Federalism and decentralization: where do we stand?

Canada

Dn 2263245

Copy 2285424

Federalism and decentralization: where do we stand?

...one of the characteristics of federalism is that it obliges countries which adopt it to rethink their constitutional situation constantly and redefine intergovernmental relations in the light of their experience and development.

Maurice Lamontagne

Government of Canada Gouvernement du Canada

Cat. No. CP 46-3/8 ISBN 0-662-50354-6

515B (10-80)

Table of contents

Preface

This document, written by Richard Bastien within the Federal-Provincial Relations Office, is an expanded version of chapters 2, 3, 4 and 5 of a book by the same author entitled *La solution canadienne,* which was published through Les Éditions La Presse in 1979. The document is published by the Government of Canada in the interest of contributing to public discussion.

Additional copies may be obtained by writing to:

Publications Canada
P.O. Box 1986, Station B
Ottawa, Canada
K1P 6G6

Introduction

How has Canadian federalism evolved through time? Is it now too centralized or too decentralized? Is it sufficiently flexible to meet the needs of people in all parts of Canada? These are important and complex questions. Supporters of federalism fall into two schools of thought. One claims that our federal system would work better if certain powers now held by the federal government were transferred to the provinces. The other asserts, on the contrary, that the present system is already very decentralized and that any further transfer of powers to the provinces will need to be very limited.

This classification of two schools of thought, however, greatly oversimplifies the many suggestions that have been made for constitutional reform. The report of the Task Force on Canadian Unity, *A Future Together*, for example, stresses that constitutional revision should "provide greater institutional responsiveness to the regional and provincial self-confidence reflected in current demands for greater provincial autonomy and for more effective provincial influence upon central policy formulation."[1]

The problem with the notions of centralization and decentralization is that different interpretations follow from one's view of the ability of a federal system to bridge regional and cultural differences. Restructuring the Canadian federal system to the satisfaction of all regions, however, is at the heart of the national debate. In this context, it is important to ascertain where we stand at present.

This report, then, reviews one dimension of the centralization-decentralization issue: the financial arrangements between the federal and provincial governments, and the relative importance of each in raising revenues. Tracing the changes that have occurred in these financial arrangements and the relative shares of total revenues accounted for by each order of government should assist in evaluating whether the Canadian federation has become more or less centralized over time, that is, whether the provinces have become more or less important, vis-à-vis the federal government, in determining the level and nature of overall public sector activities.

Further, this historical review should also indicate the degree to which provincial autonomy—the ability of the provinces to act independently of the federal government in their respective fields of jurisdiction—has been reinforced or weakened.

The changes that have taken place in the financial arrangements between the federal and provincial governments should, of course, be viewed in light of

[1] Task Force on Canadian Unity, *A Future Together*, 1979, p. 81. This view was also elaborated upon in a paper entitled "Towards the Development of an Effective Federal System for Canada" prepared by D. Elton, F. C. Engelmann and P. McCormick and presented at the Canada West Conference on Confederation at Banff in March 1978.

the social and economic conditions of the time, and the general attitudes respecting the role of government. The transformation of Canada from an essentially rural society in 1867 to the highly urbanized and industrialized society of today has wrought significant changes in the manner in which governments must work together. In an important sense, the classical concept of federalism put forth in 1956 by the Quebec Royal Commission on Constitutional Problems (better known as the Tremblay Commission), which proposed the separation and exclusive assignment of functions as between the two orders of government, has given way to an increasing degree of interdependence between governments.

The flexibility of the federal system to respond to social and economic changes is also at issue. Again, one could judge this adaptability (or non-adaptability) from a variety of vantage points. The usual reference is to the Constitution, which has been subject to numerous, but piecemeal, adjustments over the years. However, many students of federalism believe that a more important measure of flexibility is the manner in which policies and expenditures of one order of government have been adjusted within the existing constitutional framework to take account of specific requirements and concerns of the other order of government. Indeed, this aspect has been achieved in large measure through the evolving financial arrangements, which is an important reason for studying them.

Finally, it is useful to make reference to other federations. Accordingly, comparisons of fiscal arrangements are offered in this report for four other federations: the United States, Switzerland, Australia and West Germany.

All these matters are pertinent to the issue of centralization and decentralization in our federal system, and thus should assist in judging where we stand currently. The decentralization issue has been a frequent source of tension, particularly since World War II. Prior to this, the government sector was much smaller and the debate more limited. For this reason, we will pay greatest attention to the period from World War II to the present, although we will review briefly the period from 1867 to 1939.

Chapter 1

Centralization and decentralization from 1867 to 1939

The financial arrangements of 1867

One of the main aims of the Fathers of Confederation was to create a large common market that, with the laying of a transcontinental railway and the elimination of trade barriers between the colonies, would encourage the development and consolidation of a Canada from sea to sea. A strong central government was deemed necessary to bring this about and, therefore, the federal government was entrusted with the major powers to regulate interprovincial trade, interprovincial transportation, currency and financial institutions.

Responsibilities in the spheres of education, social welfare, health, roads and local government, were assigned to the provinces. At the time, these matters did not have as great a financial significance as those conferred on the federal government.

The federal government was given the power to raise money "by any Mode or System of Taxation" and in particular the exclusive right to levy customs duties, which, at that time, constituted more than three-quarters of the colonies' revenues. The new Constitution gave the provinces the right to impose direct taxes and to raise revenues from the public domain. With the exception of property taxes, direct taxes were little used at the time.

A comparison of the spending estimates of the future provinces with their powers of taxation showed, however, that the provinces would not be able to balance their budgets. Furthermore, the transfer of customs duties to the federal government meant a greater loss of revenue for New Brunswick and Nova Scotia than for the provinces of Upper and Lower Canada. If the provinces were to balance their budgets, it was necessary either to grant them further taxation powers or to establish a system of grants. The second course was chosen. It was agreed that the provincial governments would receive from the federal government 80 cents per inhabitant per year for up to 400,000 inhabitants. The federal government also assumed various proportions of each province's debt. Finally, New Brunswick received a special annual grant of $63,000 for 10 years following Confederation because of the province's special financial difficulties. The payment of all these grants was guaranteed under the British North America (BNA) Act and was to "be in full settlement of all future demands upon the General Government for local purposes."

At the outset of Confederation, these subsidies and grants were the most important source of revenues for the provinces. They represented 80 to 90 per cent of expected revenues in Nova Scotia and New Brunswick, and between one-half and two-thirds in Ontario and Quebec.[1] The federal government clearly dominated over revenue matters.

A period of decreasing centralization: 1867-1914

Despite the clause stating that the grants provided in the 1867 arrangement were a full settlement of all provincial claims, the federal government allocated further "special" grants to the provinces during the years following Confederation.

These new grants reflected the need to continuously change the financial arrangements in order to assist the provinces in balancing their budgets. Nova Scotia was the first to press the case for revisions of the 1867 financial arrangements. As early as 1869 it threatened to withdraw from the new federation and asked leave of the British Parliament to do so on the grounds that only by seceding could it raise the revenues it needed. The federal government then allocated a special grant to Nova Scotia for a period of 10 years. This precedent prompted financial claims from the provinces that joined the federation between 1870 and 1873. The application of a new customs tariff starting in 1879 was perceived by the provinces other than Quebec and Ontario as providing an additional reason to claim increased grants. As one province was awarded a new grant or an increase in existing grants, the other provinces insisted on revisions of their financial agreements. As changes were made to one province's agreements, the other provinces found justification for demanding "more equitable treatment" from the federal government.

The economic situation during this period, however, was not such as to encourage a revision of the provisions of the 1867 act. Starting in 1873, the Canadian economy was affected by a worldwide recession that lasted almost 25 years. It severely limited taxable resources for both orders of government. The federal government found it increasingly difficult to finance the major construction activities required to establish a transcontinental economic infrastructure. The provinces, for their part, were faced with increasing financial obligations in education and welfare and were in need of additional revenues.

Because the federal government resisted the pressure for larger grants, the provinces had to make greater use of their own taxation powers. In 1876 British Columbia introduced a personal income tax. Prince Edward Island followed suit in 1894. In 1882 Quebec created a tax on business premises and corporate profits, and other provinces quickly adopted that idea. In 1892 Ontario imposed succession duties and most of the other provinces subsequently did likewise.

The recession, which began in 1873, came to an end at the turn of the century and the subsequent renewal of economic activity increased federal revenues from customs duties. In 1906, in response to continued provincial

[1] A. Milton Moore, J. Harvey Perry and Donald I. Beach, *The Financing of the Canadian Federation, The First Hundred Years* (Toronto: Canadian Tax Foundation, 1966), p. 2.

pressure for a review of the financial arrangements, Sir Wilfrid Laurier's government invited the provinces to a federal-provincial conference to discuss the question of grants. This was the first conference of its kind. Its aim was to discuss the recommendations made at an interprovincial conference arranged in 1902 by Premier S.N. Parent of Quebec. At the end of the 1906 federal-provincial conference, an agreement was signed that provided that the statutory grants would continue to be paid at a rate of 80 cents per capita, the ceiling of 400,000 persons would be raised to 2.5 million persons, and 60 cents would be added for each person above this ceiling. These new arrangements required an amendment to the 1867 act and a new "full settlement" clause was inserted. Subsequent developments were to show, however, that there could be no full and final settlement of financial relations between the two orders of government.

During the period leading up to World War I, there was a new wave of prosperity. The prosperity led to accelerated urbanization and industrialization, and this created further problems for the provinces as their education and welfare budgets increased rapidly. Technological developments, notably the automobile and electric power, required an enormous increase in public expenditures and almost all of this fell upon the provinces. Although the provinces' revenues were growing rapidly, their expenditures and consequently their debts were growing even faster.

With the onset of World War I, the emphasis shifted back to the federal government. Federal expenditures increased very rapidly and additional taxes had to be imposed, including personal and corporate income taxes. Thus began a period of joint occupancy of major tax fields.

The changing circumstances of the federal and provincial governments leading up to World War I are reflected in table 1.

Table 1

Federal payments as a percentage of federal and provincial revenues, 1868-1915

Fiscal year	Total federal payments to provinces ($ million)	% of provincial revenues (approximate)	% of federal revenues (approximate)
1868	2.8	54	20
1873	2.9	42	14
1880	3.4	50	15
1890	3.9	39	10
1900	4.3	32	8
1910	9.4	26	9
1915	12.3	25	9

SOURCE: M.A. Moore, J.H. Perry and Donald I. Beach, *The Financing of the Canadian Federation, The First Hundred Years* (Toronto: Canadian Tax Foundation, 1966), p. 119.

While the Canadian federation began as a highly centralized system, there were quite a number of forces at work that had the effect of increasing the responsibilities and financial resources of the provinces. The federal government contributed to this growth in provincial strength by ceding huge tracts of land it had received in 1867: the federal Parliament passed legislation in 1898 and 1912 that considerably increased the size of Ontario and Quebec. During this period, too, the idea of provincial autonomy—the right of the provinces to act independently of the federal government—became increasingly recognized as a basic principle of Canadian federalism. The "hands-off" position of Sir Wilfrid Laurier in the conflict over French schools in Manitoba (1890-1896) was defended on the grounds that education was a matter of exclusive provincial jurisdiction.

Thus, as the long economic recession, which marked the last quarter of the 19th century, drew to an end, the provinces began to play an increasingly large part in the country's economic and political life. While this accelerated with the prosperity of the early years of the 20th century, the trend was interrupted by World War I.

A period of decentralization: 1918-1929

The end of World War I marked a major turning point in the history of Canadian federalism. During the subsequent 11 years, the federal government ceased to be the main actor on the political stage and the provinces were called on to play leading roles. In a number of respects, the changes in Canadian federalism at that time are similar to those that have taken place since 1962. In both periods, the changes coincided with rapid peacetime economic expansion and a relatively stable international situation.

Expenditures incurred through the war effort and the continuation of railway construction had weakened the federal government's financial position. Moreover, the major tasks related to establishing across-Canada transportation and communications infrastructure were—for that period, at least—almost complete. After the war, the federal government therefore preferred to play a smaller part in economic affairs and to straighten out its finances. One of the few major federal initiatives in this period was the establishment of an old age pension program in 1927.

The reduction in the relative importance of the federal government at this time was facilitated by the fact that the peacetime priorities were in areas such as roads, education and social welfare, all of which came under provincial jurisdiction. Although the operating expenditures of the provincial governments increased moderately, their capital investment expenditures grew rapidly and provincial debts reached unprecedented levels. The rapidly increasing use of electricity and automobiles required huge public investments by the provinces and municipalities. By the end of the 1920s, total spending by the provinces and their municipalities was approximately 50 per cent higher than federal government spending.[2]

The increase in the provinces' financial responsibilities obliged them to find new sources of revenue. Most of them set up government monopolies for the sale of alcoholic beverages and imposed excise taxes that brought in substantial income. Taxes on gasoline, commercial permits and drivers' licences also provided new revenues.

The per capita revenue from these sources, however, varied considerably from one province to another. The benefits of the new economic prosperity reached the Maritime provinces well after they reached the other provinces and the governments in Halifax and Fredericton experienced relative difficulties in balancing their budgets. They requested further special grants from the federal government, which set up a royal commission (the Duncan Commission) in 1926 to examine their claims. The commission recommended that fixed grants be paid to the three Maritime provinces, and this was done. The Prairie provinces demanded that the federal government give them control of natural resources and compensate them for the revenues they had foregone when the federal government retained control of sub-surface mineral rights. Control of resources was ceded to the provinces in 1930 and royal commissions were set up to determine the amount of compensation the provinces ought to receive.

Although federal grants to the provinces increased considerably during this period, tax revenues raised by the provinces increased even more quickly, and by 1930, grants represented no more than 10 per cent of total provincial revenues. At the same time, provincial expenditures had increased very rapidly. In 1930 provincial and municipal expenditures were almost double those of the federal government. This shows the extent to which the provinces had taken on new responsibilities when circumstances demanded. The new initiatives being taken by the provinces were later recognized by the Royal Commission on Dominion-Provincial Relations (the Rowell-Sirois Commission) set up by the federal government in the late 1930s:

> *Throughout this period the provinces were politically aggressive in undertaking new activities, in advancing their own affairs, and in securing concessions from the Dominion. In their difficulties, in their ambitions and opportunities, as well as in the disparities between them, several sets of common interests of a regional character emerged. These regional forces served to weaken the common interest in a national integration. In the general prosperity of the twenties, which provided an expanding national income, the regional interests were harmonized amicably without serious friction or serious sacrifice and the provinces were able,*

[2] *Ibid.*, p. 9.

with more or less difficulty, to carry the new responsibilities they had assumed.[3]

Provincial debts had increased as a result of large capital investment expenditures and a substantial proportion of their budgets was used for servicing these debts. Therefore, despite the prosperity of the times, the provinces' fiscal system was vulnerable to any serious economic downturn.

A period of crisis: 1929 - 1939

The economic crisis that began in 1929 and continued until the outbreak of World War II had a considerable effect on the federal system. During the 1920s, the provinces had invested huge sums in roads, urban development and hydro-electric facilities. These investments had been financed by issuing bonds, many of which matured during the thirties.

