Fraser Institute Digital Publication
December 2006

Questioning the Legality of Equalization

Burton H. Kellock, Q.C. and Sylvia LeRoy

Executive summary

Questioning the legality of equalization

The inclusion of a commitment to equalization in the *Constitution Act, 1982* has led politicians, lawyers, economists, and citizens alike to argue that a federal program transferring money from all Canadian citizens to the governments of some "have not" provinces is a constitutional imperative. This argument is based on faulty assumptions about (1) the legal significance of the Constitution's equalization provisions, and (2) the federal government's power to fund spending in areas of exclusive jurisdiction.

1 Equalization in the *Constitution*

Scholars considering the legality of equalization have concluded that the commitment to "the principle of making equalization payments" included in section 36(2) of the *Constitution Act, 1982* lacks the clear legal language needed for judicial review or enforcement. Any court asked to consider the matter would have to be mindful of its duty to interpret the law and leave political matters to Parliament and the legislatures who have the technical expertise, institutional capacity, and democratic mandate to debate them properly.

Framers' intent

The non-justiciability of the Constitution's equalization provisions is supported by the documented intentions of the federal and provincial governments that debated and ultimately agreed to include equalization in the *Constitution Act, 1982*. Far from committing themselves to a legally binding obligation to fund a certain level of transfers, the signatories to the 1982 constitutional deal believed that the mechanism and details of equalization were left open to negotiation. Attempts to strengthen the Constitution's equalization provisions in the *1992 Charlottetown Accord* were defeated by popular referendum along with the entire package of amendments, suggesting that the fulfillment of the government's commitment to equalization is a matter on which only the court of public opinion, not a court of law, can render judgment.

2 Constitutional division of powers

Debate over the specific requirements of the Constitution's commitment to equalization ignores a more fundamental issue: equalization uses federal revenues to fund spending in areas of provincial jurisdiction. This "federal spending power" conflicts with the division of powers between federal and provincial governments delineated in section 91 and 92 of the *British North America (BNA) Act, 1867* (since renamed the *Constitution Act, 1867*), a core principle upon which Canada was founded. Specifically, while section 91 gives the federal government broad powers of taxation, these tax revenues may not be directed to matters that fall within the areas of provincial jurisdiction described in section 92.

Constitutional authority for federal-provincial grants

The single exception to the stipulation that only provinces may raise revenue for provincial purposes can be found in section 118 of the *BNA Act* (now amended as per the *Constitution Act, 1907*), which narrowly authorized the federal government to pay the provinces fixed annual grants "in full Settlement of all future Demands on Canada" (*BNA Act, 1867*). The precise language of these now-exhausted subsidy provisions lies in sharp contrast to the ambiguity of the 1982 Constitution's equalization provisions, emphasizing the framers' intent to restrict the scope of the federal spending power to the specific terms and conditions that were actually written into the Constitution.

This division of powers was supported by a definitive series of judicial decisions issued in the 1930s by the Judicial Committee of the Privy Council (then Canada's highest court of appeal) that recognized federal funding of programs in relation to matters within provincial jurisdiction required formal constitutional amendment.

The legality of the "federal spending power"

Despite these binding precedents, today the federal government operates under a host of statutes that it itself enacted to exercise its spending power, including the *Federal-Provincial Fiscal Arrangements Act*, *Canada Health Act*, *Provincial Subsidies Act*, and many more. The validity of the federal spending power implicit in this legislation has been alluded to by the Supreme Court of Canada but never fully debated or examined. This leaves the broader constitutionality of the federal spending power, and other federal-provincial transfer programs, open to future challenge.

Introduction

The inclusion of a commitment to equalization in the *Constitution Act, 1982* has led politicians, lawyers, economists, and citizens alike to assume that a federal program transferring money from all Canadian citizens to the governments of some "have not" provinces is a constitutional imperative. This assumption has been used both to justify the redistributive system and to oppose any changes that might limit the amount of the transfers made through the federal program. Before the costs (now nearly $11 billion per year) and benefits of equalization are considered, the basic legal arguments that have supported the program deserve careful scrutiny.

This study uncovers two seldom-discussed problems. First, there is consensus that Canada's constitutional commitment to equalization cannot be enforced by a court of law. Insofar as the commitment is a vague expression of political goals, the action that governments must take to fulfill it is open to debate. Second, this debate over the specific requirements of the Constitution's equalization commitment ignores a more fundamental issue: equalization uses federal revenues to fund spending in areas of provincial jurisdiction. As a result, its legality cannot be resolved without considering the larger question of the federal government's spending power.

