# The Political Economy of the Federal Spending Power

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*A constitution is both an explicit text and a set of implicit understandings about how power is to be used. The roles of the different branches of government and, in a federal state, the different orders of government are constantly shifting, as are the tools through which governments try to attain their goals. Normative tools (statutes and other regulatory instruments) lay down rules and regulate or facilitate conduct. Financial tools (those used in raising and spending revenue) also have normative effects, either by directly steering conduct or by influencing peoples' choices of the activities they pursue. Direct spending by the federal government to compel or induce provinces and fund bureaucratic welfare state programs in areas of provincial jurisdiction — the bane of federal constitutionalism — is being made obsolete by changes in what citizens expect of government. More pertinent in the future will be government actions that empower citizens to realize their increasingly diverse identities and aspirations. The main challenge is to design an institution that can balance, as between the federal and provincial governments, the power to raise revenue and the power to spend it. Section 36 of the* Constitution Act, 1982 *offers a basis for a normative argument on the purposes and instruments of federal spending.*



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# Introduction

Understanding what has come to be called the "spending power problem"[1] in Canadian constitutional law is no mean trick. Despite assertions that its scope, scale, uses and abuses are easily identified, to capture the issue, assess its pertinence and develop appropriate policy responses requires analysis that goes both to the theoretical foundations of liberal-democratic states and to the instrumentalities by which governance agendas are pursued in such states. This essay seeks to trace the links between these two frameworks of inquiry. Its fundamental premise is that today's preoccupation with the spending power is tributary to a constellation of myths: about the nature and purposes of constitutions; about the central features of constitutional interpretation; about the relationship between regulatory instruments and fiscal instruments; about the rationales for government action in Canada since the 19th century; about the policy tools that governments should now deploy; and about the policy role of the federal government in the early 21st century. The essay begins by linking constitutional theory (Part I), tools of governance analysis (Part II) and the general framing of concerns with the spending power (Part III). It then shows how governing instruments are shaped by overall policy choices (Part IV), how federal spending is just one locus of contestation of federal jurisdiction (Part V) and how recent changes in citizen expectations of government and in instrument choice theory shape constitutional decision-making (Part VI).

1. The literature on this subject is robust, and much emanates from Quebec. For a recent conspectus, see Andrée Lajoie, "The Federal Spending Power and Fiscal Imbalance in Canada" in Sujit Choudhry, Jean-François Gaudreault-DesBiens & Lorne Sossin, eds., *Dilemmas of Solidarity: Rethinking Redistribution in the Canadian Federation* (Toronto: University of Toronto Press, 2006) 145 [Lajoie, "Federal Spending Power"].

# I. The Sites of Governance

Human beings are social animals who find meaning in the relationships they build with others. Sadly, these relationships are not always bilateral or equitable, for human beings in the Western cultural tradition also appear to have an insatiable appetite to project their views about life, community, social organization, spirituality and justice onto others. Sometimes they accomplish this through war, terror or episodic violence; sometimes through brainwashing and other forms of psychological manipulation; sometimes through religious crusades, pogroms and jihads; and sometimes by economic coercion wrapped up in the guise of free market exchanges. In contemporary Western societies, the primary vehicle for self-assertion and domination of the other is the political state. The state is idealized as a reflection of the will of the people to be a "nation," and this "nation" is imagined as a singular collective project to which all who inhabit a specific territory must adhere.[2]

But let us be clear. The fact that the state is idealized as a monolithic aspirational project, and that the inter-subjective violence it authorizes in pursuit of this project is disciplined by institutions and procedures supposedly made legitimate by the consent of the governed, in no way diminishes either the intensity or the extent of the coercion. Whether exercised for malignant or benign purposes, political power no less than economic and religious power tends toward authoritarian subjugation. Hence the rationales for requiring political power to be explicitly delegated to the state by the people, and for dispersing this power both functionally and by subject matter. Sharp distinctions between the authority of the legislature, the executive and the courts are meant to

2. There is, admittedly, an alternative vision of the political state. The state can also be theorized as providing the institutions and processes through which human beings may achieve fulfillment in pursuit of their own purposes without either subsuming themselves in the will of others or sating their appetite to dominate. Both visions are always reflected in the governance practices of liberal democracies, and the dominance of one or the other varies over time, and from state to state. For a helpful exposition of the point in the context of Canadian constitutionalism, see Albert S. Abel, "A Chart for a Charter" (1976) 25 U.N.B.L.J. 20.

provide institutional and procedural checks on each of these organic branches of government.[3] So, too, independently legitimated political units (component states of a federation, most notably, but also municipal councils and school boards) are designed to ensure the existence of discrete sources of power that also will compete for authority, and that often are able to wield effective coercion only by acting in concert — a concertation of effort that normal political processes will, it is believed, usually prevent from becoming tyrannical.[4]

The constitution is the most visible legal mechanism by which these manifold sources of violence are disciplined in liberal democracies. Not just the constitution as canonical text that may have been written at a particular moment to achieve a particular congeries of purposes, but also the constitution as the implicit set of beliefs, practices and understandings by and through which power is actually wielded. So understood, the constitution serves two complementary purposes. First, it recognizes, authorizes and constrains those (including political majorities) who would impose their will on others. Second, in doing so, it offers a panoply of discrete institutions, processes and instruments for translating this will, when appropriately conceived and legitimated, into action. In federal states particularly, the further assumption is made that the smaller the aggregated units, the greater the chance that national heterogeneity will be possible and that diverse sub-national and communal aspirations will flourish without limiting or suppressing personal self-fulfillment.[5]

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3. Of course, distinctions among these organic components of government that may be sharp in theory are in practice not so sharp — a point that jurists often have trouble understanding. See notably, Ontario, Royal Commission, *Inquiry into Civil Rights*, Report Number One, vol. 1 (Toronto: Queens Printer, 1968) at 15-65.

4. See James Madison, Alexander Hamilton & John Jay, *The Federalist Papers* (New York: Penguin Books, 1987). The theory of dispersed, competitive institutions of governments as guarantors of civil liberties is conventionally ascribed to James Madison, as expounded in the Federalist Paper #10.

5. The risk to federations, however, is that too great a deference to "particularisms" will lead to dissolution, while too great a deference to the liberating power of the larger unit will prevent achievement of the human potential it makes possible, as the hegemony of the central authority asserts itself. The issue is helpfully explored in Ronald J. May, "Decision-Making and Stability in Political Systems" (1970) 2 Canadian Journal of Political Science 73.

