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long drawn out. Not until July 11, 1947 was legislation concerning new tax agreements with seven provinces passed by the House of Commons. Ontario and Quebec had not budged from their position of May 1946; consequently, no agreements were signed with them. The other seven provinces had, however, managed to get considerably better financial terms from the Dominion. In brief, their guaranteed minimum payments were raised \$10,700,000, and their estimated 1947 payments \$14,500,000.³¹ In addition, the federal government agreed to withdraw, effective April 1, 1947, its gasoline tax of 3 cents per gallon.

DETAILED EXPLANATION OF THE FEDERAL PROPOSALS

When the over-all negotiations failed, the Dominion's proposals concerning social security and public investment were suspended, and attention was concentrated on the financial arrangements. The Dominion promised, however, that "as soon as there is a sufficient acceptance of the proposed tax agreements", it would "be ready to explore in a general conference or otherwise the possibility of working out mutually satisfactory arrangements in regard to the whole or any part of our earlier public investment and social security proposals."³²

Social Security

OLD AGE ASSISTANCE (PENSIONS)

The most important element of the social security program in terms of immediate financial cost is old age assistance. Under the existing system the federal government gives the provincial governments a grant in aid equal to 75 percent of the net cost of pensions, but not in excess of \$25 a month per recipient. The age eligibility is 70 years, and the pensions are subject to proof of need, i.e., to a means test. A twofold expansion was

³¹ If Ontario and Quebec are presumed to sign agreements, the over-all changes would be:

	<i>1946 formula</i>	<i>New formula</i>
	(millions of dollars)	
Minimum payments	181.4	206.5
Estimated 1947 payments	198.2	228.7

³² Conference, *Correspondence Since The Budget of 1946*, p. 54.

proposed: (a) assumption by the federal government of complete responsibility, both financial and administrative, for pensions to persons 70 or more years old at the uniform rate of \$30 per month and without a means test, (b) federal grants on a 50/50 basis for provincially administered pensions up to \$30 per month to needy persons 65-69 years old.

This expansion was, of course, in answer to demands identical with those voiced in the United States. In support of the abolition of the means test for persons 70 or more years old, it was pointed out that in Canada 40 percent of such persons make application and receive pensions and that an additional number who could demonstrate need are deterred by a means test. As long as a means test is applied, provincial administration is essential, because the federal government cannot investigate individual circumstances in scattered places. Without a means test, federal administration would be entirely feasible. For persons 65-69 years old a means test was to be applied with federal participation through 50/50 grants to the provincial governments. It was appreciated that the existing system of 75 percent grants was unfortunate because provincial financial responsibility was unduly minimized and effective federal control was not established. The total cost of the new plan was estimated to be \$234 million for 1948, of which the federal government would bear \$217 million and the provinces \$17 million. The actual cost of the existing system in 1944 was \$40 million for the federal government and \$16 million for the provinces.³³

UNEMPLOYMENT INSURANCE AND ASSISTANCE

The Royal Commission on Dominion-Provincial Relations as well as the National Employment Commission, which reported in 1936, recommended a system of unemployment insurance on a federal basis. In establishing it in 1941 the Dominion took a long step toward the assumption of responsibility for relief to the employable unemployed. The scheme provided for coverage of 2,300,000 wage and salary earners out of approximately 3,000,000. It fell short of full assumption of responsibility because of incomplete coverage of earners, because payments to those covered might be inadequate, and because of failure

³³ Dominion-Provincial Conference, 1945, *Submissions and Discussions*, p. 99.

to cover the self-employed (a matter of special concern to the agricultural provinces). During the war no problem of unemployment existed. But the provincial governments, worried about the burden that might fall upon them thereafter, pressed the federal government to implement what they regarded as a commitment.

The federal government in August 1945 declared its intention to extend the insurance system as rapidly as was administratively practicable but made no promises concerning coverage of the self-employed. Meanwhile, it was prepared to set up a system of unemployment *assistance* for employables who had no benefit rights under the unemployment insurance act: it would make payments equal to 85 percent of the unemployment compensation benefits. No estimates of cost were presented. Obviously the cost would be slight if full employment was maintained. The immediate purpose of the proposal was to lift from the provinces a potential threat to their solvency and to increase their receptiveness to the complete plan offered by the federal government.

