Volume Title: Recent Developments in Dominion-Provincial Fiscal Relations in Canada

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more effective appeal to history in the United States, although the usefulness of this appeal may be doubted for two reasons. First, the broad trend of intergovernmental relations has been markedly similar in the two countries. Second, discovery of the intentions of the wise men who deliberated at Philadelphia in 1787 and at Quebec in 1864 provides little direct guidance in the solution of today's problems. At present the demand is for a social service state; eighty or one hundred and sixty years ago the sphere of government was narrowly viewed. This is not a criticism of the framers of the constitutions of either country. These men were neither prophets nor soothsayers. The proof of their wisdom is that the constitutions they wrote have been flexible enough to survive a revolution in economic and social philosophy.

The Royal Commission on Dominion-Provincial Relations

The regional diversity of Canada is not as obvious or as marked as that of the United States, principally because Canada has no such variety of climatic conditions. "Economically Canada can be compared to a string of beads, and they are not all pearls."[5] More than nine out of every ten Canadians live in a discontinuous belt of land, two hundred miles wide, along the American border.[6] The Appalachians separate the maritime provinces from Quebec; a vast V-shaped area of ancient rocks surrounding Hudson Bay — the Canadian shield — separates the prairie provinces from Ontario; the Rockies separate British Columbia from the prairie provinces.

The ruinous incidence of the depression of the early 'thirties upon the prairie provinces, and therefore upon the finances of the provincial governments, was the occasion for the appointment of a Royal Commission on Dominion-Provincial Relations in August 1937. It was to investigate the distribution of functions and revenues between the Dominion and the provinces, "and to express what in its opinion, subject to the retention of the distribution of legislative powers essential to a proper carry-

[5] *Report of the Royal Commission on Dominion-Provincial Relations,* Book I, p. 186.

[6] F. R. Scott, *Canada Today* (Oxford University Press, 1939), p. 5.

ing out of the federal system in harmony with national needs and the promotion of national unity, will best effect a balanced relationship between the financial powers and the obligations and functions of each governing body, and conduce to a more efficient, independent and economical discharge of governmental responsibilities in Canada."[7]

The recommendations of the Royal Commission, made in May 1940, can be summarized under reallocation of (a) governmental functions, (b) revenues and debts. With respect to (a), the Royal Commission was conscious of the complexities inherent in a federal system. Some enlargement of Dominion functions seemed desirable, but the Commission examined each of the many suggestions to see whether there was a reasonable uniformity of viewpoint among the provinces and whether Dominion administration was likely to be successful. Provincial autonomy was to be preserved without hamstringing effective action and without entailing costs and wastes the Canadian economy could not afford.

By all odds the most important recommendation with respect to jurisdiction was that unemployment relief, i.e., relief for unemployed employables as distinct from unemployables, should be a Dominion function. Ancillary to this recommendation, the Dominion in 1941 enacted a measure of compulsory unemployment insurance as a national scheme.

The residual responsibility for social welfare functions was to remain with the provinces. Provision for unemployables, widows' pensions, mothers' allowances, child welfare, public health, health insurance, workmen's compensation should, the Commission declared, be left under provincial jurisdiction and be financed from provincial treasuries. So also should education. Admittedly these services will expand in the future and admittedly "it is highly desirable that every province should provide these services in accordance with average Canadian standards;"[7a].

[7] *Report of the Royal Commission on Dominion-Provincial Relations,* Book I, p. 10.

[7a] *Ibid.,* Book II, p. 44. The Commission, as a supplement to the recommendation that the Dominion assume responsibility for employables, concluded that the Dominion should be given jurisdiction "to establish basic minimum wages and maximum hours of labour, and to fix the age of employment, leaving to any province jurisdiction to raise minimum wages, lower hours of labour, or raise the age of employment if it so desires." *Ibid.,* p. 49.

but for reasons that will appear presently the Commission was opposed to conditional grants as a means of ensuring average standards, and it recommended a different method of alleviating provincial fiscal need. In the whole field of social services it favored a clean-cut separation of functions and responsibilities.

Federal assumption of responsibility for employables would, of course, lift an onerous burden from provincial shoulders. The Commission made, in addition, three recommendations concerning the reallocation of revenues and debts that form part of an integrated plan: (1) transfer of certain taxes, (2) assumption of provincial debt, and (3) replacement of the old unconditional subsidies by national adjustment grants.