Section one of the study examines the narrow question of equalization as it is included in section 36 of the *Constitution Act, 1982*, reviewing both published scholarly opinion and the original intentions of the Constitution's drafters. Section two addresses the broader question of the federal spending power in the light of the division of legislative powers between the federal and provincial governments enshrined in Canada's founding Constitution, the *British North America Act, 1867* (*BNA Act*). This division of powers, reinforced by early decisions of Canada's highest courts of appeal, poses a direct challenge to both the federal spending power and Canada's equalization program.

1 Equalization in the Constitution

A basic assumption is made, even by those who oppose equalization, that such payments are required under the Canadian Constitution and, accordingly, that any attempt to limit or suspend these payments can be prevented by a court of law. This assumption is based on the inclusion of a section in the *Constitution Act, 1982* pertaining to "equalization and regional disparities." Specifically, section 36(2) states: "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."

It is clear that the target recipients of the payments are provincial governments rather than individual citizens. The stated aim of equalization is to give governments resources (*i.e.* revenues) to spend on providing "comparable levels of public services," presumably services such as healthcare and education as distinct from individual income assistance. How these government-to-government transfer payments are to be made, or these services provided, is not specified. Insofar as these services are provided universally, this leaves open the possibility that income may be taxed from poor citizens in rich provinces to pay for services benefiting rich citizens in poor provinces (Hogg, 2000: ch. 6.6, 155; Usher, 1995; Poschmann, 1998). [1]

To confuse the issue further, section 36(2) is riddled with non-specific terms. For instance, Parliament and the government of Canada are committed to the "principle," not the practice, of making equalization payments, and no threshold is provided to clarify what level of services or taxation is considered either "reasonable" or "comparable." The ambiguity of these terms raises questions as to their legal significance and invites competing interpretations of their practical application.

Scholarly consensus: Equalization is non-justiciable

Scholars considering the question have concluded that the equalization provisions lack the clear legal language needed for judicial review [2] or enforcement. As University of Alberta law professor, Dale Gibson, has observed: "… it could be contended that because s. 36(2) contains no reference to legislative jurisdiction, and employs soft terms like

[1] For example, Poschmann (1998) found that an Alberta family with an income of $30,000–$40,000 contributed 9% to federal programs in 1997 but a Newfoundland family earning over $100,000 received benefits equivalent to 1.2% of their income.

[2] Judicial review refers to the power of courts to review and strike down or declare invalid government legislation, regulations, or behavior that conflicts with the supreme law of the Constitution.

"committed" and "principle" rather than power-granting expressions like "may make laws," it was not intended to have any direct legal effect" (Gibson, 1996). The ambiguity of these terms has contributed to a consensus amongst academics that "the constitutional obligation to make adequate equalization payments to the poorer provinces is probably too vague, and too political, to be justiciable" (Hogg, 2000: ch. 6.6, 156; see also Brown, 2002: 116; Milne, 1998: 176; Sossin, 1998). [3] The implication of the ambiguity in section 36(2) is considerable: it means that a court cannot legitimately decide that section 36(2) imposes any definite or specific obligations on either the federal government or the provinces.

While ambiguity in constitutional law or language has not always dissuaded Courts from venturing their opinion, such judicial interventions on matters widely deemed "political" can pose a serious threat to the Supreme Court's perceived legitimacy in a liberal democratic society. This has been referred to as the "counter-majoritarian difficulty" of judicial review (for further discussion, see Bickel, 1962; Manfredi, 1992). For this reason, even when such "political" questions have passed the initial test of justiciability, the Supreme Court has used great creativity to avoid answering definitively. To cite but one well-known example, when asked questions concerning the legality of Quebec secession—a matter upon which the Constitution was conspicuously silent—the Supreme Court left the matter open by inventing a "duty to negotiate" secession after a "clear majority" had voted affirmatively to a "clear question" on the subject (*Reference Re Secession of Quebec* [1998]). This did not resolve the issue: as Peter Hogg would later write, "it is not entirely clear why it [the duty to negotiate] is a legal rule, since it appears to have no legal sanctions" (Hogg, 1999; see also Walters, 1999: 389; Newman, 2001: 17, note 44). This ultimately deflected the matter back to the political arena for resolution.