This said, a certain form of constitutional fetishism stands as a great threat to liberal democracies. Preoccupation with constitutional jurisdiction has become the opiate of both the political right (those who would disperse and constrain state power so as to prevent tyranny in the name of freedom) and the political left (those who would consolidate state power in a central government so as to build a nation). Yet the constitution being fetishized is typically only the explicit, textual constitution — those documents (and judicial decisions interpreting such documents) that bear the label "constitution."[6] The implicit, non-textual constitution is relegated to the realm of (i) the historical common law constitution; (ii) non-justiciable constitutional conventions; and (iii) ordinary political practices, which under the classical definition are neither law nor conventions.[7]

By formulae like "we the people," the explicit constitution of a state habitually identifies who is establishing the new political order and the justifications for doing so. It also structures the organic components of government, and typically (although not fully in Canada) it establishes the processes whereby each of these components derives its legitimacy — election, appointment, heredity, *etc.* Third, it usually elaborates constraints on legislative and executive action in the form of voting supermajorities, guaranteed constituencies, bicameral legislatures, bills of rights and complex amendment processes. In geographically dispersed or socio-culturally diverse states, the textual constitution often also allocates power as between a federal authority and the constituent sub-state units. Finally, given the history of democratic liberalism and responsible government, constitutions invariably elaborate how the state may raise revenue — for example, by taxation, borrowing, joint venture and receipt of a donation or subsidy — although they invariably

6. In Canada, of course, the explicit constitution comprises, at a minimum, those documents that are recited in s. 52(2) of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11.

7. The relevance of these distinctions, apparently well understood at the time of the *Reference Re Resolution to amend the Constitution*, [1981] 1 S.C.R. 753 [*Patriation Reference*], is much less clear following the *Reference Re Secession of Quebec*, [1998] 2 S.C.R. 217. See the fine discussion in Fabien Gélinas, "La Cour suprême du Canada et le droit politique" 24 C. du Cons. Const. 72 [forthcoming in 2008].

do not at the same time speak to the authority of the state to spend any revenue it generates.[8]

What, then, of the implicit constitution? Viewed as a matter of purpose rather than as a matter of pedigree, the unwritten constitution has two main components. The first is the constitutional inheritance. To understand constitutional documents for example in Canada — United Kingdom statutes such as the *Quebec Act* of 1774, the *Constitutional Act* of 1791, the *Act of Union* of 1841, the *British North America Act* of 1867 and the *Canada Act* of 1982 — is to recall that they each presuppose constitutional principles that pre-date them. Every written constitution, no matter how revolutionary, is tributary to the existing common-law (or unwritten) constitution of the political community to which it bears witness. To assert continuity, however, is not to assert stasis. Through its texts and their application, a living constitutional order constantly mediates the claims of history and the claims of necessity. Thus, we have the second dimension of the implicit constitution: political practice and constitutional conventions. Certain texts become obsolete — for example, in Canada, the powers of reservation and disallowance, or educational appeals[9] — because other political processes and conventions have overtaken them. Meanwhile, certain governance practices develop precisely because there never were texts to address a felt need.[10] Examples of such practices are geographic representation in cabinet, limitations on Crown immunity, responsible government, co-operative

8. I have elaborated upon the general features of explicit constitutions in Roderick A. Macdonald, "The Design of Constitutions to Accommodate Linguistic, Cultural and Ethnic Diversity: the Canadian Experiment" in Kálmán Kulcsar & Denis Szabo, eds., *Dual Images: Multiculturalism on Two Sides of the Atlantic* (Budapest: Hungarian Academy of Sciences,1996) 52.

9. See *Constitution Act, 1867* (U.K.), 30 & 31 Vict., c. 3, ss. 56, 90, 93, reprinted in R.S.C. 1985, App. II, No. 5. Likewise, many principles of the common law constitution — the unconstrained exercise of the royal prerogative of mercy, the non-justiciability of conventions and the delivery of the "Speech from the Throne" in Quebec — have been overtaken by practice or convention, quite independently of explicit legislation that modifies them.

10. The discussion of Fabien Gélinas in "Les conventions, le droit et la Constitution du Canada dans le renvoi sur la 'sécession' du Québec: le fantôme du rapatriement" (1997) 57 R. du B. 291 is particularly insightful on this point.

federalism, the judicial appointment prerogative of the Prime Minister and the protection of judicial remuneration.

The upshot of these observations is that one should not be transfixed by the explicit constitution.[11] The fundamental interpretive and performative choice is not between two extremes: (i) a constitutional order that comprises only a frozen, written constitution drafted in language particular to a conjunctural event in the past, and subject to amendment only through formalized processes; or (ii) mere political pragmatism unconstrained by text, history and principle. Rather, because constitutions in their fullest sense are about the basic distributional terms under which constant and continuing negotiation of coercive authority within a state takes place, constitutional interpretation requires a rich interweaving of textual arguments, arguments grounded in the need to respond to changed circumstance and arguments about the best reading of the constitution based on normative demands and historical arguments about the nature of a federal state.[12] Constitutions are, substantively, about competing visions of the relationship between personal fulfillment and collective endeavour; they are also about the balance to be struck between instrumental concerns (the means for facilitating human interaction) and policy concerns (the prescription of specific ends to be pursued through that interaction).[13] Procedurally, constitutions are about competition for jurisdiction, authority and power: competition between Parliament and the executive; between courts and Parliament; between the executive and courts; among courts; among executive agencies; and, in federal states, between actors at both the federal and provincial level, as well as across the various provinces.[14]

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11. See Harry Arthurs, "Constitutional Courage" (2004) 49 McGill L.J. 1 for an exploration of this point.

12. The implications of this interpretive approach for understanding the federal spending power are discussed in Part VI, below.

13. It will be obvious that I am drawing heavily on the work of Lon Fuller. The best expression of his understanding of the issue may be found in Lon L. Fuller, "Means and Ends" in Kenneth I. Winston, ed., *The Principles of Social Order*, 2d ed. (Oxford: Hart, 2001) 61.

14. In signalling these competitions between the formal institutions of a given constitutional order, one should not be unmindful of similar competitions between

Recognition of the multiple, overlapping, polycentric commitments through which a political state is constituted and given institutional expression leads to a final point about constitutionalism: these distributional judgments, whether grounded in the explicit or implicit constitution, need not be driven by an identical logic. In federal states especially, there are various ways of allocating the legislative, executive and judicial jurisdiction on the one hand, and of distributing the powers to tax, to borrow, to spend, to subsidize, to effect intergovernmental transfers or to divide the public debt on the other hand. So, for example, there is no impediment to dividing the judicial power jurisdictionally along different fault lines than the legislative power. Nor is it necessary to frame the reserved or personal prerogative powers of the executive identically between federal and sub-state units.[15] The sites of governance and the boundaries between these sites are both inescapably plural and continuously shifting.