The first concerned chiefly the personal income tax, corporation taxes, and inheritance taxes—all of which were to be relinquished by the provinces. The aim was to make an adjustment in the interest of equity and efficiency; there was no question of increasing the constitutional power of the Dominion, since its right to levy these taxes is not limited. These taxes, in the opinion of the Commission, call for an administrative unit larger than a province; centralized control will bring greater economy and efficiency in collection, and most important, increase national income. A personal income tax was being levied at this time by six of the nine provincial governments, but in three (Ontario, Manitoba, and Prince Edward Island) the Dominion acted as collector, and in British Columbia alone did the definition of taxable income differ greatly from that of the Dominion. Corporation taxes were of a variety and complexity beyond belief; they "violate every canon of sound taxation," with a growing tendency in difficult times to victimization of exposed business.[8] Death taxes have given rise to the same types of double taxation as in the United States. During the 1920's reciprocal agreements minimized the difficulties, but they were destroyed during the depression. The Commission felt that even if the provinces retained death taxes, a program of Dominion collection with

[8] The provinces would be permitted to levy bona fide license fees, real estate taxes, and consumption taxes collected through corporations. On the ground that a province is entitled to compensation for depletion of its natural wealth, the Commission recommended also that the Dominion "pay over to the province concerned 10 percent of the corporate income derived from the exploitation of the mineral wealth of the province" (*ibid.*, p. 271).

distribution of the proceeds on some agreed basis would be wise.

If these important sources of revenue were to be placed in Dominion hands, something had to be done to compensate the provinces. The Commission, convinced that no great shift in functions from the provinces to the Dominion was desirable, and disliking conditional grants, had to find some large expenditure of which the provinces could be relieved if its tax transfer recommendations were to be worth considering. As provincial interest charges were large, in 1933 absorbing one-third and in 1937 over one-fifth of provincial revenues, the Dominion was to assume all provincial debts. In addition, the Commission proposed a new system of unconditional subsidies — grants without strings paid by the federal government to the provinces.

Canada since 1867 has had a system of unconditional subsidies. The fathers of confederation, conscious of the dangers of such a system, put a clause in the constitution declaring that original subsidies were to be "in full settlement of all future demands". The clause proved utterly ineffective: the subsidies have been altered beyond recognition and many of the alterations have been made because of political pressure and for political purposes. Of this the Commission was well aware, and in an amusing understatement it said: "the negotiations between the Dominion and the provinces [about subsidies] have lacked the candour which is desirable in a democracy".[9] It recommended the abolition of these subsidies, but believed that Canada could start *tabula rasa* with a new system of subsidies—"national adjustment grants"—which would be soundly calculated and which it would make the balance-wheel of its whole fiscal plan.

How were these to be calculated? In essence the Commission calculated for each province, first, the expenditure that would be necessary if a normal Canadian standard of governmental services was provided, and second, the revenue that would be derived from taxation of normal severity. If the provinces were left with a deficit, a national adjustment grant would be indi-

[9] *Ibid.*, p. 271. See also J. A. Maxwell, *Federal Subsidies to the Provincial Governments in Canada* (Harvard University Press, 1937), especially Chapter XIV, for a proposal dealing with the abolition of the subsidies and federal assumption of provincial debt.

cated, and the Commission declared that six provinces—Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Manitoba, and Saskatchewan—should receive grants, while three—Ontario, Alberta, and British Columbia—should not. The grants were to be reviewed every five years.

Because the grants were unconditional, they would effect some redistribution of the tax burden in favor of the poorer provinces, wipe out the old subsidies, and put the poorer provinces in a fiscal position enabling them to provide a normal level of governmental services, especially social services. The Commission left no doubt concerning its belief that "in the interests of national unity it is highly desirable that every province should be able to provide these services in accordance with average Canadian standards".[10] But *actual* provincial provision, or lack of it, was held to be no concern of the Dominion. Dominion responsibility was to end when a provincial government had been put in a fiscal position to discharge its responsibilities.

The Commission took this attitude because of its strong belief that any attempt on the part of the Dominion to control or direct provincial expenditures would be incompatible with provincial autonomy. And it considered autonomy important because of "the wide differences in social philosophy and economic and social conditions among the provinces" and because in the social services "local, detailed and highly personal administration is often required".[11] For certain services in which these differences were marked, the Commission was not prepared to recommend even conditional grants, but for other social services, notably unemployment insurance and old age insurance, the Commission argued that a national standard of provision and national administration were essential and recommended complete Dominion control.

The experience of the United States would indicate that the conditional grant is a practicable method of providing for services that for constitutional, administrative, or financial reasons, are neither wholly federal nor wholly provincial. The Commission believed, however, that this device called for cooperative

[10] *Report of the Royal Commission on Dominion-Provincial Relations,* Book II. p. 44.

[11] *Ibid.,* p. 44.

administration by the Dominion and the provinces. The Dominion, when it decides to assist the provinces in performing a function, must not only choose the function with care; it must also set up an adequate system of administrative supervision to see that national standards are maintained. The Commission was inclined to believe that both the choice and the supervision would lead to friction and fumbling.

Certainly these difficulties are very real, and the judgment of the Commission may be based on political realities in Canada. Yet its judgment against joint 'occupancy' meant less likelihood of achieving a national minimum standard for certain services. The essential fact is, moreover, that in a federation any reasonable remedy for problems of federal-provincial relations will face difficulties. It is not easy to reconcile the sentiment of Quebec and Ontario against centralization with the sentiment of the other provinces in favor of Dominion assumption of a larger responsibility.