While equalization appears in the written Constitution, its ambiguity and political nature nevertheless make it a constitutional oddity, its legal significance "one of the most puzzling parts of the *Constitution Act, 1982*" (Gibson, 1996: ¶69). Professor Peter Hogg, former Dean of Osgoode Hall Law School and one of Canada's leading constitutional scholars, characterizes equalization as "statements of economic and social goals that ought to guide government but which are not enforceable in court" and likens the commitment to equalization in section 36(2) with the "directive principles of state policy" in the Constitution of India, which are also non-justiciable (Hogg, 2000: ch. 6.6, 156). [4] At most, equalization payments may have assumed some of the characteristics of a constitutional convention, in that it is a practice widely acknowledged and accepted by political actors, but is unenforceable by courts as a matter of law. [5]

[3] Sossin (1998) refers to this as the "conventional view."

[4] The effect these principles in the Indian Constitution is discussed in Aikman, 1987.

[5] Eugene Forsey expressed the common view when he described conventions as "first and foremost … political: political in their birth, political in their growth and decay, and political in their application and sanctions. In politics they live and move and have their being" (Forsey, 1984:13). The unenforceability of conventions has also been affirmed by the Supreme Court of Canada (*Patriation Reference* [1981]).

This makes equalization a political, not a legal issue, and any court asked to consider the matter would have to be cognizant of its "proper role within the constitutional framework of our democratic form of government" (*CAP Reference* [1991] at p. 545; *Reference Re Secession of Quebec* [1998] at para. 26). The proper role of the Court is to interpret the law and leave political matters—particularly decisions concerning the allocation of scarce tax dollars—to Parliament and the legislatures who have the technical expertise, institutional capacity, and democratic mandate to debate them properly.

Framers' intent

Additional insight can be gained by examining the intentions of the federal and provincial governments that debated and ultimately agreed to include equalization in the *Constitution Act, 1982*. Transcripts from the Federal-Provincial Conference of First Ministers on the Constitution in 1980 casts light on these intentions.

According to Michael Trebilcock, now chair in Law and Economics at the University of Toronto's Faculty of Law, who with Tanya Lee examined these documents, the principle or legitimacy of equalization was not questioned by the governments considering the matter. Notably, however, the transcripts from the First Ministers Conference also indicated that: "… it is clear that the governments believed that the mechanism and details of equalization were open to negotiation. Therefore, section 36(2) could only be seen to be violated where the principle of equalization, not merely the existing mechanism, has been abandoned by the federal government" (Lee and Trebilcock, 1987: 308). [6] This intention is also apparent in the preamble to section 36, which stipulates that Parliament's commitment to the principle of equalization was to be fulfilled "[w]ithout 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." Lorne Sossin, Associate Dean at the University of Toronto Faculty of Law, explains: "… the preamble makes clear that the federal and provincial governments are 'committed' to the goals set out in the section, not bound to achieve those goals. A 'commitment' can be expressed in many ways" (Sossin, 1998). [7]

[6] See Government of Saskatchewan, 1980: 443–71 for further discussion. Notably, Lee and Trebilcock (1987) also assume the legality of the federal spending power.

[7] As an example, Sossin suggests that Canada's commitment to the section 36(1)'s goals of promoting equal opportunities, reducing disparity by furthering economic development, and providing essential public services of "reasonable quality," could arguably be satisfied by provisions of the Canada Health and Social Transfer (CHST) providing a mechanism to develop shared principles (Sossin, 1998).

Professor Hogg has noted, for instance, that federal contributions to shared-cost programs are "implicit equalization" insofar as the per-capita formula for federal financing of post-secondary education, hospital insurance, and medicare work to the benefit of have-not provinces who have both lower tax yields and less costly hospitals and universities (Hogg, 2000: ch. 6.8(a), 163, note 40). As such, the per-capita bloc grants provided through the Canada Health and Social Transfers (CHT and CST) could be construed as fulfilling Canada's section 36(2) commitment "to the principle of making equalization payments." If federal and provincial governments wish to be bound by a particular formula or schedule of payments that will realize the principle of equalization, this intention would have to be given concrete expression through a properly ratified constitutional amendment.