# II. The Tools of Governance

The competition for governance in political states today is played out not just in a variety of institutional sites; it also takes place through

institutions of the state and institutions of the multiple other normative orders that seek out the loyalty and commitment of citizens. Greater attention is now being paid to non-state legal orders, whether in theories of inter-state federalism as applied to aboriginal peoples (see *e.g.* Ghislain Otis, "Territorialité, personnalité et gouvernance autochtone" (2006) 47 C. de D. 781) or in theories of legal pluralism (see Roderick A. Macdonald, "Metaphors of Multiplicity: Civil Society, Regimes and Legal Pluralism" (1998) 15 Ariz. J. Int'l & Comp. L. 69 [Macdonald, "Metaphors"]).

15. In this respect Canada is typical. Under the *Constitution Act, 1867*, *supra* note 9, the executive powers of the Queen's federal and provincial representatives are not identical, as attested by, for example, the differences in the powers of reservation and disallowance (ss. 56 and 90), and the constraints on the power to appoint judges (inapplicability of ss. 96-100 to the provincial judiciary). The powers of the judicial branch to hear and determine cases do not follow the same logic as the distribution of legislative powers under ss. 91-94A. The powers of taxation allocated to federal and provincial legislatures are not identical (ss. 91(3) and 92(2)), nor are their powers to deploy the penal sanction (ss. 91(27) and 92(15)).

the deployment of a variety of modes and instruments.[16] Not all governance is direct and not all regulation is explicit — not today, not ever. "Deregulation" and "privatization" are shallow labels to capture the change in governance brought about through a re-regulation from state to citizen. This re-regulation occurs by way of the delegation of authority from politics to markets and by way of the transformation of a multi-faceted, contextualized and overt distributive justice to a unique, universalized and covert allocation of benefit and burden through a logic of corrective justice.[17] Conversely, "governmental regulation" and "big government" are shallow labels to capture either the inter-normative trajectories between non-state and state legal orders or the delegation of governance from citizens to political actors rather than to family, cultural, religious or informal agents.[18] In other words, the very idea of constitutional government — the state — can be seen as both a site and a mode of governance. As much as diverse regulatory institutions and policies can be understood as tools of government, government can be seen as one regulatory tool among others that populations deploy to effect a governance agenda.[19]

Political theory typically does not, however, shape the details of institutional design. So, for example, in keeping with most contemporary "theories of justice" speculations, the "tools of governance" literature in public administration simply presupposes the

16. An excellent inventory of the possibilities is presented in a list of thirteen different tools in Lester M. Salamon, ed., *The Tools of Government: A Guide to the New Governance* (New York: Oxford University Press, 2002) at 21.

17. For an early study, see Roderick A. Macdonald, "Understanding Regulation by Regulations" in Ivan Bernier & Andrée Lajoie, eds., *Regulations, Crown Corporations and Administrative Tribunals* (Toronto: University of Toronto Press, 1985) 81.

18. See generally P. Eliadis, *et al.*, eds., *Designing Government: From Instruments to Governance* (Montreal: McGill-Queen's University Press, 2005) for an excellent overview of alternative frameworks for understanding these inter-normative trajectories.

19. In the Canadian context, the *locus classicus* for such analysis is Confederation itself: was Sir John A. Macdonald's first National Policy as announced in 1878 a government initiative to build the Canadian state by promoting the commercial empire of the St. Lawrence, or was the idea of a confederated Canada a governance tool of the Montreal commercial bourgeoisie? For a brief discussion, see V.C. Fowke, "The National Policy — Old and New" in W.T. Easterbrook & M.H. Watkins, eds., *Approaches to Canadian Economic History: A Selection of Essays* (Ottawa: Carleton University Press, 1988) 237.

state, rather than non-state actors, as the sole originating site of governance.[20] At the same time this "instrument choice" literature tends to be relatively agnostic about the precise political institution that actually makes use of any particular tool. The analysis is formal. Indeed, scholars observe that all the organic components of government are able to deploy most of these instruments of governance. Courts do not just decide disputes: they may make rules, they may undertake managerial functions (for example, in bankruptcy) and, increasingly in constitutional cases, they may require government expenditure.

Parliaments and legislative assemblies not only legislate: they may adjudicate disputes through bills of attainder and like strategies, and they may regulate through procurement strategies. The executive, in addition to deploying a range of managerial instruments such as orders-in-council in governmental agreements and contracts, may both legislate and adjudicate. Likewise, in a federal state, the full range of governing instruments, both direct and indirect, is assumed to be available to both federal and constituent governments, even though in some cases (notably the use of the penal power, the power to tax, the power to disburse, the power to create adjudicative institutions and the power to appoint judges) it may be textually constrained.[21] Even more generally, a

20. While nothing in the classics of modern political theory requires that the analysis be limited to "justice within the state," the standard works all focus on the political state. See *e.g.* John Rawls, *A Theory of Justice* (Cambridge: Harvard University Press, 1971); Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974); Michael Sandel, *Liberalism and Limits of Justice* (New York: Cambridge University Press, 1998); Charles Taylor, *Multiculturalism and the Politics of Recognition*, Amy Gutmann, *et al.*, eds. (Princeton: Princeton University Press, 1992). A similar point may be made about "choice of governing instrument" literature. See *e.g.* M.J. Trebilcock *et al.*, *The Choice of Governing Instrument* (Ottawa: Minister of Supply and Services Canada, 1982); Salamon, *supra* note 16; Eliadis, *supra* note 18.

21. Again, the Canadian example is instructive. So, for example, s. 91(27) of the *Constitution Act, 1867*, *supra* note 9, reserves the "criminal law power" to the federal Parliament; s. 92(2) restricts provincial taxation power to "direct taxes"; s. 96 provides that all Superior Court judges are to be appointed by the Governor-General; and s. 101 provides that only the Parliament of Canada may create statutory courts vested with the authority of a superior court of record. Of course, over the years, many of these differences have been attenuated through judicial interpretation. On s. 91(27), see Peter W. Hogg, *Constitutional Law of Canada*, 5th ed., vol. 1 (Toronto: Carswell, 2005) c. 18

similarly broad array of tools is available to delegates of these governments, be they federally-constituted territories, Indian bands, municipalities, school boards, armies, police forces, regulatory agencies or public corporations.

