federal spending power.

Sylvia LeRoy

Sylvia LeRoy holds an Honours B.A. in Political Science from the University of Western Ontario and an M.A. in Political Science from the University of Calgary. In 2001, she joined The Fraser Institute, where her publications include *Questioning the Legality of Equalization* (2006), *Can Markets Save Canada's National Parks?* (2005), *Non-Profit Performance Report* (2002, 2003, 2004, 2005), *Welfare Reform in Ontario: A Report Card* (2004), *Tax and Expenditure Limitations: The Next Step in Fiscal Responsibility* (2004), and *Judicial Accountability in Canada* (2003). She is a regular contributor to The Fraser Institute's monthly journal, *Fraser Forum*, and has published articles on social, legal, and environmental issues in newspapers across Canada. Since 2003, she has managed the Donner Canadian Foundation Awards for Excellence in the Delivery of Social Services (Donner Awards), which evaluates non-profit management and service delivery objectively.

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