Attempted constitutional change: The 1992 Charlottetown Accord

Interestingly, a strengthened constitutional commitment to equalization was the objective of some provincial governments negotiating the package of amendments known as the 1992 Charlottetown Accord. After great debate over the meaning of the 1982 Constitution's equalization provisions, and the potential (or lack thereof) for judicial supervision and enforcement, the final text of the *Consensus Report on the Constitution* moved to amend section 36(2) to read: "Parliament and the Government of Canada are committed to making equalization payments so that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation" (Canada, Privy Council Office, 1992). In other words, rather than being merely "committed to the *principle* of making equalization payments" (*Constitution Act, 1982*; emphasis added), Parliament would thereafter be actually "committed to *making* equalization payments" (Canada, Privy Council Office, 1992, emphasis added). [8] While this attempt to strengthen section 36(2) was defeated along with the entire package of amendments in a national referendum, the attempt illustrates the consensus that formal constitutional amendment would be needed before the equalization provisions could be enforced.

[8] Thanks to Dr. J. Peter Meekison for drawing attention to this legislative history. Dr. Meekison is University Professor Emeritus of Political Science of the University of Alberta. From 1974 to 1984 he served with Alberta Federal and Intergovernmental Affairs, seven and one-half of those years as Deputy Minister. During the constitutional negotiations of 1978–1981, Dr. Meekison developed and prepared the formula, tabled by Alberta, that ultimately became the amending formula in the *Constitution Act, 1982*. As constitutional adviser to the Alberta government, he was actively involved in discussions of the Meech Lake Accord as well as the discussions leading to the 1992 Charlottetown Accord (committee co-chair).

In summary, despite the assumption that any change to Canada's equalization system must pass judicial review for compliance with section 36(2) of the Constitution, there is broad agreement among legal scholars that this provision cannot be enforced in a court of law. The historical record reveals that this consensus opinion was shared by the provincial governments that ratified the *Constitution Act, 1982*, and that drafted a strengthened equalization clause in an attempt to remedy this legal deficiency in the Charlottetown Accord a decade later. This suggests that the fulfillment of the government's commitment to equalization is a matter on which only the court of public opinion, not a court of law, can render judgment. [9]

[9] While there are instances where the Supreme Court has "read in" new legal rules and rights that expressly conflict with legislative intent and written law (see for example Vriend v. Alberta [1998]; and Delgamuukw v. British Columbia [1997]), this practice is highly controversial and opens the Court to charges of judicial activism.

2 Constitutional division of powers

There is, however, the broader issue of whether the federal government even has the constitutional authority to collect federal taxes (revenues) and transfer those resources to provinces to spend in areas of their exclusive responsibility. The division of powers between the federal and provincial governments delineated in sections 91 and 92 of the *BNA Act, 1867* (since renamed the *Constitution Act, 1867*) was a core principle upon which Canada was founded (Vipond, 1991: 35; see also Romney, 1999; Ajzenstat *et al.*, 1999: 261–326). In agreeing to a common Constitution, the founding fathers agreed that Parliament and the legislatures of each province would each have "exclusive" power to legislate in their respective spheres of jurisdiction. The boundaries of this jurisdiction would be policed by a neutral arbiter, namely courts with 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 defined in sections 91 and 92.

Section 91 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 listed specific matters that were to fall within federal jurisdiction. In all, 29 classes of subjects were listed, including exclusively "the public debt and property," "the regulation of trade and commerce," and "the raising of money by any mode or system of taxation." [10]

While these federal powers of taxation may seem broad, there are clear limits to the purposes towards which these tax revenues may be directed. While all taxes and expenditures (federal or provincial) require legislative authority, [11] the *BNA Act* stipulates that "[i]n each Province the Legislature may *exclusively* make Laws in relation to Matters coming within the Classes of Subjects" enumerated in section 92 (emphasis added). Specifically, this section of the constitution gives provinces exclusive jurisdiction to use direct taxes to raise "revenue for provincial purposes," which include "the establishment, maintenance, and management of hospitals," "property and civil rights in the province," and "generally all matters of a merely local or private nature in the province." [12]

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

[11] 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 was subject to the rule of law but also that the executive branch would have to call the legislative branch into session to both raise taxes and distribute appropriations.

[12] The *Constitution Act, 1982* extended this jurisdiction to include the exploration, development, conservation, management, and taxation of "non-renewable natural resources, forestry resources and electrical energy" (section 92A).