One further feature of modern approaches to tools of governance is particularly important for understanding the spending power. Scholars recognize that these various modes of governance are fundamentally bivalent. On the one hand, the vast bulk of them have normative implications: either explicitly or implicitly, either canonically or inferentially, they are instruments aimed at "subjecting human conduct to the governance of rules."[22] On the other hand, they all have economic implications: either explicitly or implicitly, either canonically or inferentially, they are fiscal instruments that involve the getting or the giving of money.[23] Just as every tax and every subsidy is a regulatory tool implying an economic sanction or reward meant to produce normative consequences, every tool of governance that is not directly a tax or expenditure is at the same time an instrument that produces economic consequences and redistributes costs. To illustrate the idea of regulatory bivalence one need only examine how states now deploy diverse governance tools.

### *A. Normative Tools*

Historically, the most important governance tool in liberal democracies has been legislation. But legislation is a multi-purpose instrument and plays many roles. So, for example, a central premise of

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[Hogg, *Constitutional Law*, vol. 1]; on s. 92(2), see *ibid.*, c. 31; on s. 96, see *ibid.*, c. 7.1; on s. 101, see *ibid.*, c. 7.2(b).

22. The expression is from Lon Fuller in *The Morality of Law*, 2d ed. (New Haven: Yale University Press, 1969) at 106. On the taxonomy of normativity suggested in the text, see Roderick A. Macdonald, "Pour la reconnaissance d'une normativité implicite et 'inférentielle'" (1986) 18 Sociologie et Sociétés 47.

23. These two dimensions of regulation have not, however, been theorized generally. Typically, the literature focuses on the "cost of regulation," rather than "cost as regulation." For a recent analysis in the traditional mode, see External Advisory Committee on Smart Regulation, Final Report, *Smart Regulation: A Regulatory Strategy for Canada*, (2004) online: Government of Canada <www.smartregulation.gc.ca>.

constitutional governance in the parliamentary tradition is that state action can be founded only on the Royal Prerogative or on a grant of authority by a legislative body. Moreover, once Parliament has occupied a particular field through statutory enactment, the Royal Prerogative in the field is to that extent suppressed.[24] Constitutional law requires that one look first to legislation as a source of regulatory authority. Yet a distinction must be drawn between the concept of legislation as a necessary constitutional foundation for executive action and as a normative phenomenon — a regulatory tool. Insofar as the idea of legislation as an instrument of the rule of law is concerned, in Canada one must begin by attending to basic constitutional principles, and do so before turning to the division of powers in the *Constitution Act, 1867*.[25] Sections 91 to 95 allocate legislative jurisdiction by subject matter, but otherwise do not constrain how Parliament chooses to frame statutes and delegated legislation.[26]

When Parliament deploys legislation normatively, it matters little whether the legislation is directed at citizens and enforced by courts, or whether it establishes an administrative agency with the delegated authority to make rules, adjudicate claims and inspect or license activity. In both cases, Parliament is pursuing a governance agenda. Moreover, in both cases the regulatory endeavour has significant financial consequences for citizens and for the country. For example, when the Canadian Radio-television and Telecommunications Commission regulates the activity of Bell Canada, it imposes compliance costs which

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24. Particularly relevant to the present discussion is the fact that the executive (the Crown) also exercises those powers and enjoys those privileges possessed by natural persons (for example, the power to contract, to own property and to speak) independently of a grant of authority by legislation or under the prerogative, although Parliament may constrain the exercise of these powers by legislation. See Hogg, *Constitutional Law*, vol. 1, *supra* note 21, c. 1.9.

25. *Supra* note 9. Two such principles, deriving from the notion of responsible government, are pertinent. Both the power to tax and, more generally, to collect revenue, and the power to disburse money from the Consolidated Revenue Fund must be authorized by Parliament — that is, by legislation.

26. There has been surprisingly little normative scholarship by Canadian legal authors directed to teasing out the underlying structure of the division of powers sections of the *Constitution Act, 1867*, *ibid.* For one notable exception, see Albert S. Abel, "The Neglected Logic of 91 and 92" (1969) 19 U.T.L.J. 487.

are then passed on to customers. Requirements that Bell Canada provide certain services at certain rates often amount to an enforced cross-subsidy of its operations. Furthermore, statutes that create or protect a patent as a form of property provide a subsidy to patent holders, and transfer costs to users. The establishment of civil causes of actions or new liability regimes, and the use of the criminal law to prohibit activity, also impose such costs. In other words, regardless of whether governance through legislation aims at command and control regulation, licensing, inspection, the creation of new torts, property rights or crime, its deployment is not cost-free. Conversely, the elimination or abolition of forms of property, or civil causes of action arising from the private law of general application such as, for example, the elimination of tort claims relating to asbestos use, is a regulatory strategy that redistributes costs.

Governments also regulate by establishing Crown corporations. The doctrine of corporate *ultra vires* sits uneasily with the modern business corporation, even though there are important differences between public and private spheres, as modern Crown corporations can perform significant regulatory functions, either by analogy to business corporations or by virtue of broadly-cast statutory powers. Typically these regulatory functions have significant economic consequences, either through excess pricing protected by a monopoly power or by discount pricing that provides an indirect subsidy. So, for example, when Air Canada or VIA Rail signs an agreement with an intra-provincial bus company to provide for "flow through" discount fares that enable the company to offer non-market rates, or when Canada Post Corporation offers over-the-counter services only marginally related to the post office the regulatory effect is both normative and financial.

The use of contract as a governing instrument, a feature of Canadian public life since the era of land-grant companies, canals and railways, is becoming increasingly visible. Today, collateral spending occurs whether the contract is with a private agency to establish a public-private-partnership (PPP), with another government, with a private citizen (as, for example, a mortgage insured through the Central Mortgage and Housing Corporation) or with a non-governmental organization (NGO), such as the Red Cross. Moreover, government

procurement policies, such as the federal contractors program, not only have an impact on employment policies, labour standards, unionization, minimum wages and so on: they also involve expenditures that may exacerbate or relieve corporate expenditures. The latter is particularly true where contracts are deployed to establish exemptions from legislation regulating language of work, labour standards, environmental degradation and product safety, *etc.*

Finally, there are a range of mega-regulatory instruments. These include monetary policy, interest rate regulation and foreign exchange controls and "behind the wicket" requirements such as mandatory insurance, mandatory labelling, tradable permits and franchising. All of these instruments govern citizen behaviour, all have financial consequences for regulated parties and all involve indirect government expenditure.