Welfare and educational services had also been increased and improved, so the financial burden had continually grown. As a result of the Great Depression, however, tax revenues available to pay back the borrowed money were greatly reduced.

The provinces reacted to the deterioration in their financial situation by increasing tax rates and introducing new forms of taxation. Between 1930 and 1940, the number of provinces that taxed personal income rose from three to seven, while the number of provinces that taxed corporations rose from two to nine. Retail sales taxes were introduced and succession duties were increased. Because revenue from customs duties had decreased as a result of the drop in international trade, the federal government also had to introduce new forms of taxation and increase rates for those that already existed. Thus, both orders of government were using every possible means to increase their revenues and were doing so without any intergovernmental co-operation—hence the so-called "tax jungle" of the thirties.

Despite its own difficulties, the federal government felt obliged to increase special grants to the provinces. Payments were made to all the provincial governments to help them finance their unemployment assistance programs. Federal allocations of nearly $500 million were paid to the provinces during this period in aid to the unemployed.[4] Total federal grants represented approximately one-third of total provincial revenues. The neediest provinces were also given special grants to ensure that essential services were maintained.

Nowhere in Canada was there more economic hardship than in the Prairie provinces. The Great Depression was bad enough, but on top of that a period of sustained drought and soil-drifting all but devastated the region's agricultural economy.

[3] Canada, *Report of the Royal Commission on Dominion-Provincial Relations*, vol. 1 (Ottawa: Queen's Printer, 1939), pp. 136-7.
[4] Of the $500 million transferred to the provinces, $175 million consisted of loans, a large portion of which were later written off by the federal government.

Temporary grants helped to maintain basic essential services. But the Depression also prompted some long-term federal measures and gave birth to national agencies such as the Canadian Wheat Board and the Prairie Farm Rehabilitation Administration (PFRA)—legacies of the 1930s and still playing an important role in Western Canada today.

The Maritime provinces were also seriously affected by the depression, and the White Commission, which had a mandate from the federal government to examine their financial situation, proposed in 1934 that the special grants to Prince Edward Island, Nova Scotia and New Brunswick should be increased.

The economic crisis of the 1930s greatly weakened the fiscal position of the provinces. Most were on the verge of bankruptcy from which they were rescued by federal grants. It became obvious that the fiscal structure of the federal system had to be rethought.

Much of the rethinking was done by two very important royal commissions. The first, established by the federal government in 1937, was the Rowell-Sirois Commission, to which we have already referred. The second was the Royal Commission of Inquiry on Constitutional Problems, better known as the Tremblay Commission, appointed by the Quebec government in 1953.

Chapter 2

A period of centralized federalism: 1939-1957

The crisis of the 1930s was followed by World War II and a period of relatively strong centralization. This return to predominance of the central authority can be traced to the influence of the war, the effect of the Rowell-Sirois Commission, the impact of Keynesian economic thought, and the desire to avoid another economic depression.

The Rowell-Sirois report

The Royal Commission on Dominion-Provincial Relations was appointed in August 1937. It was instructed in particular:

> 1. *to examine the constitutional allocation of revenue sources and governmental burdens to the dominion and provincial governments ... and its suitability to present conditions ...;*
> 2. *to investigate the character and amount of taxes collected from the people of Canada ... and to determine whether taxation as presently allocated and imposed is as equitable and as efficient as can be devised;*
> 3. *to examine public expenditures and public debts in general, in order to determine whether the present division of the burden of government is equitable, and conducive to efficient administration, and to determine the ability of the Dominion and provincial governments to discharge their governmental responsibilities within the framework of the present allocation of public functions and powers, or on the basis of some form of reallocation thereof;*
> 4. *to investigate Dominion subsidies and grants to provincial governments.*[1]

In short, the commission was to research the facts, evaluate them in terms of administrative efficiency and fiscal equity and submit recommendations. The five commissioners appointed by the government represented the five different regions of the country: Newton W. Rowell, chief justice of Ontario, appointed chairman of the commission; Thibaudeau Rinfret, justice of the Supreme Court of Canada, from Quebec; John W. Dafoe, a journalist from Winnipeg; Robert A. MacKay, a professor of political science at Dalhousie University, Nova Scotia, and Henry H. Angus, a professor of economics at the

[1] Canada, *Report of the Royal Commission on Dominion-Provincial Relations*, vol. 1 (Ottawa: Queen's Printer, 1939), p. 1.

University of British Columbia. Four months after his appointment, Mr. Justice Rinfret had to tender his resignation owing to ill health. He was replaced by Joseph Sirois, a Quebec notary and professor of constitutional law at Laval University. In November 1938, Chief Justice Rowell also had to resign because of illness, and Joseph Sirois replaced him as chairman of the commission.

The commissioners selected six advisers to help them accomplish their task: Alex Skelton, chief of the research department of the Bank of Canada, was appointed director of research and secretary; Adjutor Savard was appointed French secretary and acted as secretary during the hearings in several provinces; Wilfred Eggleston and R.W. Fowler were appointed assistant to the secretary and legal secretary respectively, and Louis St. Laurent and James McGregor Stewart were appointed counsel. An extensive research program was planned to provide the commissioners with complete information on constitutional, economic and fiscal aspects of the Canadian situation. The economic research program was by far the most important with 27 researchers doing specialized studies.

In addition to holding public hearings in the nine provincial capitals of the time, the commission requested briefs from all the provincial governments and meetings with them. The governments of Alberta and Quebec declined to participate. The Ontario government supplied the commission with the information it requested for a few months but later decided not to co-operate further in its work.

The Rowell-Sirois Commission submitted its report in 1940. After analyzing the state of federal-provincial relations, the commissioners concluded that a serious imbalance existed between the revenues and responsibilities of each order of government. They stressed the fact that certain responsibilities of a national character were financed from revenue sources of a local or regional nature, while certain revenue sources of a national character were used almost exclusively by provincial governments. To correct this imbalance, the commission recommended a new division of responsibilities and taxing powers between the federal government and the provinces, and special arrangements to enable the poorest provinces to offer their citizens public services comparable to those in the rich provinces. In particular the commission recommended:

- that the federal government assume the responsibilities associated with unemployment relief and old age pensions, which at that time absorbed a considerable proportion of provincial revenues
- that the provinces no longer tax incomes of individuals and corporations because these "national" areas of taxation would be more efficiently administered by the federal government

- that the "chaotic and illogical" statutory grant system be replaced with "national adjustment grants"[2] to be made to the poorest provinces so that they could provide public services of "average" quality without placing an undue tax burden on their citizens.

Although the recommendations concerning the distribution of responsibilities and areas of taxation were clearly of a centralizing nature, the provinces did not object to proposals for transferring responsibility for unemployment relief measures and old age pensions to the federal government. Thus in 1940, following an agreement reached between the federal government and the nine provinces of that time, the Constitution was amended to give the federal government authority to set up an unemployment insurance plan and, in 1951, all provinces, including Quebec, agreed to amend the BNA Act so that the federal government could establish an old age pension plan for the whole country. However, the provinces severely criticized the suggestion that they withdraw from the income tax field. This was to be one of the main points of contention between the two orders of government in the postwar years.

The recommendation regarding national adjustment grants was aimed at ensuring a redistribution of wealth from the rich provinces to the poor provinces. These federal payments were intended to enable those provinces with tax yields below the national average, to provide an average standard of public services without having to tax their residents at higher rates than those applied in the wealthier provinces. In this proposal lies the origin of our present system of equalization of provincial revenues. The commission stressed that the provinces could use these federal payments as they saw fit, in accordance with the principle of provincial autonomy. According to the commission,

> *the purpose of the National Adjustment Grants to be paid by the Dominion to the provincial governments is then, in brief, to provide for balanced provincial budgets after provision for expansion of education and welfare services to the national average where these services are below it, and expansion of developmental expenditures to the 1928-31 averages of the individual provinces. . . . The Commission's recommendations for payment of National Adjustment Grants . . . illustrate the Commission's conviction that provincial autonomy in these fields must be respected and strengthened, and that the only true independence is financial security.*[3]

[2] Grants of this kind are now generally referred to as equalization grants.
[3] Canada, *Report of the Royal Commission on Dominion-Provincial Relations*, vol. 2 (Ottawa: Queen's Printer, 1939), pp. 125-126.

Although the cause of provincial autonomy had many defenders at the time, few had anticipated how a decentralization of taxing powers would affect the poor provinces. The commission's recommendation concerning national adjustment grants was an attempt to reconcile the principle of autonomy with that of greater equality in the standard of public services provided by individual provinces. This aspect of the report was largely overlooked by provincial critics. The adjustment grants, however, would have had a decentralizing effect that would have at least partially offset the centralizing effect of the other proposals. According to one commentator, the commission's report, although it put forward certain centralizing measures, did not ignore the need to preserve provincial autonomy:

> *...it reflected the growing sense of nationhood which demanded a more truly national instrument of government, yet it was the work of men who... were anxious to avoid an extensive contraction of local liberties.*[4]

Notwithstanding the foregoing, provincial reactions to the report were rather negative. At the First Ministers' Conference held in January 1941, Ontario, Alberta and British Columbia—the three provinces that, under the commission's proposals, would not have received national adjustment grants—indicated that the recommendations of the commission were unacceptable to them. Other provinces also expressed only moderate approval. Quebec, Ontario and British Columbia were strongly opposed to the recommendation that the federal government assume exclusive responsibility for income taxes and succession duties.

World War II and Keynesian ideas

The relatively high degree of centralization that occurred during and after World War II can be attributed only in part to the recommendations of the Rowell-Sirois Commission. Although these had a profound and lasting influence on the federal government's way of thinking, three other forces triggered the return to greater centralization: Canada's involvement in the war; the influence of Keynesian ideas on senior public servants and political leaders, and strong fears of postwar economic recession.

As the war effort intensified, the federal government took on increasingly greater responsibilities in almost all areas and was forced to raise considerable amounts of revenue from all social groups. The administrative machinery grew to an unprecedented size. The feeling throughout federal government circles, however, was that this machinery could be made to serve new purposes after the end of hostilities.

[4] Alexander Brady, *Democracy in the Dominions*, 2nd ed. (Toronto: University of Toronto Press, 1952), p. 54.

The prospect of peace raised fears of another recession. The theories and prescriptions of the noted economist, John Maynard Keynes,[5] were embraced by a hopeful public searching for solutions to old problems. Stimulative Keynesian measures, such as capital works projects and tax cuts, were seen as a means of generating jobs for soldiers returning from abroad and as an offset to declining war-related production. As it turned out, fears of a world recession were ill-founded, as a release in pent-up consumer demand provided the needed offset.

Nevertheless, the influence of this new Keynesian approach was quickly felt.[6] It was no longer a question of adopting a laissez-faire attitude toward the economic situation. The federal government committed itself to attaining price stability and full employment. The principle of an anti-cyclical budgetary policy, under which deficits and surpluses would be used to stimulate or slow down the economy as the situation required, was a radical departure from the conventional financial practices of the prewar period.

This new concept of the government's role in economic affairs was set out in the White Paper on Employment and Income, which was tabled in Parliament in April 1945. It was particularly significant for Canadian federalism, because it called for a full range of social measures that not only promoted the welfare of individuals but also formed part of a national stabilization policy. Social security was no longer viewed solely as a policy of assistance to the needy; it was thereafter considered as one of the instruments available to the federal government for ensuring full employment.

Since social welfare measures had always been under provincial jurisdiction, this new philosophy seriously challenged the constitutional division of powers between the two orders of government. The new concept of social security blurred any practical distinction between economic and social policies. A good case could then be made for the transfer of major functions to the federal government from the provinces. The potential implications of Keynesian thought for a federal form of government were almost revolutionary in nature.

It was clear that it would not be possible in Canada to assign complete responsibility for economic stabilization and social policy to the same order of government. But how could the two be separated in practice? For example, were manpower training policies, aimed both at training workers and at achieving full employment, to be considered a provincial or a federal responsibility? Income supplements, such as welfare payments, posed the same problem. These measures served a purpose that was social (assisting the most disadvantaged) as well as economic (maintaining a higher level of overall

[5] Among those in Ottawa schooled in or influenced by Keynes' theories were W. Clifford Clark (deputy minister of finance), Ken Eaton (assistant deputy minister of finance) and R. B. Bryce (advisor to the deputy minister of finance). Bryce was a student of Keynes at the time Keynes' *General Theory of Employment, Interest and Money* was being formulated.

[6] Referring to the influence of Keynes in various countries, Professor Brady notes that "perhaps in no capital of the English-speaking world did Keynes exercise more influence than in Ottawa." (Brady, *Democracy In the Dominions*, p. 55).

demand in order to stimulate production). Should such programs be administered by the federal government or the provinces? These were some of the questions raised by the new Keynesian philosophy, and they were to influence Canadian political debate throughout the postwar period. As we will see later, they were a major source of federal-provincial tensions.

Intergovernmental fiscal arrangements: 1941-1957

Under the pressure of circumstances created by Canada's entry into the war, the provinces recognized the necessity for a strong central government, at least for the duration of the conflict. In 1941, they agreed to refrain from collecting personal and corporation income taxes until one year after the end of hostilities. In return, the federal government agreed to pay them an indemnity or "rent"[7] as partial compensation for the revenues foregone through provincial withdrawal from these particularly lucrative tax fields. This was the beginning of the tax rental era during which the provinces rented their rights in these tax fields to the federal government.

To reach its objectives of full employment and price stability, the federal government called the Dominion-Provincial Conference on Reconstruction in 1945 and proposed a whole set of measures aimed at supporting postwar economic activity. It suggested the establishment of a nationwide old age pension plan, a health insurance plan, an unemployment insurance plan and a program of financial assistance to those provinces and municipalities willing to make public investments designed to stabilize the economy. The federal government also proposed various shared-cost programs in the areas of mental health, vocational training and research. The recommendation respecting financing was that the provincial governments continue to leave the personal income tax, corporation tax and succession duty fields entirely to the federal government in return for rental payments calculated essentially on the basis of provincial population.

These proposals upset the whole concept of federalism on which relations between the two orders of government had been based up to that time. By expanding the number and value of shared-cost programs, the federal government was suggesting that the principle of exclusive responsibility and complete independence of action for each order of government was no longer valid. The programs also implied that economic and social policies had become closely intertwined. Furthermore, the federal recommendations required that the different sources of revenue no longer be considered from a purely constitutional point of view, but in terms of their usefulness as macro-economic management tools. It was therefore not surprising that the provinces reacted with considerable hesitation and scepticism to these proposals. The reconstruction conference adjourned without producing an agreement.

[7] The term "rent" is used to indicate a payment by the federal government to a province for the exclusive occupancy of a tax field for a specified period of time.