Canada's highest court of appeal would later clarify the limits imposed by this division of powers, explaining: "… assuming that the Dominion has collected by means of taxation a fund, it by no means follows that any legislation which disposes of it is necessarily within Dominion competence … To hold otherwise would afford the Dominion easy passage into Provincial domain" (*Unemployment Insurance Case* [1937]). Thus, any federal expenditures authorized by legislation "in relation" to matters that fall within the scope of subjects enumerated in section 92 necessarily conflicts with the higher law of the Constitution. As Pierre Trudeau wrote in 1957 (before entering political life), "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, 1968: 81). The same principle, he argued, applied to equalization grants. [13]

Constitutional authority for federal-provincial grants

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 new 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." [14]

The precise language used to authorize the transfer payments in section 118 of the *BNA Act* stands in sharp contrast to the ambiguity of the equalization provision

[13] 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). He changed his mind on both equalization and the federal spending power only after assuming federal office (see Trudeau, 1969).

[14] Section 119 provided an additional grant to the province of New Brunswick, while section 120 elaborated on the form of payment of the grants under sections 118 and 119. Supporters of the legality of equalization payments (and other conditional and unconditional grants by the federal government to the provinces) have relied on the provisions of the *BNA Act*'s section 106, which authorizes payments "for the public service" to be made out of the federal consolidated revenue fund. While this has been used to justify the use of money obtained by taxes imposed for the purpose of supporting a wide range of public services that fall within provincial jurisdiction (*i.e.* health, education, and social services), in 1867 the phrase "the public service" was understood to mean the civil service. It is therefore not arguable that section 106, even if it stood alone, could authorize grants from the federal government to the provinces.

in the *Constitution Act, 1982*. This 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 sought to ensure that the grants under section 118 "shall 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. In sharp contrast, the historical record suggests that it was the intention of the drafters of the *Constitution Act, 1982* to leave the interpretation and application of section 36(2) to the discretion of political actors. [15]

When the Prime Minister John A. MacDonald tried to use his prerogative to unilaterally offer "better terms" (*i.e.* increased subsidies) to Nova Scotia shortly after Confederation, the opposition pointed to the clear terms explicitly written into section 118 and argued it would take a formal constitutional amendment to alter the terms of the 1867 deal (Vipond, 1991: 41–44). [16] 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 a vote in the House of Commons, Parliament would later recognize the need for formal constitutional amendment to end what Blake had rightly predicted would be "a general scramble for more money and increased subsidies 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" of provincial subsidies (Ollivier, 1943: 81). [17] 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,

[15] The narrow limits of section 118 also 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 in the same era as the *BNA Act*. 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).

[16] MacDonald's offer of "better terms" for Nova Scotia was 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).

[17] The British Parliament retained final authority over any amendments to Canada's Constitution until it was repatriated in 1982.

and sought by consultation with the provinces and by utilizing the formal method of amendment, to give some degree of permanence to the arrangement" (Ollivier, 1943: 79).

While the words "final and unalterable settlement" were omitted from the final amendment to section 118 of the *BNA Act* (passed as the *Constitution Act, 1907*), as it stands today, the amendment caps the grants the federal government is permitted to make to each province outside the division of powers in sections 91 and 92. The maximum, based on population, is $240,000 per year plus: "… a grant at the rate of eighty cents per head of the population of the province up to the number of five hundred thousand and at the rate of sixty cents per head of so much of the population as exceeds that number" (*Constitution Act, 1907*: section 1 (1)). Once again, the precise language of 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* (now amended as per the *Constitution Act, 1907*), Canada's founding fathers intended that the subject matter would be exhausted. [18]

This restriction is 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*. [19] Within this schedule of Acts and orders, only the *Constitution Act, 1907* provides a clear authority for federal grants to the provinces. Additional grants—including payments in furtherance of a federal equalization scheme—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*.

The legality of the federal "spending power"

Despite the intended finality of the 1907 amendment to the "grant in aid" provision of the *BNA Act*, by 1935, as Skelton observed, "revision of the terms then granted ha[d] proceeded apace without formal amendments and without incidentally the consent of

[18] This interpretation is supported by the old legal maxim which says, "*expressio unios est exclusio alterius*" or "the expression of one thing is the exclusion of another." This maxim holds, notwithstanding section 1(7) of the *Constitution Act, 1907*, 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." Far from suggesting a broad spending power, the additional grants implied by this section logically refer to the further grant to New Brunswick explicitly authorized by section 119 of the *BNA Act*, or any section 118 grants the federal government might have failed to pay.