It follows that no state regulatory activity is free. Every program costs the enacting government something, if only in the form of an "opportunity cost": in this sense, all government programs are expenditure programs. Moreover, all regulation imposes costs — on the regulating government, on regulatees, on their customers and their suppliers or on other governments:[27] in this sense, all regulation is a form of taxation. Since all taxation and all government expenditures are redistributive, so too all regulation is redistributive.

There is a further point. Most government programs also involve indirect subsidies, whether simply by providing an information hot-line, a brochure, a service at below cost or by exempting particular persons

27. Increasingly the imposition of regulatory costs on other governments has become the subject of scrutiny. Downloading of service provisions on municipalities is just a particular example of what is known as the "unfunded mandate" problem. Consider that federal criminal or regulatory legislation within s. 91 normally must be enforced by provincial police or other agencies and applied by provincial courts. Likewise, provincial legislation within s. 92 (for example, labour standards and the provision of municipal services) may impose costs on federal agencies like the Employment Insurance Commission or the Canada Lands Corporation. The obverse is also true. If a mandate is fully funded (or over-funded) the impact is a federal expenditure for provincial purposes. For example, the funding of criminal legal aid at a rate in excess of what is actually spent on criminal or federal legal aid services means that provincial legal aid plans are being subsidized by the federal government.

or service providers from costly regulatory compliance. Frequently, however, the costs and the benefits are not indirect consequences of regulatory activity, but are the primary tools of a regulatory strategy. To these instruments — taxation and expenditure — this essay now turns.

*B. Financial Tools*

The traditional tools of governance focus on the channelling of human action and interaction through commands, rules and the offer of services. Public purposes are achieved directly either by proscribing and regulating conduct, or by facilitating human interaction through the creation of institutions, processes and services.[28] A regulatory purpose may also be pursued indirectly by use of financial levers: notably the power to raise revenue by means of an involuntary transfer to government (taxes, fees, licenses, levies, *etc.*) and the power to disburse (broadly conceived as the offer of subsidy, exemption or benefit).

As noted, the exercise of both the power to raise revenue by involuntary charges and the power to disburse require legislative authorization. In Canada, these powers are textually asymmetric, both as between taxing and spending and as between federal and provincial governments. So, for example, the *Constitution Act, 1867* grants Parliament the authority (unconstrained except by the convention that money bills must originate in the House of Commons) to raise revenue by any means of taxation (section 91(2)), or to borrow on the public credit (sections 91(3) and (4)). In contrast, it grants the provincial legislatures only the authority to impose direct taxes within the province, to borrow on the credit of the province and to raise money by imposing licensing fees (sections 92(2), 92(3) and 92(9)). Nowhere is the federal power textually limited in purpose, while in sections 92(2) and 92(9) direct taxation and licensing fees may be imposed only to raise revenue for "provincial purposes," although provincial borrowing under section 92(3) is not so limited. Likewise, section 91 does not explicitly

28. On this general point, see Lon L. Fuller, "Law as an Instrument of Social Control and Law as a Facilitation of Human Interaction" (1975) B.Y.U.L. Rev. 89.

constrain the power of Parliament to authorize federal expenditures, although section 92 limits the authorization to disburse that may be granted to the provincial government by provincial legislatures.[29]

Consider first of all the power to raise revenue. Every decision of this character (and notably, every decision about taxation) has implications for human behaviour.[30] A decision to tax income produces different behavioural consequences from a decision to tax wealth. A decision to tax consumption produces different consequences from a decision to tax debt. A decision to tax imports through excise duties produces different consequences from payroll taxes. And a decision to raise revenue by imposing mandatory insurance requirements produces different consequences from a decision to raise revenue through excessive license fees. Even where governments explicitly claim that the purpose of taxation or the imposition of a levy is merely to raise the revenue necessary to finance services and programs, the choice of taxation strategy is a regulatory decision with distributive consequences that are often direct.[31]

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29. Since provincial taxation is limited as to purpose, presumably provincial disbursements are also limited as to purpose. As for the federal power to disburse, the rule of law requires Parliament and legislatures to authorize departmental budgets and to approve disbursements from the Consolidated Revenue Fund, but s. 91 otherwise does not further constrain the purposes for which such authorization is granted. Whether these textual differences should, or according to the courts, actually do, matter to the interpretation of the federal and provincial taxation and spending powers is discussed in Parts IV-VI, below.

30. The point is trite, but is exhaustively elaborated in Parliament, "Report of the *Royal Commission on Taxation*" (Ottawa: Supply and Services Canada, 1969). The present discussion will focus on taxation, although borrowing and the sale of assets such as land, broadcast licenses and airline routes are also important facets of the power to raise revenue.

31. In tax literature the expression "redistributive" rather than "distributive" is often used. For the purposes of this paper, however, the word "distributive" will be used in the generic sense. The distributive consequences of revenue raising measures can be traced out in two dimensions. First, people will often change their behaviour to avoid or minimize tax or other levies. For example, when faced with higher gasoline taxes, they may drive less or take public transit more frequently. Faced with differential taxes on income and capital gains, they will direct investments to low-dividend, but high-accretion investments. But taxation and levies also sometimes change basic patterns of human interaction. If income is taxed, people may engage in informal barter. If sales and services

The regulatory policy implications of taxation and other mechanisms for raising revenue are, however, infinitely more complex than the simple decision about whether or not to tax, or whether or not to impose a fee, a toll or a levy, whether or not to borrow and whether or not to dispose of government property. These implications also embrace decisions about the tax unit (whom to tax): a person, family units, partnerships, corporations, trusts, *etc.* Within those categories, decisions will have to be made on issues such as the following: (i) the scope and definition of the tax base (What is a good or service? What is income? What is wealth? What is an import? Who is an employee?); (ii) the structure of deductions, credits and reclamations (deductions for GST paid earlier in the process of manufacture and general GST rebates; and income tax deductions, whether from taxable income or credits from tax payable); (iii) rates of taxation — should differential tax rates be imposed for different kinds of goods, such as luxury goods, necessaries or other consumables? Should different kinds of income (investment income, capital gains, interest income) attract different rates of taxation? Should rates of taxation be progressive depending on levels of income?; (iv) when should income be taxed? When it is earned, or when it is received?; and (v) who will administer the tax system?[32] Similar choices confront governments in adopting borrowing strategies. How high should the interest rate be set? Should the borrowing instrument be offered at a discount? Should it involve a mix of capital gain and interest?