NATIONAL HEALTH

The federal government declared that it would meet 60 percent of the cost of provincially administered health insurance schemes that fell within an approved national plan. When fully introduced—and this would take years—the estimated annual cost was \$250 million, of which the federal share would be \$150 million.

The federal proposals also contemplated conditional grants to the provincial governments in aid of public health and preventive medicine. One set of grants—amounting to \$620 thousand a year—would be for the purpose of encouraging the preparation of a health insurance program. Another set, to encourage the development of public health services, hospital facilities, etc., was offered on a variety of bases and in the ceiling amount of \$13,600,900, divided among general public health, \$4,022,600; tuberculosis, \$3,000,000; mental health, \$3,987,000; venereal disease, \$499,500; crippled children, \$497,900; professional training, \$250,000; public health research, \$100,000; civilian blind, \$1,243,900.

Public Investment

The federal government was concerned also to have activities with respect to public investment coordinated. It proposed as a beginning that an attempt be made to clarify the nature of the functions that were appropriate to it on the one hand, and to the provincial and municipal governments on the other, in order to avoid duplication and inefficiency. This clarification was not, however, to preclude federal assistance to activities for which the provincial and municipal governments were responsible. In particular, the federal government stood ready to give assistance in order to gain control over the timing of public investment. Some public investment was recognized as inflexible with respect to timing, i.e., it could not be expanded when employment was low and contracted when employment was high. But other public investment was postponable and expansible with respect to the time of initiation and execution. For the latter the federal government offered two types of grant: (1) planning grants equal to one-half the cost of planning, provided the projects were accepted as subject to timing; (2) timing grants, for which provincial (and municipal) projects, when they had been accepted by the federal government and registered as fully planned, were to be eligible "on a scale and to an amount to be determined by the Dominion and to be announced in January of any year in which, in the light of the general employment and economic situation, the Dominion considers such assistance to be desirable".³⁴ Obviously these grants were to be an instrument of a compensatory spending policy; they will be appraised below.

Financial Arrangements

The most important, as well as the most controversial, feature of the federal proposals concerned the replacement of the war-time tax agreements. As was expected, the federal government desired consolidation and extension. In return for unconditional subsidies, larger and differently calculated than those in the agreements, the provinces were asked not to levy personal income taxes, corporation taxes, or succession duties for three

³⁴ *Ibid.*, p. 386. In August the federal government specified a payment of 20 percent of the cost.

years. Inclusion of succession duties meant, of course, that the plan was more ambitious than the wartime agreements, although this step was in accord with the recommendations of the Royal Commission. The Commission, however, contemplated permanent federal occupancy of these revenue fields, whereas the current proposal was for a limited period, three to five years. The reason for the limit was partly tactical and partly substantive. Tactically any recommendation of a permanent shift would stir up opposition, particularly if constitutional amendment were necessary. Substantively a trial period seemed advisable, with revision after reconversion had been accomplished.

THE TAX TRANSFERS

The August 1945 proposal was simply that the federal government have sole occupancy of the fields of the personal income tax, corporation taxes, and succession duties. An exception with respect to taxes on profits from mining and logging operations was explained as follows: "Mining royalties, Crown dues and other similar provincial charges are closely bound up with each provincial government's management of and expenditure on its forest and mineral resources. These charges are recognized costs of operation and as such can be deducted from taxable income for Dominion tax purposes. In general, however, levies of the royalty type, being based on volume of operations or gross rather than net income, discriminate against the weakest firms and prevent full exploitation of the least profitable resources. In some cases, therefore, provincial governments have chosen to levy instead on the basis of a net profits tax. Under the proposed agreement the Dominion Government would recognize such taxes as being the equivalent of royalties, etc., and as in the case of the wartime tax agreements, there would be no restriction upon the right of provincial governments so to tax profits from mining and logging operations. In addition, the Dominion Government would be willing to concede the provincial governments priority in this field, by treating such taxes as a cost for Dominion tax purposes, on a par with levies of the royalty type."³⁵

³⁵ *Ibid.*, pp. 114-15.