[19] *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>.

all of the provinces" (Ollivier, 1943: 79–82). [20] Today, the federal government operates under a host of statutes that it itself has enacted to exercise its spending power, including the *Federal-Provincial Fiscal Arrangements Act*, *Canada Health Act*, *Provincial Subsidies Act*, and many more. This federal "spending power," while not defined in either the Constitution or any statute, [21] has crept into use as "[t]he power of Parliament to make payments to people or institutions or governments for purposes on which it (Parliament) does not have the power to legislate" (Driedger, 1981: 124: see also Trudeau, 1969). The regularity of its use has prompted Thomas Courchene, one of the country's foremost economists, to observe that "the magnitude and nature of intergovernmental cash and tax transfers [are] essentially *de facto* redistributions of power under the Constitution" (Courchene, 1985: 4). [22]

Arguably, this has done nothing to enhance the federal nature of Canada as a country. As observed by Andrew Petter (1989), now Dean of Law at the University of Victoria, the federal spending power runs counter to the principles of federalism insofar as it lets national majorities override regional majorities in dictating social and economic priorities. In addition, this power makes it difficult for citizens to attribute political responsibility to one or the other level of government, thus breaking the thread of accountability required for responsible government—a core convention of Canada's parliamentary system.

For years, Canada's courts were careful to guard against this *de facto* redistribution of power. There are a number of early historical examples whereby Canadian courts and legislators alike recognized the constitutional limits on the federal government and the perils of deviating from the constitution (for example, *Bank of Toronto v. Lambe* (1887); *Caron v. R.* [1924]; *Re: the Insurance Act of Canada* (1932)). The definitive precedents

[20] Skelton recounts the observations of Mr. J.A. Maxwell that "in the sixty 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*" (Ollivier, 1943: 82).

[21] Driedger observed: "I have been unable to find the expression "spending power" in any Canadian judicial decision or statute" (Driedger, 1981: 124)

[22] Illegal practice—even if it was adopted by governments and engaged in for years—cannot make the practice legal. That this cannot be the law is laid down in the most recent edition of *Halsbury's Laws of England,* (4th): "A usage must be legal. No usage however extensive will be allowed to prevail if it is directly opposed to positive law which for this purpose includes such universal usages as having been sanctioned by the courts have become by that adoption part of the common law, for to give effect to a usage which involves a defiance of law would be obviously contrary to fundamental principle." Even if the practice were considered a constitutional convention, it would be unenforceable by a court of law (see footnote 5).

on the legality of federal grants to the provinces came from a series of Privy Council judgments in the so-called "New Deal" cases.

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. These statutes were enacted to implement draft conventions adopted by the international labour organization of the League of Nations in accordance with the labour part of the *Treaty of Versailles, 1919.* While the treaty had been ratified by the federal government, the Privy Council held that all of these statutes were beyond the powers of Parliament because each was related to matters reserved to the jurisdiction of the provinces by the *BNA Act.* The Privy Council said: "… the Dominion cannot merely by making promises to foreign countries, clothe itself with legislative authority inconsistent with the Constitution which gave it birth … While the ship of state now sails on larger ventures and into foreign waters, she still retains the water-tight compartments which are an essential part of her original structure" (*Labour Conventions Case* [1937]).

The reference to "water-tight compartments" refers to the provisions of the *BNA Act* that made Canada a federal state. These provisions were intended to prevent the federal government on the one hand, and the legislatures of the provinces on the other, from trespassing on each others assigned areas of jurisdiction. [23] The *BNA Act*, including sections 91 and 92, remain an essential part of Canada's Constitution and can only be changed by lawful amendment. [24]

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[23] Over the years there have been a number of law professors and some judges who have expressed dissatisfaction with the division of powers specified in the *BNA Act* and have argued that the Privy Council's water-tight compartment statement should be regarded as narrow and inflexible and should no longer be applied (for further discussion of these criticisms see Cairns, 1971). The answer to that is that the *BNA Act* was the Constitution of Canada in 1867 and it remains part of the current Constitution. In addition, the water-tight compartment statement is a statement of the law laid down by the highest court of appeal for Canada. The Privy Council judgments upholding this clear division of powers have not been altered explicitly by legislation, constitutional amendment or subsequent judicial decisions (Yudin, 2002). Its effect could have been mitigated or obliterated in the process leading up to the repatriation of the Canadian Constitution in 1982 but it was not.