Intergovernmental consultations nevertheless continued for two years and led to agreements based on the idea of rental payments. In 1947 all the provinces except Quebec and Ontario agreed once again to rent to the federal government, for a period of five years, their right to tax personal income, corporation income (except for a five per cent tax on corporate profits which was to be collected by the federal government on behalf of the provinces) and succession duties. The rental payments the federal government agreed to pay the provinces were to be calculated on the basis of a fixed per capita amount and statutory subsidies payable in 1947. The payments would also increase annually in proportion to gross national product (GNP) and population growth rates.[8]

Ontario and Quebec, the two most populous and highly industrialized provinces, refused to sign the rental agreements. They each collected a seven per cent tax on corporation income and various taxes on business capital and places of business. Both provinces also retained their succession duties. To avoid excessive taxation in this field, the federal government had provided for a provincial tax credit of 50 per cent under the Dominion Successions Duty Act. The Income Tax Act provided for a provincial tax credit of five per cent,[9] but since neither Quebec nor Ontario introduced such a tax at that time, the taxpayers of these provinces could not claim this credit.

Between 1947 and 1950 the federal government ceded to the provinces certain minor taxes such as the gasoline tax (then set at three cents per gallon), the sales tax on electricity and gas, and the amusement tax. The financial requirements of the provinces increased rapidly, in part due to the shared-cost programs that the federal government was implementing, such as the national health grants program that began in 1948. This was soon followed by several other shared-cost arrangements, the most important of which was the Trans-Canada Highway construction program, begun in 1948. This project, designed to improve the road transportation network in a period of rapid national economic growth, gave rise to a serious disagreement between the federal government and Quebec. The Government of Quebec felt that the project represented a federal infringement of provincial jurisdiction and it was not until 1960, with the election of Premier Jean Lesage's government, that Quebec entered the program. This participation did not reflect Quebec's approval of the concept of shared-cost programs but rather a determination to ensure the investment in Quebec of those federal tax revenues already raised within the province for the financing of this federal program.

Since the rental agreements signed in 1947 were due to expire at the start of 1952, the federal government began discussions on their renewal with the

[8] The provinces could choose between two formulas for calculating their payments: (1) a combination of $12.75 per capita of 1942 population, plus 50 per cent of provincial personal and corporation income tax receipts in 1940, plus the 1947 statutory subsidies; or (2) $15 per capita of 1942 population plus the 1947 statutory subsidies. The amounts yielded under either of these formulas were to be increased each year by a percentage equal to the gross national product growth rate.

[9] An income tax credit of five per cent meant that a taxpayer could deduct from his federal income tax a proportion of his provincial income tax not to exceed five per cent of his federal income tax.

provinces in 1950. Because Canada's involvement in the Korean War, which began in 1950, was expected to take up a significant portion of the country's tax resources, the possibility of transferring a greater share of income tax revenue to the provinces was very limited. Military expenditures had priority, and so the tax agreements concluded for the 1952 to 1957 period, although they provided for slightly higher payments than those in the preceding period, brought no significant changes. The following modifications were made:

- The two formulas set out in the 1941 agreements were retained but were to apply to data for 1948 rather than 1941.
- A third formula was provided, whereby the rental payment would be equal to the sum of the following amounts:

  —the yield of a personal income tax at five per cent of 1948 federal rates applied to 1946 incomes in the province

  —the yield of a tax of 8.5 per cent on corporate profits earned in the province in 1948

  —the average revenue received by the province from succession duties during the two most recent collection years

  —1948 statutory subsidies.
- Changes were made to the definitions of GNP and provincial population.

The new approach for calculating rental payments was formulated to satisfy Ontario, which had requested that these payments take into account the tax yields a signatory province would have to relinquish. Ontario accepted the proposed formula and signed a tax rental agreement. The Quebec government, however, rejected the new formula because it considered rental agreements contrary to the principle of provincial autonomy.

Throughout the period from 1952 to 1957, Premier Maurice Duplessis of Quebec maintained that the rental agreements violated the spirit of Confederation. Since the financial responsibilities of the Quebec government grew greater each year, the Quebec government found it necessary to seek new sources of revenue and, in 1954, it introduced a personal income tax. The income tax rates equalled approximately 15 per cent of federal rates or 10 percentage points more than the provincial tax credit allowed under the federal Income Tax Act. This meant that Quebec taxpayers had to pay a total tax (federal tax plus provincial tax) that was 10 percentage points higher than that paid by taxpayers in other provinces.

In October 1954, Prime Minister St. Laurent met with Premier Duplessis to find some way of easing the tax burden on Quebec residents. They reached an agreement that, although in appearance represented a respectable compromise for each of them, was nevertheless a major concession to Duplessis. The Quebec premier obtained an increase in the federal tax credit under the Income Tax Act from five per cent to 10 per cent. At the same time, he agreed to withdraw from the Quebec tax bill a clause stipulating that the province had primary jurisdiction in the income tax field. The federal statute was amended so that, as of 1955, any province could collect its own income tax at a rate of up to 10 per cent of the federal rates without its taxpayers having to bear a tax burden greater than that of the taxpayers in other provinces.

The decision of the Duplessis government to introduce its own personal income tax system came just when the Korean War had ended and when a considerable cut in the defence budget was anticipated. The Canadian economy was booming and public attention could once again turn to issues connected with a peacetime economy, issues such as social security, education, health care and road construction. The Duplessis challenge therefore came at a time when circumstances were especially receptive to change. However, before examining how the philosophy of autonomy defended by the Duplessis government influenced Canadian federalism, the principles of this philosophy must be studied more closely.

Chapter 3

In defence of provincial autonomy: the Tremblay report

Trop longtemps notre volonté de vivre fut supplantée par notre mémoire d'avoir été.
Fernand Ouellette

The principle of provincial autonomy, defended so ardently by Premier Duplessis during the 1940s and fifties and later espoused in various forms by his successors, was based on a particular view of the Canadian situation. This view was given one of its most complete formulations in the report of the Royal Commission of Inquiry on Constitutional Problems, better known as the Tremblay report. Since its tabling in 1956, there has been no other report or document of the same kind describing the Quebec government's views on the functioning of the federal system. The terms of reference for the commission, which was established by the Duplessis government, give a clear indication of the attitude which inspired its creation. It was to "inquire into constitutional problems ... and submit ... its recommendations as to steps to be taken to *safeguard* the rights of the Province. . . ." It was urged to study "in particular ... the encroachments by the central power in the field of direct taxation" as well as "the repercussions and *results of such encroachments* in the legislative and administrative regime of the Province and in the collective, domestic and individual life of its people."[1] The commission was therefore not asked to decide whether the federal government was encroaching on fields of provincial jurisdiction, but rather to measure the extent and consequences of such encroachment.

The members of the commission were appointed by the provincial government in March 1953. They were Thomas Tremblay, chief justice of the Court of Sessions; Esdras Minville, director of the École des Hautes Études Commerciales and dean of the faculty of social, economic and political sciences at the University of Montreal; Honoré Parent, lawyer and former president of the Montreal Chamber of Commerce; Richard Arès, SJ, editor of the magazine *Relations*; John P. Rowat, notary and chairman of the Protestant School Board of Greater Montreal; and Paul Henri Guimont, secretary of the faculty of social science of Laval University. The commissioners chose six advisers and two principal secretaries to assist them in their work. The commission also arranged for a certain number of research projects to be carried out, 10 of

[1] Quebec, *Report of the Royal Commission of Inquiry on Constitutional Problems*, vol. 1 (Quebec City: 1956), p. vi. (Author's italics)

which were published as annexes to the report. François-Albert Angers was the author of three of these; the others were signed by Charles de Koninck, Gonzalve Poulin, Arthur Tremblay, Gérard Trudel, Albert Rioux, Roland Parenteau and Patrick Allen.

Findings and conclusions of the report

The commission's report was submitted to the Government of Quebec in 1956. According to the commissioners, the constitutional problem was the result of "a fundamental divergence of opinion on the interpretation of Canadian federalism."[2] Although the problem was most apparent in regard to the distribution of tax powers, its control and remedy required a re-examination of "the foundations of our constitutional and political system" and the situation should be studied "first of all in the perspective of history and according to the basic principles of political philosophy."[3] This approach was felt to be superior to that of the Rowell-Sirois Commission, whose report was "an effort to give Canadian history an economic interpretation" which "left out the most deeply human, and, therefore, the most significant aspect" of the history of this "widely differentiated" country.[4] According to the Tremblay Commission, the problem of federalism was essentially cultural: "The duality of cultures is the central premise of the Canadian political problem, no matter from what angle it may be approached."[5]

To support this thesis of cultural duality, the commission sought to define what it believed were the distinctive characteristics of the two Canadian cultures. This led it to emphasize linguistic and especially religious differences. The report defined French Canadian culture as being "of Christian inspiration" and "French genius." On the other hand, "Anglo-Protestant culture" was "of the same general inspiration, but according to a different interpretation and genius." It differs from "French-Catholic culture" because "it does not conceive the order of temporal life and Man's relations to society in the same manner. It is not communal, but individualist and liberal."[6] The two cultural communities therefore differ in their "concepts of order, liberty and progress."[7] For this reason, the opposition between the two cultures appears not so much in cultural activities per se as in the fabric of daily life:

> *It is not on the purely intellectual and artistic plane ... that the duality of cultures presents a political problem ... it is on the plane of everyday activity, on the plane of*

[2] *Ibid.*, vol. 3, book 2, p. 278. (book 2 of vol. 3 contains a summary of the report).

[3] *Ibid.*, p. 279.

[4] *Ibid.*

[5] *Ibid.*, p. 283.

[6] *Ibid.*, vol. 2, p. 42.

[7] *Ibid.* According to the commission, the difference in interpretation "arises mainly from the fact that, by making of religion, through private judgment, a strictly personal affair, Protestantism withdrew its social morality from all ecclesiastical discipline and liberated socio-political thought from any reference to a transcendent order. For a Catholic ... liberty defines itself with respect to this order. For the Protestant ... liberty is pre-eminent ..."

economic, social, juridical and political action where, the interests of two groups being engaged, their respective concepts of life and order oppose each other and clash.[8]

According to the commission, the cultural duality of Canada requires that its federal system be sufficiently flexible to ensure the full development of both cultures. Since Quebec is the "heart" of French Canadian culture, the report said it is the responsibility of the Quebec government to take the initiative in regard to the economic and social life of its people. Provincial autonomy is necessary because only the Government of Quebec can exercise the new functions imposed on a modern state "in the manner best suited to the needs and spirit of the people."

Throughout its report, the commission insisted that the federal government's new concept of its role was incompatible with the values of French Canadian society. Federal policies have a "technical" and *dirigiste* character which is ill-suited to a "truly humanist, political and social economy."[9] The difficulty arises from the fact that "Anglo Canadian Protestants control the governments, not only of the nine other provinces, but of the Canadian Federation itself."[10] That is why, according to the report, it is essential to put an end to the fiscal, social and economic centralization, which is contrary to the spirit of federalism.

The report defined federalism as a "system of association between states in which the exercise of state power is shared between two orders of government, co-ordinate but not subordinate one to the other, each enjoying supreme power within the sphere of activity assigned to it by the Constitution."[11] The report then went on to show how, in the commission's view, postwar federal policies did not respect this concept, in spite of the fact that, according to the commission, it had inspired the Fathers of Confederation. The commission was particularly critical of shared-cost programs introduced by the federal government because they enabled the latter to spend large amounts of money in fields assigned by the Constitution to the provinces. In the view of the commission, the programs reflected "the mentality, needs and philosophy of the Anglo-Protestant majority."

The report concluded that differences between Ottawa and Quebec arose "from a unitary and non-federalist interpretation of the Constitution . . . and from an administrative rather than a political concept of the state's role in economic and social affairs."[12] A return to the spirit of genuine federalism was, therefore, recommended such that there be an undertaking to readapt the

[8] *Ibid.*, p. 45.
[9] *Ibid.*, pp. 79-80.
[10] *Ibid.*, p. 277.
[11] *Ibid.*, p. 102.
[12] *Ibid.*, vol. 3, book 2, p. 291.

federal tax system to the needs of the population. This meant, in the view of the commission, "taxes on incomes affecting individuals and institutions should be reserved to the provinces, upon which devolves jurisdiction in cultural and social matters."[13] The federal government, for its part, should "have sole access to taxes on goods and their circulation." The transfer of all funds derived from income taxes back to the provinces would enable them to assume responsibility for the whole field of social security, including unemployment insurance. The commission's report also stated that any fiscal imbalances that might result from this transfer of income taxes would be insignificant except in the case of the Maritimes, and that this problem could be solved by an equalization system.[14]

The report further proposed that the provinces, as in the case of the federal government, be able to sell their bonds to the Bank of Canada in order to have the necessary credit at their disposal for building roads, hospitals and schools. Such public works were viewed by the commission as the major means of eliminating unemployment. Finally, recognizing the need to co-ordinate the policies of the members of the federation, the report proposed the formation of a secretariat of federal-provincial conferences and a permanent council of the provinces.

It is surprising that, after proposing the separation and exclusive assignment of functions between the two orders of government, the commission later altered its position somewhat. The final pages of the report proposed an "intermediate" solution aimed at "taking into account the *de facto* situation and the habits of thought which constitutional practices of the last quarter century have brought into being."[15] According to this solution, the federal government would keep a substantial portion of the revenue from corporate income taxes, as well as the social security measures provided by it.

Ambiguities of the report

The Tremblay report was intended to be a "defence and illustration" of traditional federalism, founded on the autonomy of each order of government, i.e., on the ability of each order of government to act independently of the other. It recognized, of course, the need for governments to co-ordinate their policies. According to the commissioners' concept of federalism, however, such co-ordination is secondary. It is to be understood only in relation to the major principle: autonomy for each order of government—"no federalism without autonomy of the state's constituent parts, and no sovereignty of the various governments without fiscal and financial autonomy."[16] In brief, the commission ruled out shared responsibilities and envisioned, instead, a classic form of federalism in which responsibilities between orders of government are assigned

[13] *Ibid.*, p. 295.

[14] The report does not appear to recognize the possibility that Quebec itself might need equalization.

[15] Quebec, *Report on Constitutional Problems*, vol. 3, book 2, p. 302.

[16] *Ibid.*, p. 294. See also section 3 of chapter 9 in vol. 2 of the report.

in an exclusive manner. In its view, Canada and Quebec, which had been completely transformed by the industrial revolution between 1867 and the middle of the 20th century, did not require any modification of this traditional concept of federalism. The commissioners concluded that, although the Canadian reality had changed considerably since 1867, its cultural components and political requirements had not. What was needed, then, was an "integral return" to the Constitution of 1867 and the spirit of the Fathers of Confederation.

It was apparently of little concern to the commission that the Constitution had been written at a time when the laissez-faire doctrine was in its heyday and Canada had not yet entered the industrial age. Although the report recognized the reality of industrialization in Quebec and in Canada, it did not recognize any automatic link between this phenomenon and the workings of federalism. It made reference to the fact that industrialization broadens the responsibilities of the state, but concluded that such growth simply increases provincial responsibilities without challenging the principles of traditional federalism, which is founded on an absolute separation of powers.