The provincial governments — or certain of them — pressed for modification of two sorts: they wished (a) to narrow federal jurisdiction with respect to the taxes mentioned above, and (b) to limit the right of the federal government to utilize certain other taxes.

a) Ontario at first took the line that the provinces should “levy corporation and personal income taxes under their own rates, and under acts uniform with the Dominion”.³⁶ Before the war the federal government had negotiated agreements with Ontario, Quebec, Manitoba, and Prince Edward Island by which it collected the personal income tax. The Ontario suggestion was that centralized collection with separate uniform acts and different rates be made applicable to personal income taxation in all provinces and that the system be expanded to cover corporation taxation. The defect of this proposal is chiefly with respect to countercyclical fiscal policy. Independent and uncoordinated changes in *rates*, even of a uniform income tax, would impair the force of centralized federal decisions. Ontario did not press its proposal. Instead it offered to surrender taxation of income, provided the federal government would make other concessions.

Ontario and Quebec objected also to exclusive federal use of succession duties. The federal government did not enter this field until 1941. These provinces argued that this tax should be left to them because of long prior occupancy, because succession duties were directly related to ‘property and civil rights’ —matters of exclusive provincial jurisdiction—and because property was transmitted at death under provincial laws. This type of argument, parallel to that used in the United States, has no legal validity.³⁷ The economic arguments for federal levy of succession duties are strong, and Mr. Ilsley affirmed its great assistance in administering the income tax.

The federal government declared at once that it would not insist upon provincial withdrawal from the field of succession

³⁶ Dominion-Provincial Conference, 1945, *Submissions by the Government of the Province of Ontario*, p. 27.

³⁷ *Report of the Royal Commission on Dominion-Provincial Relations*, Book II, p. 117. The statement is made that “there can be no question of the Dominion’s legal power to levy such taxes at whatever rates and by whatever methods it pleases.”

duties. In the event that a provincial government continued to levy such duties, individual taxpayers would be permitted to deduct the provincial tax from the tax payable to the federal government and the federal government would reduce its subsidy payments to the provincial government by a like amount. As it turned out, the seven provinces that reached an agreement renounced their succession duties for the term of the agreement.

b) The natural reaction of the provincial governments to the request that they vacate the fields of income taxation and death duties was to urge that the federal government limit its own rights of taxation. Ontario, to give the extreme example, proposed that the existing federal excises on gasoline, amusements, racetracks, security transfers, and electricity be dropped and that the federal government undertake "not to enter any field of direct taxation other than personal and corporation income taxes for the life of the agreement".³⁸

Here also the federal government was prepared to make concessions. Two of the excises—those on security transfers and electricity—were, it argued, of a special character and should be retained. The former had been imposed many years before the war. The latter represented the only way in which the federal government could impose taxation upon electrical utilities taken over into public ownership, since companies in provincial or municipal hands were not taxable under the federal income tax. Quite apart from the merits or demerits of public ownership, the federal government was not prepared to face contraction of a field of revenue—corporation taxes—for which it proposed to pay subsidies to the provinces as the price of occupancy.³⁹

The federal government evinced no similar desire to cling to the other excises. They were war taxes imposed to obtain revenue and to absorb purchasing power. If the provinces were prepared to offer "financial equivalents", it would relinquish these taxes, provided that, in the event of an emergency, it could reimpose them. On April 21, 1947 the federal government indicated its intention "to vacate the amusement and pari-mutual

³⁸ Dominion-Provincial Conference, 1945, *Submissions and Discussions*, p. 398.

³⁹ This point is considered further in the discussion of the proposed federal subsidies.

fields without compensation as soon as circumstances permit",⁴⁰ although its *right* to levy was not thereby to be impaired.