What, then, of the power to disburse? Even though all regulatory actions and programs involve expenditures, some instruments of

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are taxed, people may exchange services. Even though the tax system may seek to impose tax on these actions, it is much harder to enforce reporting and collection. Moreover, in many cases, the reciprocity is not explicit. People may choose to live together in a commune where there is simply an informal division of labour. In other words, in this second dimension, pure revenue raising taxation may not only create the conditions for, but also encourage the development of deeper bonds of social solidarity. See David Cheal, *The Gift Economy* (London: Routledge, 1988); Marcel Mauss, *The Gift: The Form and Reason for Exchange in Archaic Societies*, trans. by W.D. Halls (London: Routledge, 1989).

32. On the basic structure of taxation and the policy choices open to governments, see Peter W. Hogg, Joanne E. Magee & Jinyan Li, *Principles of Canadian Income Tax Law*, 6th ed. (Toronto: Thomson Carswell, 2007).

governance seek to achieve their regulatory results through direct disbursements. Like taxation, direct spending has practically an infinite array of instantiations. One may begin with an inventory of recipients of the spending. Sometimes the spending is directed to citizens, sometimes to corporations, associations, unions, charities and NGOs acting in their own name and sometimes to these entities acting as intermediaries, or to government agencies, regulatory bodies and public corporations acting in such a fashion.

The form of the spending is also various. Sometimes it is unconditional and takes the form of an *ex gratia* cash payment or a voucher. Sometimes it is conditional and is managed through a claims process. Sometimes the expenditure involves the provision of insurance, a pension, a rebate, a grant, a loan at favourable (or no) interest or a loan guarantee. Sometimes it is a contractual commitment in the form of a favourable procurement contract. Sometimes the expenditure is unilateral. Sometimes it is meant to be a contribution matching expenditure by the recipient. Sometimes it takes the form of a gift in kind, of equipment (a flag), or of services (translation), or of an immunity or a compromise or a write-off of an existing debt.

Often, of course, expenditure is indirect. A favourite of contemporary governments is tax expenditures: for example, through general or particularized income tax deductions and credits (including tax deductions for contributions made to political parties or registered charities), GST rebates, waiver of payroll tax contributions, subsidized licensing fees or tax relief contracts. Other forms of indirect expenditures include regulatory relief expenditures in the form of tradable permits, exemption from requirements that would otherwise increase costs of production, and franchises and PPPs that authorize the collection and retention of a percentage of tolls.

These various types of disbursements — direct or indirect, through the tax system or otherwise — produce a normative effect in two ways. The first is by direct steering, as with most tax expenditures, conditional subsidies like child benefits, loan guaranties and tax relief contracts. This assumes that people will act as profit maximizers and will, therefore, orient their actions to derive maximum benefit from the program in question. The second way, just as often deployed, is through abeyance, as with old age security, disability pensions, child benefits, employment

and similar insurance programs. Many of these types of disbursements do not presuppose that the human conduct lying behind the disbursement will directly change; it is hard to imagine how one could decide not to grow older, or decide to regrow a severed limb. Rather, they produce their effects by enabling eligible recipients to reorient expenditures away from an activity that they may have previously felt obliged to attend to, and toward an activity of their choosing.

All tools of governance and all governmental actions (including inaction) are complex in their structure and impact. All generate both normative and economic consequences, and can increase or decrease the cost of goods and services. Consequently, the amount of disposable income available to citizens may increase or decrease, and the allocation of personal spending may be influenced. The character of daily activity may be changed as the practices of self-reliance, barter or gift loom larger. In other words, a theory of regulation presumes that human beings are largely rational actors who respond to incentives of various descriptions. Whether these incentives aim at liberty constraints or psychic levers, they will inevitably involve costs and lead to government expenditure.

## III. The Spending Power in Law and Mythology

Given that every conceivable governmental operation involves economic consequences and every tool of government involves redistributive spending, the exact parameters of any government's exercise of its "spending power" as a separate regulatory instrument are hard to specify. To act is to spend. Nonetheless, when Canadian constitutional lawyers talk of the spending power, the object of their concern historically has been considerably narrower than a tools-of-government analysis would suggest. They refer to state action that involves: (1) direct program spending; (2) by the federal government; (3) in areas where the legislature of a province has been given exclusive jurisdiction to enact legislation; (4) otherwise than by unconditional transfer; (5) without the express consent of the government of an affected province; and (6) where the revenue source is taxation or levies

internal to Canada.[33] To reach meaningful conclusions about the constitutional dimensions of the spending power, it is necessary to elaborate upon each of these definitional constraints.[34]

### *A. Direct Program Spending*

All state action in deploying a tool of government involves the direct or indirect expenditure of money and produces normative consequences, even where direct spending in pursuit of a policy is envisioned. However, only a portion of these actions involve what might be called targeted program spending. Neither indirect spending consequent upon the deployment of a non-fiscal instrument, nor direct disbursements in the form of tax expenditures, nor even spending by virtue of direct subsidies outside the income tax system, fits the classical definition of direct program spending. Direct expenditure outside the income tax system might involve, for example, subsidies to hydro corporations, the

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33. The above criteria are derived from articles by both those who acknowledge the constitutionality of a federal spending power so conceived, and those who contest its constitutionality. See *e.g.* Andrée Lajoie, "The Federal Spending Power and the Meech Lake Accord" in K.E. Swinton & C.J. Rogerson, *Competing Constitutional Visions: The Meech Lake Accord* (Toronto: Carswell, 1988) 175; André Tremblay, "Federal Spending Power" in Alain-G. Gagnon & Hugh Segal, eds., *The Canadian Social Union without Québec: 8 Critical Analyses* (Montreal: Institute for Research on Public Policy, 2001) 155; Andrew Petter, "Federalism and the Myth of the Federal Spending Power" (1989) 68 Can. Bar Rev. 448; Thomas R. McCoy & Barry Friedman, "Conditional Spending: Federalism's Trojan Horse" (1988) Sup. Ct. Rev. 85; Sujit Choudhry, "Recasting Social Canada: A Reconsideration of Federal Jurisdiction over Social Policy" (2002) 52 U.T.L.J. 163; Michel Maher, "Le défi du fédéralisme fiscal dans l'exercice du pouvoir de dépenser" (1996) 75 Can. Bar Rev. 403.