Although the Tremblay report clearly set out the nature of the federal system it considered suitable for Quebec, it nevertheless contained some significant ambiguities. It was critical of statist thought, which was viewed as too *dirigiste* and ill-adapted to the French Canadian mentality, but nevertheless it recommended that the Province of Quebec establish a complete social security system. The report recognized both the need to encourage Quebec's industrial development and the business acumen of Anglo-Protestants, but held that the concepts of liberty and progress, as well as "the importance of material success in human life," are interpreted differently by the two cultural groups and that the Constitution must make it possible to preserve these differences. Having emphasized how the two cultures differ in interpreting these values, the commissioners maintained nonetheless that both cultures are *personnalistes* and "qualitative" and that it is in the interest of both groups to join forces in order to resist the impersonal and technical character of big business. They insisted that the responsibilities of the federal government must be limited to matters having no direct effect on individuals, but added that Canada collectively would fulfil itself only through the purposeful, intelligent and vigilant action of the state.

The commissioners, although conscious of the changes brought about by industrialization and urbanization, evidently did not believe that these changes would necessarily influence either relations between the two cultural groups or the workings of the Canadian federal system to any significant extent. In affirming that values such as liberty, progress and order were interpreted differently in the Franco-Catholic culture than in the English-Protestant culture, they overlooked the fact that this interpretation would itself be modified under the impact of industrialization and urbanization. The commissioners apparently believed that economic developments did not necessitate cultural and political changes.

Influence of the report

Regardless of what judgment is made of the Tremblay report, it is undeniable that it has greatly influenced various governments that have come to power in Quebec since its publication in 1956. In fact, the negotiating positions adopted by the Quebec government vis-à-vis the federal government were frequently inspired by the report's recommendations. In 1962, Premier Lesage requested that a portion of federal income taxes, as well as the entire responsibility for shared-cost programs, be transferred to the provinces. Mr. Lesage's successor, Premier Daniel Johnson, reaffirmed the link established in the report between cultural duality and the nature of Canadian federalism. In his view, a new Canadian Constitution should be written "which would be founded on the recognition of both cultures and be sufficiently flexible to enable French Canadians to develop as they wished, while also allowing English Canadians to develop their own culture as they saw fit."[17] Essentially the same ideas were put forward by Premier Robert Bourassa's government during the early 1970s. Many ideas or concepts expressed by the commission have also been advocated by the Parti Québécois, although the conclusions of the latter respecting political action are very different from those drawn by other Quebec political parties and the commissioners. There is, then, a "spiritual" affinity between the Tremblay report and the constitutional positions taken by the major Quebec political parties, whether federalist or not.

[17] Daniel Johnson, *Égalité ou Indépendance* (Édition Renaissance, 1965), p. 90. (Author's translation).

Chapter 4

Canadian federalism since 1957: fiscal decentralization

No part of the Canadian Constitution has been more flexible, more responsive to changing political and economic pressures than the subsidies provisions and tax arrangements.

F. R. Scott

To what extent has Canadian federalism been able to adapt to the demands made by Quebec since the publication of the Tremblay report? Were these demands compatible with the Keynesian principles that had inspired federal initiatives after the war? Was it possible to find arrangements that would satisfy, at least in part, the different positions espoused by Ottawa and Quebec City? To answer these questions, the various arrangements worked out between the two governments in those fields of particular interest to Quebec have to be examined. The most important arrangements relate to fiscal matters. These are examined in this chapter, while other aspects of the response to Quebec's position are dealt with in the next chapter.

Canadian federalism has changed considerably over the last 20 years, particularly with respect to the financial relations between the two orders of government. These changes can best be analyzed by separate consideration of the following three major dimensions of the financial arrangements: tax-sharing, shared-cost programs (which gave rise to what are known in federal-provincial jargon as conditional grants), and the equalization of provincial revenues.

Sharing of income taxes

The tax rental agreements, under which the provinces relinquished their rights to raise income taxes and succession duties in exchange for rental payments from the federal government, first came into effect in 1941 and were renewed by all the provinces except Quebec and Ontario in 1947 and by all provinces except Quebec in 1952. Since Quebec set up its own personal income tax system in 1954, it became more and more urgent to work out an arrangement for the period 1957 to 1962 that would be acceptable to that province.

Accordingly, Prime Minister St. Laurent proposed to the provinces in January 1956 that the 1952 agreements be renewed, while explicitly recognizing the right of the provinces to raise their own taxes. Under the federal proposal, each province could either levy its own taxes on personal and corporate income as well as its own succession duties, or rent these taxes to the federal government. In the latter case, the rental payment made to a province would be 10 per cent of the amount of federal personal income tax raised in the province (this figure was increased to 13 per cent in 1958), nine per cent of taxable corporate profits, and 50 per cent of federal succession duties raised in the province. If a province did not wish to rent its right to levy a tax, its taxpayers would enjoy a tax abatement (an *identifiable* reduction in federal tax payable) from the federal government equal to the percentage used in the calculation of rental payments.

The abatement provision meant that a non-renting province could levy its own taxes and obtain the same revenues as a renting province by applying tax rates, equal to the above cited percentages, to the federal tax (in the case of the personal income tax) or to the federal definition of taxable income (in the case of the corporation income tax). Thus, the *sum* of the federal and provincial taxes paid by its taxpayers would not exceed the amount of federal tax paid by the taxpayers of a province that had signed a rental agreement. Accordingly, there would be no financial penalty on the taxpayers of a province that had refused to rent its right to levy taxes. The 1956 federal offer also provided that each province, whether it signed a rental agreement or not, would be eligible for equalization payments designed to bring the per capita yield from both types of income tax and from succession duties up to the level of the average yield from these taxes in the two wealthiest provinces. In this way, the equalization of provincial revenues was for the first time separated from the question of whether a province chose to participate in the rental agreements.

While the 1957 arrangements must be ranked very high in historical significance, further important changes were made in 1962. The federal government proposed that the idea of renting the right to levy taxes be replaced by a new form of sharing which would give greater flexibility to the provinces. Specifically the tax *rental* agreements were to be replaced by tax *collection* agreements, under which the provinces legislated their own income tax laws and the federal government undertook to collect provincial personal and corporate income taxes free of charge. Provinces could thereafter impose whatever rates they desired without having to set up their own collection services. The only condition the federal government imposed on the participating provinces was that they accept the definition of taxable income contained in the federal Income Tax Act. In other words, the provincial and federal tax bases would be the same. Since 1962, all provinces except Quebec have had tax collection agreements with the federal government respecting personal income taxes. Further, all provinces except Quebec and Ontario have had tax collection agreements with the federal government respecting corporate income taxes.

A collection agreement means that each province enacts its own tax legislation and sets its own tax rates but leaves collection of the tax to the federal government. Since there is a single authority administering the collection of the tax, the taxpayer may use a single return to calculate both his federal and provincial taxes.

Between 1962 and 1967, the federal government reduced its share of personal income tax on a number of occasions. These reductions were made by means of tax abatements. This expression simply refers to a reduction in federal personal income tax or federal corporate income tax that enables the provinces to increase their taxes on the same base without increasing the total burden on the taxpayers. Tax abatements are therefore a means of transferring tax resources from the federal government to the provinces.[1]

Under the tax collection agreements of 1962, the abatements were first set at 16 per cent of basic federal tax on personal income and nine per cent on corporate taxable income. Steps were taken to increase the personal income tax abatement from year to year until it reached 24 per cent in 1966. In 1967, it was increased by four percentage points to 28 per cent, while the corporate income tax abatement rose from nine to 10 per cent of taxable income. This increase was to compensate provinces for a portion of their costs for post-secondary education. The balance of the federal contribution was paid in cash.

The successive increases in federal tax abatements between 1962 and 1967 enabled the provinces to increase their tax revenues substantially without increasing the burden on their taxpayers. By reducing its own taxes to allow the provinces to increase theirs, the federal government recognized the need for change to preserve fiscal balance between the two orders of government.

Since 1967, however, the federal government has maintained that if the provinces need to increase their revenues, they should do so without, at the same time, demanding that the federal government reduce its own taxes. This position is based on the notion that the expenditure priorities of the federal government are, in principle, as important as those of the provinces. It is also based on the principle of fiscal responsibility: if a province wishes at any time to increase its revenues, it should be prepared to raise its own rate of taxation and accept responsibility for its action.

There is no doubt that the developments described above have considerably altered the distribution of resources between the two orders of government. The change from a system based on tax rental agreements to one based on tax collection agreements has given the provinces much more fiscal freedom. The provinces have exercised this freedom through gradual increases in their rates. In addition, through increases in income tax abatements between 1962 and 1967, the federal government reduced the extent of its tax occupancy and enabled the provinces to increase theirs without further burdening the taxpayers.

[1] In the case of the personal income tax, the value of an abatement is measured in percentage points of federal basic tax. An abatement of one point of personal tax is a reduction of one per cent of federal basic tax. In the case of the corporation income tax, the value of an abatement is measured in percentage points of the taxable income of corporations.

Shared-cost programs (conditional grants)

Shared-cost programs are another essential element of the postwar fiscal structure of Canadian federalism. Over the years a number of these programs have been introduced. The most important are hospital insurance, medicare, the Canada Assistance Plan and the post-secondary education transfer. The hospital insurance program began in 1958. Various social assistance grants were introduced during the forties and fifties and grouped under the Canada Assistance Plan in 1966. The post-secondary education transfer was introduced in 1967 and the medicare program began in 1968.

The payments made by the federal government to the provinces under these programs are generally referred to as conditional grants. These grants are conditional in the sense that the amounts are tied to provincial expenditures on the basis of 50-50 cost-sharing formulas. The notion of conditionality is sometimes used to refer to grants that are paid only if certain program criteria are satisfied, whether or not the grants are calculated on the basis of cost-sharing formulas. In order to avoid this ambiguity, the terms "shared-cost" and "conditional" are used interchangeably in this text, except as noted otherwise.

Shared-cost programs were instituted in the health and welfare fields so that the provinces could make available to their residents those services that met certain "national" standards. It was essentially a question of the federal government ensuring that the quality of these services showed no appreciable variation between the wealthy and the poor provinces. In short, these programs sprang from a desire to ensure that public services considered essential be available to all Canadians, and on an equitable basis.

The shared-cost nature of these programs, however, was seen by Quebec as an instrument of unwarranted centralization. This view was shared by some other provinces, notably Ontario and Alberta. They were critical of the fact that, by offering to pay them 50 cents for every dollar they would spend on a given program, the federal government was compelling them to implement a program they might not otherwise have introduced, or which they might have introduced in a different form. Because of provincial pressure, especially from Quebec, the federal government announced in 1963 its desire to withdraw from some of these programs, which were considered to be "well-established," and to replace cash grants with a tax abatement.

The expression "established" applied to programs that had achieved a certain level of "maturity"—that is to say, programs that had been in effect sufficiently long and which commanded sufficient public support to ensure that they would not be discontinued by the provinces. The federal government offered to turn over to the provinces additional shares (tax points) of personal and corporate tax revenues to compensate for ending the conditional grants. Each province would thereby assume the entire financial and administrative responsibility for the programs it administered.

The first concrete proposal aimed at bringing about the gradual withdrawal of the federal government from these programs was put forward in 1964 and applied mainly to hospital insurance and to welfare programs, later incorporated into the Canada Assistance Plan. The next year, the Established Programs (Interim Arrangements) Act was passed, providing a legal framework for the implementation of the proposal. The act was—as its title implies—designed as an interim arrangement. Although it amended the form of the federal contribution, it made relatively little change in the conditional character. Only Quebec took advantage of this offer and entered into what became known as "contracting out" arrangements with the federal government. Under these arrangements, Quebec taxpayers were granted an additional abatement of 19 percentage points of the federal basic personal income tax in lieu of the federal cash contribution that would otherwise be payable. Of the 19 points, 14 were for hospital insurance, four for welfare programs and one for vocational training. The total amount allocated to Quebec for these programs was identical with what would have been granted had the previous arrangements continued. Any difference between the value of the tax abatement for a program and the grant that would otherwise have been paid was made up by a cash adjustment.

In 1966, a new offer was made to complement the interim arrangements introduced in 1964. The new offer included some modifications to the tax abatement, to which would have been added, over a transition period, cash adjustment payments. Had this offer been accepted by all the provinces, it would have had the result of substantially reducing the conditionality and complexity of the three program areas already mentioned and of giving the provinces full financial and administrative responsibility for them. Only four broad conditions were involved in this offer: guarantees had to be given that the hospital insurance benefits would remain universal, comprehensive, portable and accessible.[2] Only Quebec showed any interest.

In an attempt to interest the other provinces, the federal government repeated its offer at a meeting of ministers of finance in 1968, but in vain. Some of the provinces feared that the number of tax points offered as replacement for the cash grants would not produce revenues equal to the value of the grants. As it turned out, these fears were unfounded, for the value of the tax points increased over the years much faster than the provinces had anticipated.

In 1969, the federal government withdrew its general offer of substituting special abatements for conditional grants to facilitate the introduction of basic reforms to the income tax system. The temporary withdrawal of the federal offer was necessary because a "gestation period" was required before realistic

[2] "Universal" means that each program has to apply to virtually all residents in a province irrespective of their income levels; "comprehensive" means that each program must provide an adequate range of services; "portable" means that nobody can be denied the benefits of a program by reason of moving from one province to another; "accessible" means that access to services must not be impeded by excessive charges.

projections of the value of the tax points under the new federal tax system could be made. The federal government undertook to submit a new offer after implementation of the reforms.[3]

In accordance with this undertaking, the federal government proposed in 1973 further alternatives for financing the medical care and hospital insurance programs.[4] By then, its desire to reach an agreement had been strengthened by the fact that these programs, the cost of which it could in no way control, was absorbing an important share of its resources. The 1973 offer was, however, also rejected by a majority of the provinces because they considered that the compensation offered by the federal government was insufficient for them to take the risk of assuming sole responsibility for financing the shared-cost programs.[5] Nonetheless, during negotiation of the fiscal arrangements for the period 1977 to 1982, the federal government and the provinces concluded an agreement on a new formula for financing the hospital insurance, medicare and post-secondary education programs. Under this agreement, referred to as the Established Programs Financing Arrangements or EPF Arrangements, federal contributions for these three programs are in the form of both cash and tax transfers.

Perhaps the most significant aspect of the EPF Arrangements, which came into effect on April 1, 1977, is that federal contributions for the three "established" programs are no longer tied to provincial expenditures. Rather, contributions in a base year are increased annually by the rate of growth of the economy. As noted above, these contributions take the form of a mix of tax and cash transfers. The tax transfer consists of 13.5 points of personal income tax and one point of corporate income tax, equalized to the national average.[6] The cash transfer is made up of a basic cash component designed to provide for stable financing and transition payments designed to ensure that no province loses as a result of accepting part of the federal contribution in the form of tax points.

The EPF Arrangements are subject to the four broad conditions referred to earlier, which are designed to maintain national standards in the health care field.

The purpose of these arrangements is to give the provinces greater flexibility so that they may achieve increased efficiency in the administration of their programs. Moreover, since the provinces no longer need to submit claims to the federal government, provincial expenditures no longer require federal auditing.

---

[3] The reforms became effective January 1, 1972.