The federal government was prepared also to enlarge the constitutional taxing power of the provinces. Under the British North America Act, Sec. 92 (2), the provinces have the right to "direct taxation within the province". The Privy Council has declared that "a direct tax is one which is demanded from the very persons who it is intended or desired should pay it".⁴¹ A retail sales tax is regarded as direct and levied on the consumer as long as the retailer acts as the agent of the government in collecting the tax; and similar reasoning applies to such levies as the gasoline tax. Some provincial governments complained, however, that the necessity of framing such taxes so as to conform to the court's definition of direct taxes led to inefficient and costly administration. They felt, moreover, that their right to levy retail sales taxes should be specifically defined by constitutional amendment. This the federal government was prepared to seek.⁴²

PAYMENTS IN LIEU OF TAXES

Under the wartime tax agreements the federal government had made payments to the provincial governments amounting to \$83,700,000 a year. Under statutory authority it also made payments of unconditional subsidies amounting annually to \$16,900,000 and these it desired to merge with the payments it offered under the new plan. The new plan, moreover, proposed federal assumption of succession duties, and from these the provincial governments had collected annually on the average \$23,900,000 in the five years 1940-44. Provincial receipts from the tax agreements, the statutory subsidies, and succession duties amounted, therefore, to \$124,500,000. As a substitute, the federal government in August 1945 offered for three years a

⁴⁰ *House of Commons Debates*, Daily Edition, July 9, 1947, p. 5424.

⁴¹ *Bank of Toronto v. Lambe* (1887), 12 A. C. 575.

⁴² The proposal was that the amendment should permit the delegation of powers from the Dominion parliament to provincial legislatures, or vice versa. If such an amendment were adopted, the Dominion government would "request parliament to delegate to the provinces, for the duration of the agreement, the right to levy retail sales taxes within limits to be specifically defined." Dominion-Provincial Conference, 1945, *Submissions and Discussions*, p. 385.

guaranteed minimum annual payment of \$138,000,000 — \$12 per capita on the basis of the 1941 population. The *actual* as distinct from the minimum payment was, however, to vary according to gross national product per capita. Since this was more than one-third greater in 1947 than in 1941, the actual payment in 1947 would have amounted to approximately \$188,700,000. The financial effect of this set of subsidies would have been current surpluses for all the provincial governments. The provincial governments were protected because of the high absolute floor, based upon a prosperous wartime year, set under the subsidies, and they could expect expanding subsidies in the event of a growth in gross national product.

Under pressure from the provincial governments the federal offer was liberalized in April-May 1946. The guaranteed minimum annual payment was lifted from \$12 to \$15 per capita, and the payment to a province could be based either on its 1941 actual or its 1942 estimated population, whichever was greater. *Actual* payments were to increase according to population and per capita gross national product based on the average of the preceding three years.⁴³ In no case were the payments to be less than 150 percent of the receipts of a province under its wartime tax agreement. This concession affected the minimum more than the actual payments. The total of the minimum was raised from \$138,000,000 to \$181,400,000, more than 31 percent. The total of the actual estimated payments increased only approximately 5 percent. Embedded in this general concession were special concessions for two provinces — Prince Edward Island and British Columbia. The former has a declining population, which it attributes, rightly or wrongly, to confederation. Since it could not look forward to growing future payments, establishment of a high minimum was important. The federal government accordingly agreed that in no case would the payment to a province be less than \$2,000,000 a year, a figure

⁴³ The awkward formula was: "Divide the 'Gross National Product per capita' for each of the three preceding years by the 'Gross National Product per capita for 1942'. Multiply the quotient in each case by \$15. Multiply the product in each case by the number of the population of the Province for the year in question. If the result in any of the three years is less than the guaranteed minimum, substitute the amount of the guaranteed minimum. Average the three amounts so arrived at." *Ibid.*, p. 390.

that had no relevance to the possible payment to any other province. The concession to British Columbia rested on a different premise. Before the war it had taxed income more severely than any other province and therefore the actual amount of tax collections it gave up through the tax agreements was relatively large. The option, therefore, of a minimum annual payment of 150 percent of its wartime tax agreement receipts was more favorable than that of \$15 per capita.⁴⁴ British Columbia stands between the 'have' and the 'have-not' provinces; it could be induced to favor or oppose the federal proposals, depending upon the concessions. The federal government therefore yielded to its request, thereby raising the minimum guaranteed to it from \$14,300,000 to \$18,100,000.