[24] In contrast to the view of federalism as consisting in "water-tight compartments," supporters of a "progressive" approach to interpreting the Constitution cite Lord Sankey's celebrated opinion in the 1930 *Persons Case* that "The British North America Act planted in Canada a living tree capable of growth and expansion within its natural limits." This was not intended to undermine the sharp division of powers afforded either level of government in sections 91 and 92 of the *BNA Act.* Sankey added: "Their Lordships do not conceive it to be the duty of this Board—it is certainly not their desire—to cut down the provisions of the Act by a narrow and technical construction, but rather to give it a large and liberal interpretation so that the Dominion to a great extent, but within certain fixed limits, may be mistress in her own house, *as the Provinces to a great extent, but within certain fixed limits, are mistresses in theirs*" (emphasis added).

The related *Unemployment Insurance Case* [1937] prompted such an amendment. In this case, the Privy Council held that the federal legislation that provided for a system of compulsory unemployment insurance throughout Canada was beyond the powers of Parliament because it concerned property and civil rights, assigned by section 92(13) of the *BNA Act* to the exclusive legislative jurisdiction of the provinces. In the words of the Court: "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" (*Unemployment Insurance Case* [1937]). As a result of this judgment, a constitutional amendment (now section 91(2A) of the Constitution) had to be passed before Parliament could proceed with its plan for unemployment insurance. [25]

This amendment would not have been necessary if statutes passed in the purported exercise of the federal spending power (such as the *Federal-Provincial Fiscal Arrangements Act* that enables the equalization program) were valid federal legislation. Accordly, any other federal-provincial transfer program (and its enabling legislation) that uses federal tax revenues for provincial purposes—including equalization payments 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. [26] Section 36, which stipulates Canada's commitment to equalization will be fulfilled "without altering the legislative authority of Parliament or of the provincial legislatures" does not constitute such an amendment.

Recent challenges

The validity of the federal spending power has been alluded to by the Supreme Court of Canada but never fully debated or examined. A key reason for this is that the provinces (with the notable exception of Quebec) 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. Unfortunately, by trading in their fiscal and policy autonomy for greater revenue, subnational governments

[25] A similar amendment was required prior to the introduction of an old-age pension scheme in 1951 (section 94A).

[26] While beyond the scope of this discussion, all federal transfers and related legislation, from the Canada Health Transfer (CHT) and *Canada Health Act* to the Canada Social Transfer (CST) that support provincial welfare, education, and child-care spending would fail this test, whether granted conditionally (as is the CHT) or unconditionally. This serious constitutional challenge to the federal spending power will be dealt with at length in a study to be published by The Fraser Institute in early 2007.

find themselves in what Professors Maite Careaga and Barry Weingast of Stanford University have called "fiscal pacts with the devil" that "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).

As a result of these political incentives, it took a private citizen, not a provincial government, to launch the first and only constitutional challenge of the federal spending power. In 1988, a taxpayer initiated a challenge of 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 that was then used for provincial purposes. Nevertheless, the Alberta Court of Appeal seemed unaware of the Privy Council precedents and upheld the legality of the federal provincial grants at issue, concluding that the impugned legislation (*i.e.* the *Income Tax Act* and the federal statutes authorizing the grants) did not constitute legislation "in relation to provincial matters." The taxpayers' case was refused leave to appeal to the Supreme Court of Canada, [27] leaving the matter open to future challenge. [28]

Can federal transfers be unilaterally reduced?

While the Supreme Court of Canada has never been directly asked to consider the constitutionality of the federal spending power, in the 1990s it was asked whether the federal power to *reduce* grants made to the provinces infringed provincial jurisdiction. The reference case was initiated when British Columbia challenged the constitutionality of cuts to federal transfers for provincial social spending made under the 1966 *Canada Assistance Plan* (CAP). As part of a broad plan to reduce expenditures and, thereby, the federal budget deficit, Parliament had enacted a statute

[27] The Supreme Court exercises broad discretionary power to set its own agenda and determine the cases it wishes to hear. Not granting leave allows the lower court decisions to stand until overturned by a higher court.