[4] The offer did not include the Canada Assistance Plan, the principal provisions of which were under review as part of an overall review of Canadian social security policies.

[5] The federal government proposed the transfer to the provinces of 100 per cent of the taxes and excise duties on alcoholic beverages and tobacco and six tax points on personal income, that is, the federal government would have reduced its tax by six per cent and the provinces would have raised theirs correspondingly.

[6] Technically speaking, a tax point transfer differs from a tax abatement. With a tax point transfer, the federal government makes tax room available to the provinces by means of lowering its entire rate schedule and, hence, the yield of federal basic tax. With a tax abatement, the federal government makes tax room available by a special deduction that applies after federal basic tax is determined.

The new arrangements mark a significant turning point in the history of Canadian federalism.[7] They constitute a new stage in the broad trend toward fiscal decentralization that began in the mid-1950s. This led Darcy McKeough, the former Ontario treasurer, to say that the EPF Arrangements:

> *stand as proof that substantial progress can indeed be made in terms of streamlining the relationships between the federal and provincial governments. The federal government achieved its basic objective, while the provinces achieved the flexibility that they sought.*[8]

The impact of the new financing formula is particularly evident when conditional transfers as a per cent of total transfers are examined over time. As table 2 shows, the share of total federal transfers to the provinces accounted for by conditional grants fell from 54 per cent in 1976/77 to 19 per cent in 1977/78. At the same time, the share of unconditional transfers rose from 28 per cent to 55 per cent or, if one includes tax transfers, from 46 per cent to 81 per cent.

Table 2

Federal transfers to the provinces, 1976/77 and 1977/78

	1976/77		1977/78	
Type of transfer	$ million	%	$ million	%
1. Unconditional cash grants[a] (other than on line 2)	3,065	28	3,258	26
2. Established programs financing cash grants[b]	N.A.	N.A.	3,700	29
3. Conditional cash grants paid in 1976/77 for programs absorbed by EPF[b]	3,657	33	N.A.	N.A.
4. Other conditional cash grants[c]	2,286	21	2,421	19
5. Total cash grants (lines 1+2+3+4)	9,008	82	9,379	74
6. Unconditional tax points (EPF)	1,971	18	3,362	26
7. Total unconditional transfers (lines 1+2+6)	5,036	46	10,320	81
8. Grand total (lines 5+6)	10,979	100	12,741	100

SOURCE: Department of Finance. (The data in this table are taken from the tables published in the appendix.)

N.A.: not applicable.

[a] Includes equalization payments and tax revenue guarantee payments.
[b] Consists of amounts paid in respect of medicare, hospital insurance and post-secondary education.
[c] Includes grants paid under the Canada Assistance Plan and miscellaneous programs.

[7] The Canada Assistance Plan is still financed by conditional grants, pending resolution of alternative ways of improving certain welfare and income maintenance policies.

[8] Ontario, Budget Paper B: *Federal-Provincial Fiscal Reforms*, Ontario Budget of 1977.

Equalization payments

All the provinces of Canada have the same constitutional responsibilities but, because of the economic disparities existing among the various regions of the country, they do not have the same financial capacity to assume these responsibilities. Alberta, for instance, is able to pay for higher quality public services than Newfoundland while maintaining much lower tax rates. In order to make it possible for each province to provide reasonable levels of public services to their residents without resorting to unduly high taxes, there has to be a means of redistributing wealth among regions. In Canada this takes the form of equalization payments administered by the federal government. These are unconditional payments to provinces whose tax resources (i.e., bases) are below the national average.

The various tax rental agreements included elements of implicit equalization from the very beginning. However, eligibility was conditional upon a province's participation in the rental agreements. In 1957, equalization was separated from the tax rental agreements and thereafter became unconditional in nature and a separate and distinct program. It was calculated on the basis of each province's yield from personal income tax, corporate income tax and succession duties levied at the standard rental rates. Those provinces with per capita yields lower than the weighted average of the two wealthiest provinces were eligible for equalization grants. In 1962/63, one-half of the revenues from natural resources were incorporated into the equalization formula but the level of equalization was changed from the average yield of the two wealthiest provinces to the national average. The level was temporarily restored to the top two provinces in 1964/65, although in a qualified manner.

In 1967/68, the federal government introduced the present system of equalization following extensive discussions with the provinces. This formula, which has been modified somewhat in the following years, takes account of each province's fiscal capacity in respect of almost all kinds of revenues. It employs the concept of a "representative provincial tax system." This system reflects both the tax bases, such as personal income, retail sales and oil production, and the tax rates that the 10 provinces collectively use.[9] If application to a particular province of the representative tax system results in a lower per capita yield than the average for all provinces, then that province is entitled to receive an equalization grant covering the difference.[10] The formula is open-ended, with no upper limit on total payout.

The equalization formula of 1967/68 was renewed in 1972/73 and again in 1977/78. While the concepts of a representative tax system, a national average standard of equalization and an open-ended formula have all been

[9] Any tax is made up of a "base" and a "rate". The product of the two is the "yield" of the tax. In Quebec, the base for the retail sales tax is the set of goods sold by retailers (except certain goods that are specifically excepted in the law); the rate of the tax is 8 per cent; the tax yield is the total amount which the government draws from that tax during the fiscal year.

[10] However, equalization cannot compensate a province for a revenue deficiency arising from the fact that it imposes lower tax rates on average than other provinces.

retained, a number of technical, but financially-significant, changes have been made since 1967/68. In 1973/74 school purpose taxes were added, while in 1974/75 and again in 1977/78 certain restrictions were placed on natural resource revenues, which had increased enormously as a result of higher oil and natural gas prices.

Equalization payments have been an essential element in the financial structure of the poorer provinces for many years. For the 1979/80 fiscal year, Quebec was to receive an estimated $1,352 million or $216 per resident, while Newfoundland was to receive an estimated $340 million or $592 per resident. Equalization payments in 1977/78 accounted for approximately 18.5 per cent of the value of the taxes levied by the seven recipient provinces. The payments to Quebec represented approximately 15 per cent of the value of the taxes levied by the government of that province.

Revenue sharing: the overall picture

The arrangements described above respecting sharing of income taxes, shared-cost programs and equalization of provincial revenues involve decisions that contributed to a considerable decentralization of the system prevailing in the 1940s and fifties. The scale of this decentralization is evident in the way each order of government's share of total government revenues has changed during the last 30 years.

Table 3

Federal and provincial/local shares of total government revenues from own sources
(per cent)

	Federal	Provincial/local
1926	44.9	55.1
1930	33.4	66.6
1945*	71.5	28.5
1950*	64.1	35.9
1960*	58.2	41.8
1970	50.9	49.1
1976	50.7	49.3
1977	47.2	52.8
1978	45.6	54.4

SOURCE: Federal Department of Finance, based on the national economic accounts. See appendix 2.

NOTE: Excludes contributions to the Quebec Pension Plan and the Canada Pension Plan.

*Rental payments have been treated as provincial revenues and have been deducted from federal revenues.

Table 3 and graph 1 show that in 1945 the federal government levied 71.5 per cent of all the taxes paid by Canadians, while the provinces raised only 28.5 per cent. Since then, however, the provincial/local share has shown continuous growth, reaching 41.8 per cent in 1960, 49.1 per cent in 1970 and 54.4 per cent in 1978. From 1945 to 1967, the federal share was always greater than the provincial/local share, but the gap between the two diminished year by year. Throughout the period from 1967 to 1976, the two orders of government split the fiscal pie more or less in half, the federal share hovering around 51 per cent and that of the provinces around 49 per cent. But since the new formula for financing established programs came into force in April 1977, the provincial/local share has grown to 54 per cent while the federal share has dropped to less than 46 per cent.

The extent of decentralization appears even greater when federal transfer payments to the provinces are taken into account. Deducting the value of these grants from federal revenues and adding it to the revenues of the provincial/local sector, the figures, as indicated in table 4, are obtained.

Table 4

Federal and provincial/local shares of total government revenues when federal grants are deducted from federal revenues and considered as revenues of the provincial/local sector

(per cent)

	Federal	Provincial/local
1926	43.1	56.9
1930	30.5	69.5
1945	69.2	30.8
1950	59.8	40.2
1960	51.6	48.4
1970	39.8	60.2
1976	38.6	61.4
1977	34.3	65.7
1978	32.6	67.4

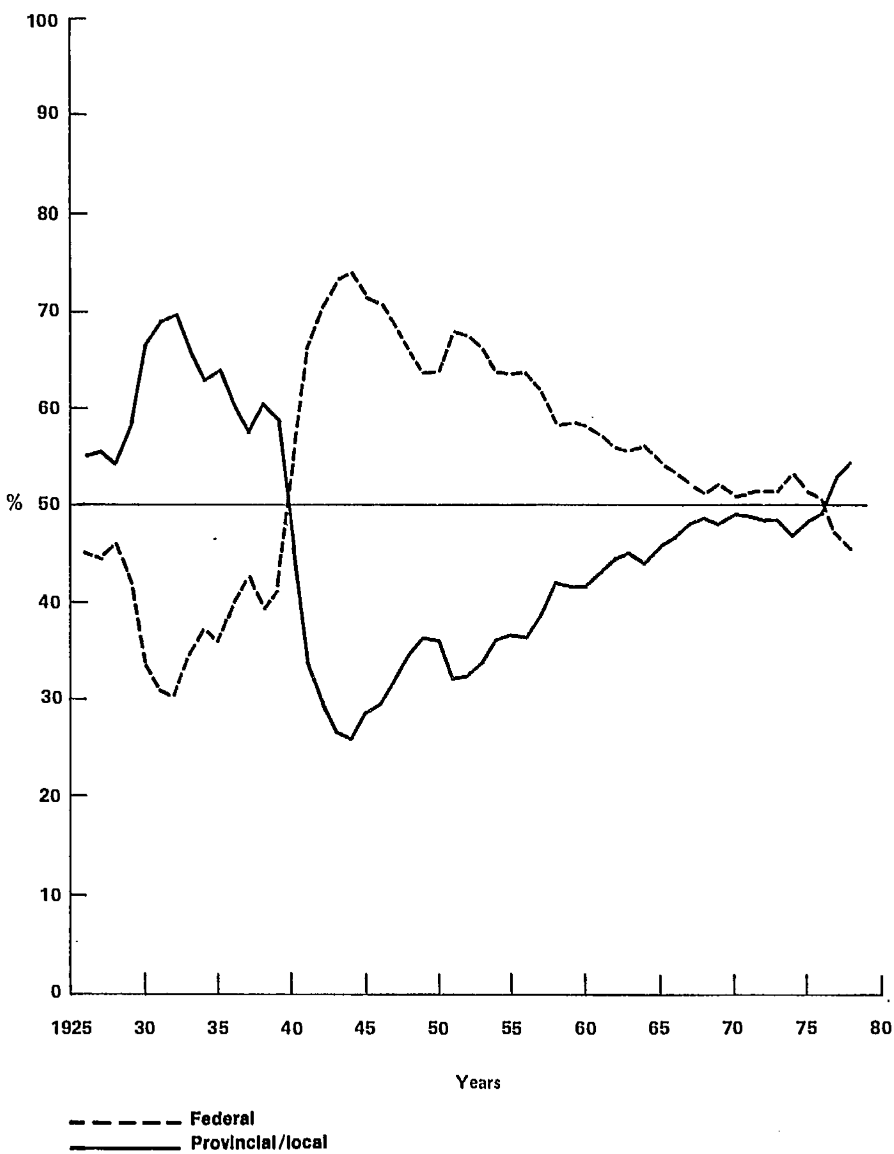
SOURCE: Same as table 3.

Table 4 and graph 2 show an even greater trend toward decentralization. In some respects, they are more relevant as a measure of decentralization than table 3 and graph 1 because they indicate the "real" resources available to each order of government. Admittedly, the inclusion of conditional grants in provincial revenues overstates the case, particularly for the period 1967 to 1976 when conditional grants were relatively important. But since conditional grants to the provinces now make up less than five per cent of total provincial/local revenues, this is no longer an important qualification.

Table 4 reveals that Canada has reached a high degree of decentralization in comparison with our past. Two-thirds of total government revenues after transfers accrue to the provincial/local sector. In 1978, the federal share was below one-third. The only other period in which federal revenues are known to

Graph 1

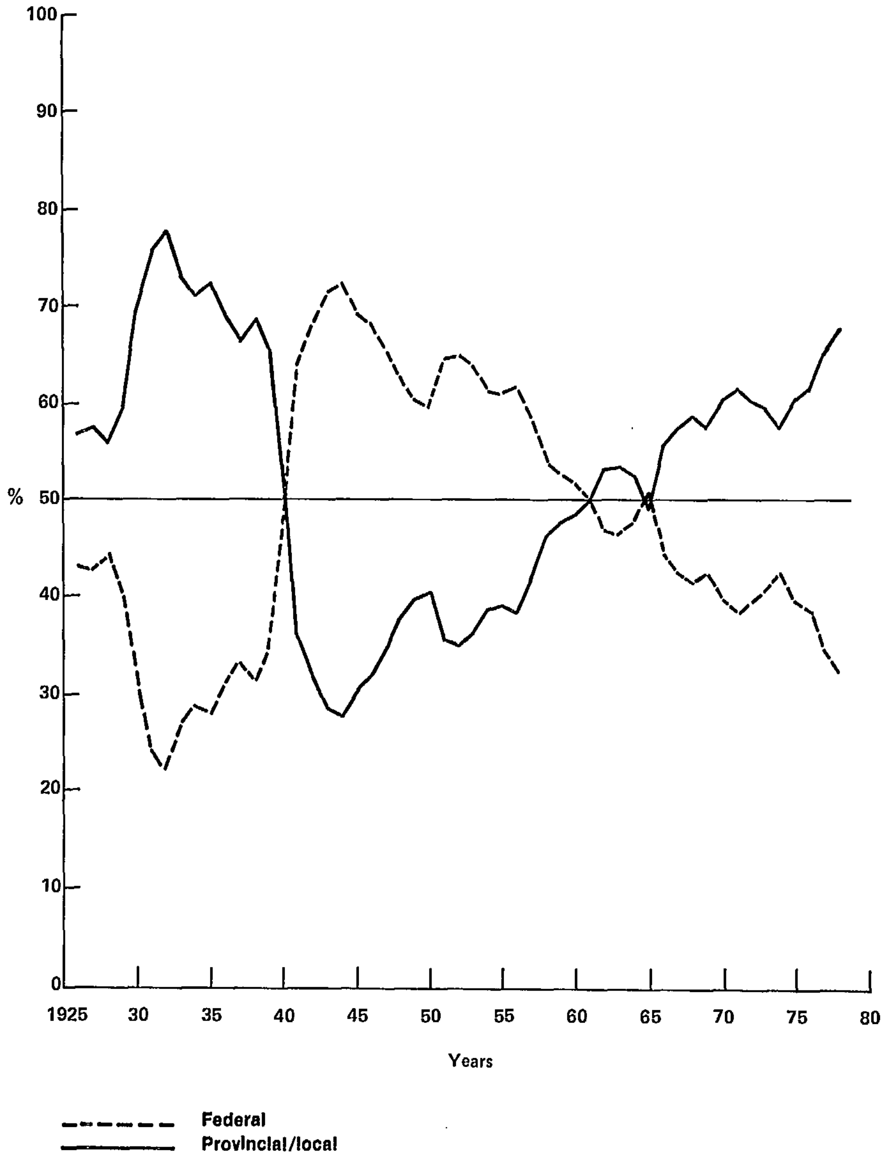
Distribution of own source revenues by order of government (national accounts basis)



NOTE: The data on which this graph is based are found in appendix 2.