The federal government offered also to liberalize its payments to all the provinces by turning over one-half of its collections of corporation income tax from "companies whose main business is generating for distribution to the public or distributing electrical energy, gas and steam".⁴⁵ To this one restriction was attached. Such payments were to be reduced by the amount of any tax loss the Dominion suffered because a provincial government or a municipality took over a tax-paying utility. The point was, of course, that the Dominion could not afford to pay the provinces for retiring from the field of corporate taxation and also allow the provinces to reduce the area to which such taxation applied.⁴⁶

In the budget speech of June 27, 1946 similar payments were proposed as a basis for negotiation with individual provinces. During this negotiation, however, the Minister of Finance soon discovered 'special circumstances' that justified "some modifications of the original proposals".⁴⁷ One modification was an enlargement of the earlier concession made to British

⁴⁴ See *ibid.*, pp. 448-54, for a presentation of the position of British Columbia.

⁴⁵ *Ibid.*, p. 385.

⁴⁶ Considerable concern has been expressed in Canada at the stimulus exemption of publicly owned enterprises from taxation gives to the absorption of private companies. Premier Garson of Manitoba declared at the Conference that his province, if denied a satisfactory adjustment of Dominion-provincial relations, would be tempted to extend the area of its 'tax-free ventures' in order to augment its revenues. *Ibid.*, p. 138.

⁴⁷ Conference, *Correspondence Since the Budget of 1946*, p. 65.

TABLE 3

Calculation of Guaranteed Minimum Annual Payment
(millions of dollars)

	Prince Edward Island	Nova Scotia	New Brunswick	Quebec	Ontario	Manitoba	Saskat- chewan	Alberta	British Columbia	Total
First Option										
1	\$12.75 per capita on 1942 population... 1.1	7.5	5.9	43.2	49.5	9.3	11.3	10.2	11.1	149.1
2	50% of provincial income and cor- poration tax revenue for year ending nearest December 31, 1940 (War- time Tax Agreement)..... 1	.8	1.2	10.3	14.5	2.5	1.1	2.0	6.0	38.6
3	Statutory subsidies payable in 1947..... 7	2.0	1.6	2.9	3.2	1.7	2.0	2.0	1.0	17.1
	Total	10.3	8.8	56.4	67.2	13.5	14.4	14.2	18.1	204.8
Second Option										
1	\$15.00 per capita on 1942 population... 1.3	8.9	7.0	50.8	58.3	10.9	13.3	12.0	13.1	175.5
2	Statutory subsidies payable in 1947..... 7	2.0	1.6	2.9	3.1	1.7	2.0	2.0	1.0	17.1
	Total	10.9	8.6	53.7	61.4	12.6	15.3	14.0	14.1	192.6

House of Commons Debates, Daily Edition, July 9, 1947, p. 5417.

Columbia. This province, it will be recalled, had been allowed to choose a minimum annual payment of 150 percent of its receipts under the wartime agreement (instead of \$15 per capita). But the alternative payment had not been subject to adjustment for increases in population and gross national product. When the federal government agreed to liberalization by introducing for it a so-called 'escalator clause', the other provinces promptly urged reconsideration of their payments on the ground that in the negotiations with individual provinces the Dominion government had promised that any more favorable treatment given a province would be extended to provinces with which it had already reached agreement. As a result, two options or formulae emerged which superseded their predecessors (see Table 3). The two were similar in that the former statutory subsidies were added to the payments otherwise calculated. They were different in that one retained, in calculating the minimum, the basis of \$15 per capita on the 1942 population, while the other substituted \$12.75 per capita on the 1942 population and added amounts equal to 50 percent of provincial income and corporation tax receipts in 1940. Obviously the former option was favorable to provinces that in 1940 were not utilizing intensively income and corporation taxes (Nova Scotia and Saskatchewan), while the latter option favored provinces that were (New Brunswick, Manitoba, Alberta, British Columbia, as well as Ontario and Quebec). Prince Edward Island was a special case, since it was guaranteed a minimum payment of \$2,100,000. The *total* amount of the minimum, no matter how calculated, was to be increased according to increases in gross national product and provincial population since 1942. Table 4 shows the estimated actual payments for 1947.

TABLE 4
Estimated Payments, 1947
(millions of dollars)

Prince Edward Island	2.3	Manitoba	14.5
Nova Scotia	12.1	Saskatchewan	15.8
New Brunswick	9.5	Alberta	15.3
Quebec	63.4	British Columbia	21.4
Ontario	77.4	Total	228.7