[28] Reviewing this case law, 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).

that amended the CAP to reduce the amounts payable by the federal government to provinces not eligible for equalization payments. [29]

The Supreme Court of Canada upheld the ability of the federal government to reduce its payments to the provinces (*CAP Reference* [1991]). Relying on the long-standing principle of Parliamentary sovereignty, the Court held that no one, including Parliament itself, could prevent Parliament from repealing or amending legislation it itself had enacted. [30] While Manitoba attempted to argue that Parliament could interfere in the provincial arena by enacting the CAP but could not then repeal or amend it, the Court concluded that "[t]he simple withholding of federal money which had previously been granted to fund a matter within provincial jurisdiction does not amount to the regulation of that matter." [31]

Relevance to equalization

This prompts two observations that are directly relevant to the legality of equalization. First, if by providing money to provinces for purposes reserved to their original jurisdiction the *Canada Assistance Plan* was beyond the authority of Parliament under the *BNA Act*, then the CAP was invalid when enacted in 1966, and would still be invalid in 1991 when the case reached the Supreme Court of Canada. The validity of the amendment reducing payments made under CAP would be moot or irrelevant. The same logic holds true for equalization: if the federal transfer program was beyond the powers of Parliament when first initiated, it would also be invalid when the equalization commitment was drafted into the *Constitution Act, 1982*.

[29] 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.

[30] 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 p. 29).

[31] As indicated, the basis for the decision of the Supreme Court of Canada in the *CAP Reference* was Parliamentary sovereignty, and this additional comment is of the sort known in law as *"obiter dicta."* While technically judges deciding cases in the future are entitled to look at *obiter dicta* but not obliged to follow them, the Supreme Court of Canada has purported to lay it down that anything the Supreme Court of Canada says whether *obiter* or not is to be followed by all other courts in Canada (*R. V. Henry* [2005], at para 638).

Second, the provisions of sections 91 and 92 of the *BNA Act* do not divide jurisdiction between the federal government and the provincial legislatures on the basis of the "regulation" of subject matter. The dividing line is whether or not a law is "in relation to" subject matters reserved exclusively to Parliament or reserved exclusively to the provincial legislatures. Even if federal equalization grants do not amount to regulation of the public services falling within provincial jurisdiction, they are most certainly granted "in relation" to these provincial matters, and as such run afoul the Constitution. The constitutionality of any changes or reductions to these payments would be irrelevant because the payments themselves would have been invalid. Because the Supreme Court disposed of the *CAP Reference* on the issue of Parliamentary sovereignty alone and failed to consider the broader constitutionality of the federal spending power, the matter remains open to future challenge.

Conclusion

The assumptions concerning the legal requirements of equalization made in the past do not stand up to scrutiny for two key reasons. First, insofar as the Constitution's equalization provisions represent a vague expression of political goals, constitutional scholars are in broad agreement that they cannot be enforced by a court of law. How these political goals are to be achieved is left entirely to the discretion of Parliament and the legislatures; should these political actors reach an impasse in their negotiations, the Constitution provides no guide as to what level of public services, taxes, or equalization payments might be "reasonable", "comparable," or "sufficient." Second—and more fundamentally—because equalization uses federal tax revenues to fund spending in areas of exclusive provincial jurisdiction, the entire equalization program falls beyond the powers of Parliament as defined by Canada's founding Constitution, the *British North America Act, 1867* (*BNA Act*). While beyond the scope of this discussion, this has serious implications for other federal-provincial transfer programs.

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About the authors

Burton H. Kellock, Q.C., is a Partner Emeritus with Blake, Cassels, & 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 to 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.

Sylvia LeRoy is a Senior Policy Analyst in the Fiscal Studies Department at The Fraser Institute. She 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. She joined The Fraser Institute in 2001, where her publications include *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 objectively evaluates non-profit management and service delivery.

Acknowledgments

The authors would like to thank Jason Clemens of The Fraser Institute and two anonymous reviewers for their comments, suggestions, and general review of this paper. Any remaining errors, oversights, or omissions are the sole responsibility of the authors. The authors would also like to thank Katrina Wywalec of Blake, Cassels, & Graydon for her assistance transcribing and coordinating revisions to early drafts of this study. We are also grateful to the Publications Department of The Fraser Institute for their assistance and diligence in producing this study in timely manner. As the authors have worked independently, the views expressed in this study do not necessarily represent the views of the trustees or supporters of the Fraser Institute.

About this publication

Questioning the Legality of Equalization is a chapter from a forth-coming Fraser Institute book examining Canada's system of equalization payments, their legality, and the impact they have on the fiscal balance in Canada. The as-yet-untitled book will be published in early 2007.

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ISSN

1714–6739

Date of issue

December 2006

Editing, design, and production

Lindsey Thomas Martin

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