Graph 2

Distribution of revenue after transfers* by order of government (national accounts basis)



*Transfers between orders of government are subtracted from the revenues of the paying governments and added to the revenues of receiving governments.

have accounted for a lower share was in the early 1930s when the federal share of revenues after transfers fell below 30 per cent for several years. This, however, was almost 50 years ago, at a time when views concerning the role of government were profoundly different from today's. Moreover, during that period the country was floundering in the grip of a severe world-wide depression. It would be difficult to regard the revenue shares that then existed as providing a norm for today.

In order to judge the extent to which Canada is now decentralized, the revenue shares of the different orders of government may be compared with data for other federations. This is done in table 5, which compares Canada with Australia, the United States, West Germany and Switzerland as of 1976.

Table 5

Revenues from own sources as a share of total government revenues by order of government, 1976
(per cent)

	Federal	Provincial/local
Australia	77.7	22.3
United States	55.8	44.2
Canada	50.0	50.0
West Germany	49.4	50.6
Switzerland	43.1	56.9

SOURCE: National Accounts of OECD countries, 1976, vol. 2 (1976 is the most recent year).

NOTE: Excludes contributions to social security programs, i.e., programs that are organized separately from the other activities of governments. In the case of Canada, such programs are the Canada Pension Plan, the Quebec Pension Plan, the Unemployment Insurance program and government employee pension funds. The relative importance of social security contributions varies from country to country. In 1976, such contributions represented the following percentages of total government receipts: Australia, 0 per cent; United States, 23 per cent; Canada, 10 per cent; West Germany, 33 per cent; Switzerland, 26 per cent.

The figures in table 5 indicate that, prior to introduction of the EPF Arrangements, Canada's fiscal structure was very much like that of Germany and that Switzerland was the only modern federal country that was significantly more decentralized in fiscal terms than Canada. Given the fact that, since 1976, the federal share of total revenues in Canada has been reduced by approximately five percentage points (see table 3), it is altogether probable that Canada is now only second to Switzerland in terms of fiscal decentralization, the latter generally being considered the most decentralized federation in the world.

The Swiss experience may appear particularly relevant to Canada.[11] It should be recognized, however, that this country differs in many ways from

[11] The report of the Task Force on Canadian Unity (co-chaired by Messrs. Pepin and Robarts) states that "Canada would do well to emulate Switzerland" because its people have "managed to root their commitment to diversity in their hearts and in the foundation and institutions of their country so that it has become their dominant shared value." (p. 37).

Canada. One example is the way in which the central government manages the economy. According to some experts, fiscal arrangements in Switzerland make it virtually impossible for the Swiss government to implement a conventional policy of economic stabilization.[12] However, the Swiss have an alternative stabilization mechanism based upon their control over the number of foreigners permitted to work in the country. This safety valve is unique and certainly not one that could apply to Canada. In 1971, for example, Switzerland's official statistics indicate that there were about a million foreign workers, 59 unemployed persons, and 4,885 unfilled jobs. When an economic recession sets in, it is reflected not in a rise in the number of unemployed but in the dismissal of foreign workers. Barring this type of safety valve, decentralization in fiscal affairs necessitates a greater degree of federal-provincial co-ordination in macro-economic policy formulation. What should be surprising to Canadians is not so much the fact that their country has attained a degree of decentralization comparable to Switzerland's, but rather that it has done so *in an economic context of fiscal and structural policies for which Switzerland has no substantial need.*

The decentralized character of Canadian federalism has been recognized by many experts. Bora Laskin, who later became chief justice of the Supreme Court of Canada, noted in 1969 that:

> *on these two related questions (federal tax authority and federal responsibility in the field of social welfare and economic regulatory authority), I would observe that I know of no federal system in which the constituent units have as extensive a regulatory authority as the Provinces of Canada and in which the federal commerce power is as truncated as is that of the central government.*[13]

According to a study conducted by a group of American experts, the sharing of tax revenues among governments is far more favorable to provincial governments in Canada than to state governments in the United States:

> *One of the tests for ascertaining the relative fiscal and political strength of the partners in a Federal system is to observe how they share the intergovernmental revenue pie over time. Using the "revenue pie" test, the performance of the Provinces is truly impressive.... By comparison, the performance of our States was far less impressive.*[14]

In 1967 the present minister of finance of Quebec, the Hon. Jacques Parizeau, recognized the decentralized character of the Canadian federation.

[12] "One result of the foregoing arrangements is that the Swiss federal government is unable to conduct a positive macro-economic fiscal policy." See: Commission of the European Communities, *Report of the Study Group on the Role of Public Finance in European Integration*, vol. 2 (Brussels: April 1977), p. 495.

[13] Bora Laskin, "Reflexions on the Canadian Constitution after the First Century," *Canadian Bar Review*, September 1969.

[14] United States, Advisory Commission on Intergovernmental Relations, *In Search of Balance: Canada's Intergovernmental Experience*, Study M-68, (Washington, D.C.: U.S. Government Printing Office, 1971), p. 1.

In a lecture given at Banff, he said "the British North America Act had invested the provinces with full powers to determine their priorities in important spheres of activity, full powers to raise certain taxes, and most surprising of all, the power to borrow at will in the country and abroad."[15]

After talking about the intention of the federal government to withdraw from the shared-cost programs and the new collection agreements (1967) that enabled the provinces to set their own income tax rates, Mr. Parizeau noted that Canadian politicians were at the point of including in the Constitution the decentralizing trend in national economic and social policy which, as he saw it, had already been pushed too far. He noted in conclusion that any further decentralization would lead to a fragmentation of decision-making powers that would be incompatible with any "rational planning." More recently, Mr. Parizeau has observed that "because rather often in Canada, we tend to talk of the abusive centralized powers of Ottawa, we tend to forget that in reality Canada is highly decentralized."[16]

[15] The most significant passages of the lecture were reproduced in an appendix to René Lévesque's book, *Option Québec*, published in 1968, which constituted a kind of manifesto of the Sovereignty-Association Movement, the forerunner of the Parti Québécois.

[16] See *Globe and Mail*, Dec. 9, 1977.

Chapter 5

Canadian federalism since 1957: recognizing specific needs

The preceding chapter traced the decentralization and flexibility of federal-provincial fiscal arrangements during the past two decades. The discussion turns now to certain expenditure and policy arrangements that have been made in order to meet the wishes of the provinces. An entire book could be devoted to a systematic treatment of such arrangements, for there are few fields of government activity in which the two orders of government have not developed some arrangement to take special provincial or regional needs into consideration. The following gives a number of examples of such arrangements with particular reference to those worked out as a consequence of representations by the Quebec government.

The Quebec Pension Plan

In the spring of 1963, the federal government announced its intention to introduce a universal retirement pension plan. At the same time, studies were in progress in Quebec with a view to establishing a provincial pension plan. In fact, the Lesage government was in the process of developing a comprehensive income security program for senior citizens. Apart from the social security aspects, the Lesage government anticipated that a retirement pension plan would provide the government with a substantial savings fund that could be used to meet the particularly high borrowing requirements of the time. It was also seen as a source of funds for the development of certain industries.

At the federal-provincial conference of July 1963, the federal government submitted its proposal for a pension plan to the provinces. Premier Lesage indicated that he did not object to the federal plan being applied in the other provinces but he intended to introduce his own plan in Quebec. At a second conference in April 1964, Premier Lesage presented the main points of the Quebec plan. These differed from the federal plan in several important respects. In the following weeks, hard bargaining took place between the federal government and the provinces and a compromise was worked out: Quebec was to implement its own pension plan and the federal government was to set up a plan in the other provinces. However, the plans had to be identical with respect to eligibility rules and benefits—a requirement that facilitated the transfer of benefits from one plan to another. Further, it was agreed that only the provinces would be able to borrow funds accumulated by the Canada and Quebec Pension Plans. Thus Quebec acquired its own retirement plan, while at the same time the transferability of pension benefits of people moving to or from Quebec was guaranteed.

Youth allowances for 16- and 17-year-olds

In 1964 the federal government instituted a youth allowances program for students aged 16 and 17. As the Quebec government had already established a similar program, it requested that the federal government refrain from applying its program in Quebec but that it increase the abatement of personal income tax revenues to Quebec residents. An agreement was reached under which the federal government increased its abatement of personal income tax in Quebec by three points. Thus the provincial tax could be increased without an increase in the tax burden of Quebec residents. Any difference between the value of the tax points and the amount that the federal government would otherwise have paid out to Quebeckers, had there been no provincial program, was to be paid or recovered, as the case might be, in the form of cash payments.

Student loans

In 1964 Parliament passed the Canada Student Loans Act under which the federal government undertook to guarantee bank loans to post-secondary students and to pay the interest on these loans as long as their studies continued. Since the Quebec government already had its own student loans program, arrangements were made for Quebec to receive an annual "compensatory payment." The amount of this payment is determined according to an estimate of what it would cost the federal government if the federal program were applied in Quebec. Any province willing to set up its own loans program is entitled to receive similar payments.

Family allowances

In 1973 the federal and provincial governments decided to carry out a review of Canada's social security system. One of the guiding principles was the right of the provinces to modify the social security structure to meet their particular needs, average income levels and the cost of living.[1] The *Working Paper on Social Security in Canada*, which launched this review, included the following passage:

> *The levels of minimum wages, of income supplementation and income guarantees, of training allowances, and of universal allowances should be such as to provide reasonable equity as between the individuals and families who are benefiting from them. To achieve this balance within each* province, *the* governments of the provinces should have a predominant voice *in setting the income levels involved.*

[1] See: Canada, Department of National Health and Welfare, *Working Paper on Social Security in Canada* (Ottawa: April 1973). (Made public in April 1973 by the Hon. Marc Lalonde, then Minister of National Health and Welfare.)

With this principle in mind, the federal government proceeded a year later with a major reform of its family allowance program. This reform not only involved a substantial increase in program payments and the indexing of allowances to the cost of living, but it also recognized the right of the provinces to vary payments according to the age and number of children in the family. Adjustments could be made provided that the total amount of federal allowances paid in the provinces was not greater than if the recommended federal rates had been paid, and the amount of federal family allowance paid for any one child was not less than 60 per cent of the general federal rate.

These provisions were made mainly as a result of representations by the Quebec government, which felt it was particularly important for allowances to vary according to the number of children and the position of each child (oldest, second oldest and so on) in the family. Hence the monthly allowances paid out in Quebec since 1974 have been different from those paid in other provinces.

The Family Allowance Act implemented in 1974 provides for arrangements whereby a province may supplement the allowance paid by the federal government by drawing on provincial funds. Prince Edward Island has taken advantage of this provision and allocates to families with more than four children an additional $10 per child for the fifth and each subsequent child. Thus the new federal act makes it possible for each province to set up its own family allowance program without having to shoulder the administrative burden involved. This is particularly advantageous to the less populous provinces, such as those in the Atlantic region.

Agreements on immigration

Quebec authorities have always expressed a keen interest in the growth of Quebec's population and, in this regard, immigration to the province has from time to time been a key issue. In 1868 the Quebec government opened an immigration office in France. This office was closed after a few years because it did not bring a substantial number of immigrants to Quebec. For the last decade or so, however, the Quebec government has expressed a desire to participate in the development and administration of Canada's immigration policy. Provincial rights in this field are recognized in section 95 of the BNA Act.

An initial agreement was signed by the federal and Quebec governments in 1975, enabling the province to place its own officers in Canadian immigration offices overseas so that they could share in the task of selecting immigrants who wanted to settle in Quebec. One of the aims of this agreement was to increase efforts to attract francophone immigrants to Canada. However, the federal government retained ultimate responsibility for the selection criteria and choice of immigrants.

In early 1978, when Parliament passed a revised Immigration Act spelling out a new division of immigration responsibilities between the federal government and the provinces, Quebec proposed that both orders of government have an equal say in the selection criteria. This proposal led to a new agreement that gives Quebec considerable decision-making power with respect to independent immigrants, temporary workers, foreign students and refugees. It provides for the creation of two "point systems" or "sets of criteria," one administered by the federal government and the other by the provincial government (naturally, this applies only to those wishing to settle in Quebec). In the case of a conflict between the two systems, that of Quebec must prevail unless there is a national security or public health concern. If a would-be immigrant is turned down by Quebec, he or she may still be allowed to settle in another province.

The effect of this agreement is to give Quebec a veto with respect to any person wishing to immigrate to Quebec. It also enables the province to encourage the immigration of those who meet the criteria established for settlement in Quebec rather than in another province. Since 1978, therefore, the provincial government has had the final say in the selection of immigrants to Quebec. Similar agreements are open to all provinces, if they so wish.

Deposit insurance

In 1967, the federal government created the Canada Deposit Insurance Corporation (CDIC) to provide insurance for deposits in banks and banking institutions up to a maximum of $20,000 for any one depositor. As the Quebec government had expressed the desire to set up its own deposit insurance scheme for provincially-chartered institutions, the legislation providing for the creation of the CDIC was worded with this in mind. For this reason, the only deposits insured by the CDIC in Quebec are those in federally-chartered institutions; other deposits are insured by the Quebec Deposit Insurance Board. The federal legislation establishing the CDIC also provides for reciprocal agreements with the Government of Quebec covering provincially-chartered institutions with branches outside Quebec. Finally, the CDIC is empowered to grant guaranteed short-term loans to the Quebec Deposit Insurance Board to enable it to meet urgent requirements for funds arising in the course of its insurance operations.

It would be possible to give other examples of special arrangements designed to meet the particular needs of various provinces. Examples can be found in areas such as regional development, environmental protection and fisheries. However, the foregoing examples should suffice to illustrate the very great flexibility and changing nature of the Canadian federal system.

Chapter 6

From autonomy to interdependence

Those who want to get back the substance of the classical federalism will have to reduce greatly big business, big government, and economic interdependence.
J. A. Corry

The data presented in the preceding chapters suggest that there has been a progressive decentralization in fiscal arrangements since 1957; that many arrangements regarding federal expenditures and policies have been worked out to take account of the special needs of the provinces, and that the Canadian federal system appears to be one of the most decentralized systems in the world. The question that remains to be answered, however, is whether our federal system has moved away from or come closer to the concept of provincial autonomy which the Tremblay report deemed essential to federal decentralization and which has influenced successive governments in Quebec since its publication.