34. The issue has become more complicated in recent years, as concern about federal spending has shifted considerably to also embrace the larger context of what has come to be called the "fiscal imbalance." A comprehensive discussion is presented in Commission on Fiscal Imbalance, *Fiscal Imbalance in Canada: Historical Background, Report — Supporting Document 1* (Quebec: Bibliothèque nationale du Québec, 2002) [*Fiscal Imbalance Report*]. To capture this additional dimension of constitutional contestation requires a brief excursion into the law and practice of "fiscal federalism" — an endeavour that will be taken up in Part VI of this essay. See generally Harvey Lazar, ed., *Canadian Fiscal Arrangements: What Works, What Might Work Better* (Montreal: McGill-Queen's University Press, 2005).

post office, municipal mass transit services or VIA rail, GST and PST rebates for low income earners, and various forms of information on health, nutrition, recreation, housing safety standards and so on, provided free through pamphlets and the internet. Nonetheless, the primary focus of debate about the spending power has been on direct program spending in areas like health, welfare, pensions, infrastructure, research and post-secondary education, through shared-cost programs, conditional grants to provinces, mediated payments to institutions for redistribution to citizens and direct grants to citizens.[35]

*B. Federal Spending*

The second limitation on the scope of the spending power which generates scholarly concern is the limit that the federal government must be the source of the money spent or the channel through which that redistributed money flows. In other words, critics are less concerned with direct program expenditures as a tool of government *per se* than with expenditure by the federal government in particular.[36] The argument is not one of political theory (that governments ought not to tax and spend), but rather one of constitutional law. The claim is that there are constitutional limits on the authority of the federal government and its agencies to engage in direct program spending. No such limits, however, attach to such spending by other governments or agencies. So, for example, any spending by a provincial government or one of its agencies (municipalities, school commissions and regulatory commissions) is not seen to raise constitutional concerns. There may be

35. In the literature on the spending power prior to the Meech Lake Accord, there was only rare discussion of disbursements in the form of tax expenditures, operating subsidies or favourable procurement policies. For the exception that proves the rule, see Petter, *supra* note 33. Discussions at that time also did not discuss spending by way of the direct gift of property to citizens. Examples of such gifts might include the gratuitous disposal of excess Crown assets, the allocation of shares in privatized Crown corporations or the distribution of Crown lands.

36. Each of the critics, *supra* note 33, and the various studies prepared for the *Fiscal Imbalance Report*, *supra* note 34, focus on spending by the federal government.

political concerns, but if so, the remedy is political.[37] In addition, there is little concern over program spending by foreign countries (for example, through cultural exchanges, scholarship programs and financing of research consortiums, as well as through direct expenditures and gifts to their non-resident nationals). Program spending by international agencies such as the World Bank, the International Monetary Fund or the United Nations Educational, Scientific and Cultural Organization, or even by foreign or extra-provincial charities, corporations, unions and NGOs also escapes the censure of constitutional scholars preoccupied with the spending power.

### *C. Exclusive Provincial Legislative Jurisdiction*

The key to the constitutional concern, as conventionally formulated, is that federal spending must be related to a matter over which provinces are given exclusive legislative jurisdiction. Where jurisdiction is exclusively federal under an enumerated head of power, or an explicitly shared responsibility — for example, agriculture and immigration — the constitutional concern does not arise. Of course, what constitutes a matter of exclusive provincial legislative jurisdiction can only be determined by a careful consideration of what the limits of federal power may be. The question has two dimensions. The first is to determine whether the limits on the federal power to spend are identical

37. For example, extra-provincial spending in the manner of the original sixth point raised (but quickly abandoned) in the run-up to the Meech Lake Accord, namely the special role of Quebec in promoting the welfare of francophone communities outside Quebec, has not generally been seen to be constitutionally illegitimate. On this sixth point see Peter W. Hogg, *Meech Lake Constitutional Accord Annotated* (Toronto: Carswell, 1988). An early example of Quebec spending to this effect can be found in *An Act to authorize school commissions to make contributions from their funds for patriotic, national or school purposes*, S.Q. 6 Geo. V (1916) c. 23, s. 1, under which the Quebec legislature undertook to assist the financing of patriotic, nation or scholarly endeavours in Quebec, or elsewhere. A recent case of extra-territorial provincial spending, in which the court held the spending to be within provincial legislative competence is *Dunbar v. Saskatchewan (A.G.)* (1985), 11 D.L.R. (4th) 374 (Sask. Q.B.) [*Dunbar*]. For further discussion of the implications of this point for the rationale and scope of limitations on the federal spending power, see Part V, below.

in scope to the limits on the power of the Parliament of Canada to enact legislation.[38] The second is to determine the limits of federal legislative jurisdiction where expenditure arises as a collateral or ancillary effect of the exercise of an enumerated federal power. Historically, the "watertight compartments" metaphor of Lord Atkin dominated the analysis of constitutional jurisdiction.[39] Today, a different metaphor of constitutional jurisdiction controls. Jurisdictional frontiers are no longer to be established by what look like *ex ante* bright-line rules, but are rather to be determined by a functional logic under which the scope of federal legislative jurisdiction is capable of significant enlargement.[40] As the Supreme Court moves to an expansive reading of the ancillary and national dimensions doctrines, the limits of jurisdiction in each order of government become much more difficult to pin down.[41] While the same type of expansive reading can be given to provincial jurisdiction, much

38. It is often claimed that the speeches of Lord Watson in *Liquidators of Maritime Bank v. Receiver General of New Brunswick*, [1892] A.C. 437 (P.C.) and Lord Haldane in *Bonanza Creek Gold Mining Co. v. R.*, [1916] 1 A.C. 566 (P.C.) [*Bonanza Creek*] settled this question. While the court in *Bonanza Creek* held at 580 that "the distribution under the new grant of executive authority in substance follows the distribution under the new grant of legislative powers," this conclusion is not definitive on the extent of the power to disburse. This point will be considered in greater detail in Part VI, below.

39. *Reference Re Weekly Rest in Industrial Undertakings Act, Minimum Wages Act and Limitation of Hours of Work Act*, [1937] 1 D.L.R. 673 at 684 (P.C.), (*sub nom. Canada (A.G.) v. Ontario (A.G.)*), [1937] A.C. 326 [*Labour Conventions Case*]. It is important to note that the "watertight compartment" view does not demand that constitutional interpretation be grounded in an "original intent" ontology. Rather, the watertight compartment view is one that seeks to reduce (if not eliminate) the possibility of concurrent legislative jurisdiction, and is usually accompanied by a narrow reading of the ancillary powers doctrine. For further elaboration of the point, see Part V, below.