The two large provinces, Ontario and Quebec, which contain respectively 33 and 30 percent of the population of Canada, have always opposed centralization, although for different reasons. Broadly, the opposition of Ontario grows out of economic, and that of Quebec out of cultural, religious, and demographic factors. Ontario is the richest province. As a governmental unit it can provide its people with a level of services higher than that of the other provinces while imposing taxation of less than average severity. The federal proposals, 1941-46, were therefore viewed by the provincial government of Ontario as a diminution of its financial autonomy and as a method of placing a larger financial burden upon its residents.

The case of Quebec is more complex. In many respects Quebec is an island which, culturally, is separate from the rest of Canada. Over 77 percent of the people of French origin in Canada reside in Quebec, and over 80 percent of its residents are of French origin. Nearly 58 percent of Canadians professing the Roman Catholic religion reside in Quebec, and nearly 87 percent of the residents of Quebec profess the Roman Catholic religion. Factors such as these explain the insistence of the provincial government of Quebec that nothing be done that might impair provincial autonomy.

These cultural factors partly explain why the distribution of governmental functions in Quebec differs from that of the other provinces, and why the level of expenditure for education and public welfare is lower. Expenditure for education is one-quarter less, and that for public welfare one-tenth less than in the other provinces (Table 1). However, governmental expenditure in Quebec is supplemented by the Roman Catholic Church more than in the other provinces. This again indicates the unique position of Quebec.

TABLE 1

Governmental Expenditure in Quebec and in the Other Provinces for Education and Public Welfare, 1942
(dollars per capita)

	QUEBEC			OTHER PROVINCES		
	Provincial	Municipal	Total	Provincial	Municipal	Total
Education	4.43	5.32	9.75	4.10	9.06	13.16
Public Welfare..	5.18	3.39	8.57	6.00	3.60	9.60

With respect to other governmental functions, the burden upon the municipalities in Quebec is relatively larger; as a result, their debt charges per capita have been appreciably higher than those of municipal governments in the rest of Canada. For 1942 net debt charges of the municipal governments of Quebec were $5.09 per capita; those of municipal governments elsewhere, $2.80 per capita.

In terms of economic strength, Quebec is not on an equality with Ontario. The Royal Commission calculated the per capita income paid to individuals in 1937 to be $345 for Canada as a whole, $438 for Ontario, and $299 for Quebec. Moreover, the distribution of income in Quebec is significantly out of line at the top and bottom of the scale. The aggregate income in 1942 received by recipients in the $25,000 and over group was 3.9 percent of the total for Quebec, and only 2.3 percent for the rest of Canada (Table 2). The aggregate income received by the under $1,000 group was 18.8 percent for Quebec, and only 15.9 percent for the rest of Canada.

TABLE 2

Percentage Distribution of Aggregate Income, 1942, by Income Groups, excluding Agriculture and the Armed Services

	Quebec	Ontario	Canada except Quebec
Under $1,000	18.8	14.3	15.9
1,000–2,000	38.3	41.7	40.6
2,000–5,000	27.7	30.9	30.8
5,000–10,000	6.5	6.2	6.3
10,000–25,000	4.8	4.2	4.1
Over 25,000	3.9	2.7	2.3
	100.0	100.0	100.0

Dominion Bureau of Statistics, *National Accounts, Income and Expenditure, 1938-1945* (King's Printer, Ottawa, 1946), pp. 40, 42, and 36.

Factors of this sort, consciously or unconsciously, influenced the attitude of the Commission. In addition, the political history of the Liberal Party in Canada has been dominated by an awareness of Quebec. The present Prime Minister, Mackenzie King, has an innate appreciation of the significance of provincial autonomy and has taken an uncompromising position against conditional subsidies.[12]

DOMINION-PROVINCIAL CONFERENCE, 1941

The Commission did not conclude its deliberations until after Canada had entered the war, and the federal government had to consider whether it should call a Dominion-provincial conference to deal with the Report. As the Report looked toward long-term revision of Dominion-provincial relations, to consider it in wartime might seem inappropriate. On the other hand, the war was certain to aggravate and magnify certain defects of existing Dominion-provincial arrangements. To maximize the war effort of Canada, the federal government would have to levy high rates of income tax, to invade fields of revenue occupied by the provinces, to ration gasoline, thereby reducing provincial revenues. No question of its constitutional rights to take such steps as war measures could be raised, but the provincial government might financially be left in the lurch. A Conference to work out methods of alleviating provincial embarrassments seemed advisable. Accordingly, on November 2, 1940, Prime Minister King sent a letter asking the provincial govern-

[12] See J. A. Maxwell, *op. cit.*, pp. 253-6.