If the members of the Tremblay Commission were to review the actual functioning of the Canadian federation they would probably find reasons for satisfaction. The commissioners would have to acknowledge in particular that the distribution of tax receipts has been radically altered; that equalization payments are made unconditionally and are very generous; that conditional grant programs have been greatly reduced in scope and importance, and that the provinces have been able to play a major role in shaping social security programs, while maintaining the concepts of universality and portability between provinces. In short, the commissioners would have to admit that Canadian federalism has undergone extensive decentralization with respect to control over government revenues, and that it operates in a much more flexible manner with respect to expenditure and policy formulation.

On closer examination, however, the commissioners would have to conclude that the present structure does not correspond to the traditional concept of federalism that they espoused. They would find that in many fields of government activity, the federal government and the provinces are called upon to confer with one another regularly; that the number of mechanisms for federal-provincial consultation has increased enormously over the past decades,[1] and that agreements, understandings and programs involving both

[1] An inventory prepared by the Federal-Provincial Relations Office in 1972 shows that there were 482 organizations providing liaison between the two orders of government and that dealt with matters relating to all fields of government activity.

orders of government have multiplied dramatically. They would discover that the federal government has a continuing interest in many matters falling primarily under provincial jurisdiction. At the same time, they would discover that the provinces also have an interest in many matters that are of federal concern, such as monetary policy, international trade, the law of the sea, and that it is often difficult for the federal government to act on these matters without provincial co-operation. Finally, they would discover that certain policies, such as those concerning scientific research and development, environmental protection, industrial growth and regional development are not unequivocally under the sole jurisdiction of either order of government and require close federal-provincial collaboration.

The commissioners would find a very decentralized federal system in which each order of government can seldom act without influencing in some way the programs and policies of the other. They would discover that provincial autonomy has been gradually eroded, just as federal autonomy has been gradually eroded. On closer examination, they would discover that no one ever decided to put an end to the principle of autonomy but that it gradually, almost imperceptibly, disappeared as both orders of government expanded their areas of activity. In short, they would find that the autonomy of each order of government has generally given way to interdependence.

It is important to analyze this concept of interdependence in order to understand how the present federal system works. The Canadian federation, like those of the United States, Australia and Switzerland, was created at a time when the liberal values of laissez-faire and individualism reigned supreme. It was an era of professional craftsmen, independent small businessmen and small family firms that rarely had more than 15 to 20 employees. Moreover, society was much less urbanized and complex than it is at present. The role of government in this early industrial society was relatively simple and clearly circumscribed. In this context, it was possible and desirable for a federally organized country to create a distribution of powers so that each order of government could enjoy almost total independence in dealing with matters under its jurisdiction.

It was precisely this possibility of allocating or splitting up the functions of government that opened the way for and, at the same time, guaranteed the long-respected principle of provincial autonomy. What, in fact, does a province's autonomy mean if not the possibility of governing its own affairs without having to worry constantly about what the other governments within the federation are doing?

The notion of autonomy is thus founded upon a certain concept of federalism that was appropriate at a certain point in history. But can it be appropriate at a time when the free enterprise economy has been replaced by a mixed economy, when means of transportation and communication put people at opposite ends of the country into daily contact with each other and when small family firms have been largely replaced by large national and multinational corporations? To ask the question is to answer it. In such a society, a government's presence is by no means limited to a few well-defined areas: it intervenes in nearly every field of human activity. In the modern industrial state, government is involved in all areas. All its components are interdependent. A government's activities in the education field affect its activities in the area of employment; its activities in employment affect its social welfare programs, which in turn affect housing policy, and so on.

This interdependence of government policies has serious consequences for a federal system: in effect, it means that the orders of government must co-operate if coherent action is to be taken. The federal government is as dependent on the provinces as they are on it. To deny that there is a need for co-operation or close, ongoing consultation in almost all major areas of government affairs is to deny the very possibility of coherent government action. This need for concerted action is related to the very nature of the modern state. To obviate it, our governments would have to relinquish most of the functions they have acquired since World War II.

However, it can never be emphasized too strongly that the lessening of autonomy does not mean the end of decentralization. In fact, there appear to be two basic ways to satisfy the requirement for consultation and co-ordination in a federal system. The first is to grant the federal order the responsibility for making major policy decisions and give to the provinces or states the role of implementing the policies. The United States and Australia seem to have adopted this centralist approach. The second approach is to grant the two orders of government the responsibility for developing *jointly* major policies of national concern and, to the greatest extent possible, ensure that the provinces have the means to implement these policies themselves. The latter decentralized method seems the one best suited to countries as heterogeneous as Canada and Switzerland. Thus decentralization does not lead to a separation of powers, as in traditional federalism, but rather to co-operation in decision-making.

In losing much of their autonomy the provinces have, *like the federal government*, lost their ability to make totally independent decisions in many areas. However, because of the interdependence of the functions of modern government, the provinces now have a say in major areas from which they were previously excluded. The ability of the federal and provincial governments to act has therefore not so much increased or declined as it has become more and more *integrated* in many areas; neither order of government can act without the co-operation, or at least the tacit agreement, of the other.[2] This change is, moreover, characteristic of most modern federal systems and operates internationally as between sovereign states. On the basis of this observation, certain

[2] Essentially, this observation applies to the major initiatives undertaken by governments in a federal system. The fact remains that in certain areas, each order of government retains substantial independence from the other order. A provincial government may, for example, introduce education programs in its elementary schools or new policy for the operation of municipal institutions without having a significant impact on the federal government.

analysts have concluded that federalism is not merely a *structure* of government but also a *process*. Daniel Elazar defines the concept of a federal process in the following way:

> *One of the elements of a federal process is the idea of parties working together on concerns of the federation as a whole; it is expressed through* negotiated co-operation *on problems and policies and is based on every party's commitment to negotiate a consensus or, failing that, a compromise which preserves the basic integrity of all partners.*[3]

In the same way, Carl Friedrich maintains that:

> *federalism should not be seen only as a static pattern or design, characterized by a particular and precisely fixed division of powers between government levels. Federalism is also and perhaps primarily the process ... of adopting joint policies and making joint decisions on joint problems.*[4]

Thus the concept of autonomy in a modern federation no longer refers to a form of independence in areas defined by the constitution but to an ability to act or influence the course of events.

The fact that Canadian federalism can be distinguished from most other federal systems by its great degree of decentralization and the many special agreements aimed at meeting specific provincial needs has been due, to a considerable extent, to Quebec. This was particularly true of the period following World War II. However, other provinces have exerted strong influences on many occasions and there can be little doubt today that there is widespread support in Canada for a system that gives considerable powers to the provinces.

The Tremblay Commission would not find in Canada today the traditional federal structure that it proposed. However, it would find a unique form of federalism, the essential components of which are the result of negotiations between Ottawa and the provinces. Admittedly, these negotiations often underline the tensions that exist in our federal system, but above all they reflect its creative nature.

[3] Daniel Elazar, "Les objectifs du fédéralisme," *L'Europe en Formation*, 190-192, January-March 1976, p. 166. (*L'Europe en Formation* is an international federalist publication.) (Author's translation)

[4] Carl J. Friedrich, *Trends of Federalism in Theory and Practice* (New York: Praeger, 1968), p. 7.

Bibliography

Books

Brady, Alexander L. *Democracy in the Dominions*. 2d ed. Toronto: University of Toronto Press, 1952.
Bryden, Kenneth. *Old Age Pensions and Policy-Making in Canada*. Montreal and London: McGill-Queen's University Press, 1974.
Carter, George E. *Canadian Conditional Grants Since World War II*. Toronto: Canadian Tax Foundation, 1971.
Charbonneau, J.P., and Paquette, G. *L'Option*. Montreal: Les éditions de l'homme, 1978.
Clark, Douglas H. *Fiscal Need and Revenue Equalization Grants*. Toronto: Canadian Tax Foundation, 1969.
Dafflon, Bernard. *Federal Finance in Theory and Practice with Special Reference to Switzerland*. Bern: Paul Haupt, 1979.
Friedrich, Carl J. *Trends of Federalism in Theory and Practice*. New York: Praeger, 1968.
Johnson, Daniel. *Égalité ou indépendence*. Éditions Renaissance, 1965.
Lamontagne, Maurice. *Le fédéralisme canadien: évolution et problèmes*. Québec: Les presses universitaires Laval, 1954.
Lower, A.R.M., and Scott, F.R. *Evolving Canadian Federalism*. Durham, N.C.: Duke University Press, 1958.
Lynn, James H. *Comparing Provincial Revenue Yields, The Tax Indicator Approach*. Toronto: Canadian Tax Foundation, 1968.
Maxwell, James A. *Federal Subsidies to the Provincial Governments in Canada*. Cambridge: Harvard University Press, 1937.
Meekison, Peter J. *Canadian Federalism: Myth or Reality*. Toronto: Methuen, 1968.
Moore, Milton A.; Perry, J. Harvey; and Beach, Donald I. *The Financing of the Canadian Federation, The First Hundred Years*. Toronto: Canadian Tax Foundation, 1966.
Simeon, Richard. *Federal-Provincial Diplomacy: the Making of Recent Policy in Canada*. Toronto: University of Toronto Press, 1972.
Veilleux, Gérard. *Les relations intergouvernementales au Canada, 1867-1967*. Québec: Les presses de l'Université du Québec, 1971.
Wheare, Kenneth C. *Federal Government*. 4th ed. London: Oxford University Press, 1963.

Articles from periodicals

Bastien, Richard. "La structure fiscale du fédéralisme canadien: 1945-1973." *Public Administration in Canada* vol. 17, no. 1 (Spring, 1974) (includes English abstract).
Brady, Alexander. "Report of the Royal Commission on Dominion-Provincial Relations." *Canadian Historical Review* vol. 21, no. 3 (September 1940).

Dehem, Roger and Wolfe, J.N. "The Principles of Federal Finance and the Canadian Case." *Canadian Journal of Economics and Political Science* vol. 21, no. 1 (February 1955).

Elazar, Daniel. "Les objectifs du fédéralisme." *L'Europe en Formation* (January-March 1976).

Laskin, Bora. "Reflections on the Canadian Constitution after the First Century." *Canadian Bar Review* (September 1969).

Pigeon, L.P. "The Meaning of Provincial Autonomy." *Canadian Bar Review* vol. 29, no. 10 (December 1951).

Smiley, Donald J. "The Rowell-Sirois Report, Provincial Autonomy and Post-War Canadian Federalism." *Canadian Journal of Economics and Political Science* vol. 27, no. 1 (February 1962).

Public documents

Canada, Dept. of National Health and Welfare, *Working Paper on Social Security in Canada*. Ottawa: April 1973.

Canada, *Federal-Provincial Grants and the Spending Power of Parliament* (working paper on the Constitution). Ottawa: 1969.

Canada, *Federal-Provincial Programs and Activities: A Descriptive Inventory* (published by the Federal-Provincial Relations Office). Ottawa: December, 1977.

Canada, *Federal-Provincial Tax Structure Committee*, December 14 and 15, 1966. Ottawa: Queen's Printer, 1966.

Canada, *Report of the Advisory Committee on Reconstruction*. Ottawa: September 24, 1943.

Canada, *Report of the Royal Commission on Dominion-Provincial Relations*, vols. 1 and 2. Ottawa: Queen's Printer, 1939.

Canada, *Report of the Task Force on Canadian Unity*. Ottawa: 1979.

Canada, *Summary Notes of the 5th Meeting of the Ministers of Finance and Provincial Treasurers*, held in Ottawa, November 4 and 5, 1968 (photocopied document).

Commission of the European Communities, *Report of the Study Group on the Role of Public Finance in European Integration*, vols. 1 and 2. Brussels: April 1977.

Lynn, James H., *Federal-Provincial Fiscal Relations*, Studies of the Royal Commission on Taxation, no. 23. Ottawa: Queen's Printer, 1967.

MacIntosh, W.A., *The Economic Background of Dominion-Provincial Relations*, Appendix III of the Royal Commission Report on Dominion-Provincial Relations. Toronto: McClelland and Stewart Ltd., 1964.

Ontario, *Budget of 1977* (presented by the Honourable Darcy McKeough).

Quebec, *Report of the Royal Commission of Inquiry on Constitutional Problems*, vols. 1-4. Quebec City: 1956.

United States, Advisory Commission on Intergovernmental Relations, *In Search of Balance—Canada's Intergovernmental Experience*, Study M-68. Washington D.C.: U.S. Government Printing Office, 1971.

Appendix 1
Summary of federal transfers to the provinces, 1976/77
($ thousand)

Program	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.	Total
Unconditional cash payments											
Equalization	226,220	59,943	291,555	213,493	1,189,511	—	171,433	17,127	—	—	2,169,282
Statutory subsidies	9,708	659	2,174	1,774	4,484	5,504	2,156	2,100	3,132	2,117	33,808
1972 revenue guarantee	18,600	3,981	25,311	21,306	219,498	379,358	41,197	39,025	73,263	121,573	943,112
1971 undistributed income on hand	105	10	358	266	3,385	6,185	868	454	1,844	2,080	15,555
Public utilities income tax transfer	2,317	310	—	—	2,022	4,708	1,373	44	25,536	2,190	38,500
Estate tax adjustment	273	22	-497	-305	-2,927	-3,373	294	-340	1,954	—	-4,899
Youth allowance recovery	—	—	—	—	-130,315	—	—	—	—	—	-130,315
Sub-total	257,223	64,925	318,901	236,534	1,285,658	392,382	217,321	58,410	105,729	127,960	3,065,043
Conditional cash payments											
Hospital insurance	67,335	12,509	98,199	81,659	-16,067	1,019,924	124,396	109,448	219,612	290,226	2,007,241
Medicare	24,148	5,178	35,593	29,746	270,395	359,963	45,042	41,882	82,336	106,717	1,001,000
Post-secondary education cash transfer	6,732	1,492	21,255	8,738	335,642	189,859	19,477	14,966	39,003	11,536	648,700
Sub-total	98,215	19,179	155,047	120,143	589,970	1,569,746	188,915	166,296	340,951	408,479	3,656,941
Canada Assistance Plan	40,347	10,668	46,820	67,266	391,498	408,665	53,131	63,512	107,152	184,701	1,373,760
Health Resources Fund Act	1,065	—	749	4,052	4,358	6,138	807	2,146	—	4,735	24,050
Other health and welfare	5,055	162	1,641	1,816	699	70,718	17,960	2,396	14,926	817	116,190
Development of regions & localities	47,666	34,153	35,165	40,211	60,321	18,420	19,562	17,068	7,758	7,076	287,400
Bilingualism development	1,120	555	2,395	14,396	93,745	39,787	3,335	1,170	3,398	2,920	162,821
Citizenship language texts and instructions	—	—	25	—	612	2,253	144	6	485	598	4,123
Natural resources and environment	—	4,592	29,595	781	1,687	2,112	1,493	1,459	4,688	6,631	53,038
Agriculture, trade, industry and tourism	232	497	304	178	2,619	6,261	9,650	24,983	17,027	2,246	63,997
General government	—	—	—	—	—	83	2	—	—	—	85
Protection of property	238	96	474	425	3,776	5,778	746	740	1,292	1,808	15,373
Transport and communication	213	—	—	—	163	—	15,774	10,186	10,598	55,400	92,334
Labour and employment	—	121	94	82	425	1,370	309	313	425	330	3,469
Research establishments	—	—	111	83	—	83	—	111	87	140	615
Municipal grants	662	153	5,009	1,389	16,891	42,542	5,623	2,473	5,709	8,036	88,487
Sub-total	96,598	50,997	122,382	130,679	576,794	604,210	128,536	126,563	173,545	275,438	2,285,742
Total cash transfers	452,036	135,101	596,330	487,356	2,452,422	2,566,338	534,772	351,269	620,225	811,877	9,007,726

Summary of federal transfers to the provinces, 1976/77 (cont.)

Program	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.	Total
Tax abatements											
Post-secondary education tax transfer											
4.357% personal income tax	10,298	1,970	18,411	14,061	187,044	304,615	27,621	26,074	69,936	94,955	754,985
1.000% corporate income tax	1,229	282	2,435	2,030	32,555	59,228	5,903	5,590	23,054	16,781	149,087
Youth allowances	—	—	—	—	130,315	—	—	—	—	—	130,315
Hospital insurance	—	—	—	—	719,783	—	—	—	—	—	719,783
Canada Assistance Plan	—	—	—	—	217,121	—	—	—	—	—	217,121
Blind persons allowance	—	—	—	—	53	—	—	—	—	—	53
Disabled persons allowance	—	—	—	—	39	—	—	—	—	—	39
Unemployment assistance	—	—	—	—	-21	—	—	—	—	—	-21
Total tax transfer	11,527	2,252	20,846	16,091	1,286,889	363,843	33,524	31,664	92,990	111,736	1,971,362
Total cash plus tax transfer	463,563	137,353	617,176	503,447	3,739,311	2,930,181	568,296	382,933	713,215	923,613	10,979,088
Equalization — dollars per capita	406	507	352	315	191	—	168	19	—	—	—

SOURCE: Public Accounts of Canada 1977 (vol. 2, section 34) and Department of Finance tax abatement data.

Summary of federal transfers to the provinces, 1977/78
($ thousand)

Program	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.	Total
Unconditional cash payments											
Equalization (1972 and 1977 acts)	272,024	67,270	365,456	279,185	1,277,500	—	220,382	39,886	—	—	2,521,203
Statutory subsidies	9,707	659	2,174	1,774	4,484	5,504	2,182	2,125	3,350	2,117	34,076
1972 revenue guarantee	13,276	2,739	18,365	16,412	143,889	210,395	31,369	38,160	66,254	59,524	600,383
1971 undistributed income on hand	161	153	294	300	3,495	6,165	524	484	1,930	1,776	15,282
Public utilities income tax transfer	2,089	402	—	—	1,665	8,072	1,230	44	31,916	478	45,896
Youth allowances recovery[1]	—	—	—	—	-122,540	—	—	—	—	—	-122,540
Reciprocal taxation	2,139	1,160	7,390	2,763	11,104	22,093	—	—	—	—	46,649
Municipal grants	1,041	361	7,153	1,500	23,738	53,627	7,929	3,056	7,007	11,561	116,973
Sub-total	300,437	72,744	400,832	301,934	1,343,335	305,856	263,616	83,255	110,457	75,456	3,257,922
Established programs financing cash transfer											
Hospital insurance	40,910	8,173	64,336	49,739	374,238	624,999	80,624	70,478	140,007	161,711	1,615,215
Medicare	14,508	2,898	22,816	17,639	132,717	221,646	28,592	24,994	49,651	57,348	572,809
Post-secondary education	26,523	5,299	41,712	32,248	242,635	405,214	52,272	45,694	90,772	104,844	1,047,213
Extended health care	11,251	2,407	16,708	13,728	125,661	167,469	20,625	18,731	37,993	49,952	464,525
Sub-total	93,192	18,777	145,572	113,354	875,251	1,419,328	182,113	159,897	318,423	373,855	3,699,762
Conditional cash payments											
Hospital insurance[2]	2,345	—	2,438	—	97,229[3]	29,131	3,447	—	4,183	—	138,773
Medicare[2]	734	66	898	398	7,310	7,632	1,085	594	2,790	2,098	23,605
Post-secondary education (1972 act)	150	101	—	1,770	68,820	-19,230	3,900	—	-30,000	22,788	48,299
Canada Assistance Plan	40,036	7,381	47,638	51,087	365,256	395,670	54,451	55,810	115,462	198,889	1,331,680
Health Resources Fund	71	—	561	71	8,140	8,792	—	2,439	—	2,045	22,119
Other health and welfare	5,009	177	1,886	1,310	749	42,163	6,227	2,549	3,735	676	64,481
Development of regions and localities	57,804	29,782	34,367	44,485	132,010	19,165	19,244	13,084	7,461	11,298	369,060
Education (including bilingualism, citizenship language, native people, co-op education)	1,479	610	2,822	13,907	144,351	50,019	3,866	1,377	3,230	4,995	226,656
Natural resources and environment	1,355	—	653	600	2,824	2,656	1,674	1,317	777	6,464	18,230
Agriculture, trade, industry and tourism	146	540	266	217	2,507	7,703	8,968	37,040	17,808	1,896	77,091
General government	—	—	—	—	—	227	—	—	—	100	327
Protection of property	291	109	691	608	5,389	8,333	1,028	960	1,934	2,511	21,854
Transportation and communication	141	428	5,215	850	—	414	14,650	10,800	10,548	30,599	73,645
Labour and employment	—	149	122	85	813	1,162	382	340	544	336	3,933
Research establishments	—	—	124	92	—	92	—	123	125	124	680

Summary of federal transfers to the provinces, 1977/78 (cont.)

Program	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.	Total
Sub-total	109,561	39,343	97,681	115,840	835,398	553,929	118,922	126,433	138,597	284,819	2,420,523
Total Cash Payments	503,190	130,864	644,085	531,128	3,053,984	2,279,113	564,651	369,585	567,477	734,130	9,378,207
Tax abatements											
Established programs financing tax transfer[4]											
13.5 personal income tax points	34,153	6,540	61,247	46,875	619,543	1,015,533	91,316	86,115	229,297	315,966	2,506,605
1.0 corporate income tax points	1,815	342	3,446	2,982	40,395	80,962	6,975	5,854	28,953	19,794	191,518
Contracting out tax transfer											
8.5 personal income tax points for EPF	—	—	—	—	354,417	—	—	—	—	—	354,417
5.0 personal income tax points for CAP	—	—	—	—	204,167	—	—	—	—	—	204,167
3.0 personal income tax points for youth allowances[1]	—	—	—	—	122,540	—	—	—	—	—	122,540
Hospital insurance[3]	—	—	—	—	-16,828	—	—	—	—	—	-16,828
Blind persons allowances	—	—	—	—	40	—	—	—	—	—	40
Disabled persons allowances	—	—	—	—	22	—	—	—	—	—	22
Unemployment assistance	—	—	—	—	4	—	—	—	—	—	4
Total tax transfer	35,968	6,882	64,693	49,857	1,324,300	1,096,495	98,291	91,969	258,250	335,780	3,362,485
Total cash plus tax transfer	539,158	137,746	708,778	580,985	4,378,284	3,375,608	662,942	461,554	825,727	1,069,910	12,740,692

SOURCE: Public Accounts of Canada 1978 (vol. 2, section 34) and Department of Finance, tax abatement and EFP data.

[1]The Youth Allowances Program has expired. The amount shown represents the continued transfer of 3 personal income tax points to Quebec for the now defunct program and the recovery of their value by means of a reduction in the amounts otherwise payable to the province.

[2]Represents prior year adjustments.

[3]Represents prior year adjustments under the now defunct Established Programs (Interim Arrangements) Act.

[4]The established program financing tax transfer is equalized under the provisions of the general equalization program.

Appendix 2

Revenues by order of government, before and after intergovernmental transfers, national accounts basis, 1926 to 1978 ($ million)

Year	Revenues from own source			Total revenue	Revenues after intergovernmental transfers			% distribution of own source revenues			% distribution of own after transfers		
	federal	provincial	local		federal	provincial	local	federal	provincial	local	federal	provincial	local
1926	389.	156.	322.	867.	374.	154.	339.	44.9	18.0	37.1	43.1	17.8	39.1
1927	404.	168.	334.	906.	388.	164.	354.	44.6	18.5	36.9	42.8	18.1	39.1
1928	449.	184.	349.	982.	432.	179.	371.	45.7	18.7	35.5	44.0	18.2	37.8
1929	418.	209.	375.	1002.	401.	203.	398.	41.7	20.9	37.4	40.0	20.3	39.7
1930	293.	210.	375.	878.	268.	209.	401.	33.4	23.9	42.7	30.5	23.8	45.7
1931	249.	190.	366.	805.	193.	202.	410.	30.9	23.6	45.5	24.0	25.1	50.9
1932	233.	179.	356.	768.	171.	213.	384.	30.3	23.3	46.4	22.3	27.7	50.0
1933	266.	177.	337.	780.	210.	347.	341.	22.7	43.2	26.9	26.9	28.6	44.5
1934	316.	186.	351.	853.	245.	241.	367.	37.0	21.8	41.1	28.7	28.3	43.0
1935	332.	229.	361.	922.	258.	291.	373.	36.0	24.8	39.2	28.0	31.6	40.5
1936	422.	267.	365.	1054.	331.	341.	382.	40.0	25.3	34.6	31.4	32.4	36.2
1937	485.	298.	358.	1141.	380.	382.	379.	42.5	26.1	31.4	33.3	33.5	33.2
1938	437.	305.	364.	1106.	351.	368.	387.	39.5	27.6	32.9	31.7	33.3	35.0
1939	481.	311.	370.	1162.	402.	365.	395.	41.4	26.8	31.8	34.6	31.4	34.0
1940	884.	361.	377.	1622.	814.	409.	399.	54.5	22.3	23.2	50.2	25.2	24.6
1941	1523.	386.	390.	2299.	1469.	416.	414.	66.2	16.8	17.0	63.9	18.1	18.0
1942	1957.	430.	393.	2780.	1892.	465.	423.	70.4	15.5	14.1	68.1	16.7	15.2
1943	2380.	458.	403.	3241.	2321.	484.	436.	73.4	14.1	12.4	71.6	14.9	13.5
1944	2524.	474.	414.	3412.	2456.	491.	465.	74.0	13.9	12.1	72.0	14.4	13.6
1945	2385.	538.	415.	3338.	2309.	558.	471.	71.4	16.1	12.4	69.2	16.7	14.1
1946	2555.	619.	440.	3614.	2458.	644.	512.	70.7	17.1	12.2	68.0	17.8	14.2
1947	2696.	780.	485.	3961.	2584.	798.	579.	68.1	19.7	12.2	65.2	20.1	14.6
1948	2681.	879.	540.	4100.	2567.	873.	660.	65.4	21.4	13.2	62.6	21.3	16.1
1949	2659.	925.	583.	4167.	2512.	925.	730.	63.8	22.2	14.0	60.3	22.2	17.5
1950	2972.	1013.	649.	4634.	2769.	1055.	810.	64.1	21.9	14.0	59.8	22.8	17.5
1951	4113.	1194.	746.	6053.	3906.	1215.	932.	67.9	19.7	12.3	64.5	20.1	15.4
1952	4492.	1320.	850.	6662.	4319.	1288.	1055.	67.4	19.8	12.8	64.8	19.3	15.8

Appendix 2 (cont.)

Year	Revenues from own source			Total revenue	Revenues after inter-governmental transfers			% distribution of own source revenues			% distribution of own after transfers		
	federal	provincial	local		federal	provincial	local	federal	provincial	local	federal	provincial	local
1953	4563.	1410.	922.	7895.	4397.	1346.	1152.	66.2	20.4	13.4	63.8	19.5	16.7
1954	4344.	1481.	994.	6819.	4178.	1401.	1240.	63.7	21.7	14.6	61.3	20.5	18.2
1955	4745.	1640.	1073.	7458.	4558.	1515.	1385.	63.6	22.0	14.4	61.1	20.3	18.6
1956	5411.	1865.	1220.	8496.	5213.	1710.	1573.	63.7	22.0	14.4	61.4	20.1	18.5
1957	5455.	2075.	1357.	8887.	5151.	1939.	1797.	61.4	23.3	15.3	58.0	21.8	20.2
1958	5163.	2216.	1489.	8868.	4746.	2082.	2040.	58.2	25.0	16.8	53.5	23.5	23.0
1959	5871.	2489.	1686.	10046.	5259.	2479.	2308.	58.4	24.8	16.8	52.3	24.7	23.0
1960	6228.	2629.	1853.	10710.	5523.	2605.	2582.	58.2	24.5	17.3	51.6	24.3	24.1
1961	6473.	2860.	1982.	11315.	5651.	2823.	2841.	57.2	25.3	17.5	49.9	24.9	25.1
1962	6899.	3396.	2142.	12437.	5845.	3358.	3234.	55.5	27.3	17.2	47.0	27.0	26.0
1963	7323.	3639.	2286.	13248.	6154.	3625.	3469.	55.3	27.5	17.3	46.5	27.4	26.2
1964	8355.	4189.	2396.	14940.	7103.	4117.	3720.	55.9	28.0	16.0	47.5	27.6	24.9
1965	9095.	4949.	2646.	16690.	7664.	4888.	4138.	54.5	29.7	15.9	45.9	29.3	24.8
1966	9984.	5782.	2956.	18722.	8320.	5615.	4787.	53.3	30.9	15.8	44.4	30.0	25.6
1967	10906.	6782.	3298.	20986.	8914.	6708.	5364.	52.0	32.3	15.7	42.5	32.0	25.6
1968	12218.	7966.	3658.	23842.	9846.	8024.	5972.	51.2	33.4	15.3	41.3	33.7	25.0
1969	14490.	9293.	4067.	27850.	11764.	9470.	6616.	52.0	33.4	14.6	42.2	34.0	23.8
1970	15528.	10548.	4438.	30514.	12131.	10797.	7586.	50.9	34.6	14.5	39.8	35.4	24.9
1971	17241.	11744.	4748.	33733.	12918.	12528.	8287.	51.1	34.8	14.1	38.3	37.1	24.6
1972	19560.	13253.	5214.	38027.	15002.	13791.	9234.	51.4	34.9	13.7	39.5	36.3	24.3
1973	22809.	15880.	5582.	44271.	18002.	16226.	10043.	51.5	35.9	12.6	40.7	36.7	22.7
1974	29978.	20039.	6247.	56264.	23813.	20937.	11514.	53.3	35.6	11.1	42.3	37.2	20.5
1975	31676.	22245.	7306.	61227.	24016.	23254.	13957.	51.7	36.3	11.9	39.2	38.0	22.8
1976	35552.	26028.	8531.	70111.	27042.	27390.	15679.	50.7	37.1	12.2	38.6	39.1	22.4
1977	36369.	31216.	9484.	77069.	26408.	32380.	18281.	47.2	40.5	12.3	34.3	42.0	23.7
1978	38177.	35194.	10408.	83779.	27318.	36428.	20033.	45.6	42.0	12.4	32.6	43.5	23.9

SOURCE: Department of Finance (based on national economic accounts).

NOTES

NOTES