40. See Jean Leclair, "The Supreme Court of Canada's Understanding of Federalism: Efficiency at the Expense of Diversity" (2003) 28 Queen's L.J. 411. He argues that "bright-line" jurisdictional frontiers are necessary to prevent federal encroachment on provincial authority. For further discussion, see text at note 78, *infra*.

41. See, for example, *General Motors of Canada Ltd. v. City National Leasing*, [1989] 1 S.C.R. 641 [*General Motors*]. Some scholars also observe that the waning of doctrines of interjurisdictional immunity such as propounded in *Bank of Montreal v. Hall*, [1990] 1 SC.R. 121 are further evidence that the Supreme Court no longer respects "bright-line" jurisdictional frontiers and is prepared to tolerate increasing encroachment on what was previously considered to be exclusive provincial or federal jurisdiction.

of the constitutional concern about federal spending is now expressed not just in terms of limiting such spending to areas within federal legislative authority, but also in terms of contesting recent judicial decisions that are seen as enlarging Parliament's legislative jurisdiction.[42] In other words, if one's policy or political objective is to constrain federal regulatory action by limiting the spending power to federal heads of legislative jurisdiction, one's purposes can be defeated if courts give a continually broadening interpretation to the extent of that legislative jurisdiction.

*D. Otherwise Than By Unconditional Transfer*

In its most general form, the critique of the federal spending power is directed to all direct federal program spending in areas of provincial jurisdiction, regardless of how the spending occurs. Under one version of this critique, even if the federal government were simply to give money to a province as an unconditional transfer this would be an unconstitutional expenditure, and its acceptance by the province would also be unconstitutional.[43] However, most critiques of the spending power imagine that what is constrained by the constitution is not the federal spending in itself, but its conditional or directed nature. The problem arises because the offer of money, either in the context of a shared cost program or as a conditional transfer, will impliedly drive provincial policy in an area of provincial jurisdiction.[44] Even some

42. See notably, Eugénie Brouillet, *La négation de la nation: l'identité culturelle québécoise et le fédéralisme canadien* (Sillery: Septentrion, 2005).

43. For an early argument to this effect, see Jean Beetz, "Les attitudes changeantes du Québec à l'endroit de la Constitution de 1867" in P.-A. Crépeau & C.B. Macpherson, eds., *The Future of Canadian Federalism* (Toronto: University of Toronto Press, 1965) at 113. Since the enactment of s. 36 of the *Constitution Act, 1982*, *supra* note 6, this argument about unconditional grants is probably no longer tenable.

44. Other problems are that it forces provinces to commit to programs that may then be underfinanced in the future; also if the program is accepted by others, and there is no opt-out, it penalizes the recalcitrant province. See generally, Albert Abel, "Constitutional Charter for Canada" (1978) 28 U.T.L.J. 261 [Abel, "Constitutional Charter"], and especially, Part IV of this unfinished work entitled, "Spending: Scope of the Spending Power" at 313.

unconditional transfers can have important, though indirect, steering effects. If the transfer is to citizens, this may undermine provincial economic redistribution policy: for example, the federal transfer of a substantial fixed amount in the form of a gift or interest-free loan to all taxpayers could well compromise the effectiveness of policies favouring a steeply graduated income tax. This is even truer for unconditional transfers to corporate entities such as hospitals, hospital foundations, universities, food banks and so on. Unconditional gifts to any non-universal recipient group are redistributive, however widely the net is cast. Taken to the limit, unless some formula were found so that the amount returned to a province was identical to the amount raised within the province, the transfer of funds would have an impermissible regulatory effect. Here the policy steering arises because all transfers imply a transfer formula. Moreover, if the chosen formula involves explicit equalization of some sort, this is redistributive federal spending that has implications for provincial capacity to raise revenue and to target spending as the province sees fit.[45]

### *E. Without the Express Consent or Possibility of Fully Compensated Opt-out of the Affected Province*

One reason why critics disparage even unconditional federal spending is that it puts provinces under enormous pressure to accept the funds. Consider first conditional spending. The only way in which a province can be truly free to consent is if it will receive, through an opt-out, exactly the same amount of money from the federal treasury that it would have received had it consented to the shared-cost program or the conditional transfer. Moreover, if some provinces agree to a conditional

45. This latter position must rest on a different constitutional footing than the conditional transfer critique, however, for in this case the federal expenditure in no way trenches on provincial jurisdiction or otherwise seeks to "guide" provincial policy. Rather, the argument must be to the effect that the federal government should not have the capacity to *raise* revenue beyond that required to finance strictly federal purposes. Accepting the legitimacy of this claim, however, merely displaces the issue: is economic redistribution a legitimate federal purpose? On this issue, see Part VI, below, discussing s. 36 of the *Constitution Act, 1982*, *supra* note 6.

transfer and others do not, it may be difficult to control for externalities. Imagine a direct subsidy to citizens for certain prescription drugs. Even with an opt-out, given the difficulty of enforcing inter-provincial trade barriers, cheap drugs in Saskatchewan can easily be marketed in any other province, and this would have an impact on policy formation in those provinces. Where the subsidy is to a provincial health agency, this implies policy steering as long as inter-provincial mobility of citizens is possible. Moreover, unless the amount of the transfer by opt-out is exactly equal to a province's pro-rated share of tax collected in the province, then even an unconditional transfer via an opt-out can mean foregone revenue for the province and a cross-subsidy to other provinces. Consequently, even with express consent or the right to an unconditional opt-out, program expenditures may be inter-provincial equalization expenditures in disguise. Put slightly differently, in order for the federal spending not to have a redistributive effect the amount of the compensated opt-out would have to be the greater of the amount the province would have received under the scheme or the province's share of the total tax bill necessary to fund the program.[46]

*F. Revenue Source is Tax or Levies within Canada*

A further issue relating to the source of the money that sustains direct federal program spending remains. Initially those who contested the existence of a federal spending power focused on expenditures of tax and other revenues raised by the levies on Canadian taxpayers.[47]

46. The rationale is this: *Ex hypothesi* these programs are not "equalization programs" justified as falling within federal jurisdiction under s. 36. Consequently, the federal government should have no authority to raise revenue in an opting-out province that is greater than the amount received in compensation. If it did so, it would be engaged in an unauthorized equalization program by conscripting taxpayers in a province that has opted out into financing the program in "have-not" provinces.

47. Notwithstanding the express language of s. 91(2), courts have sometimes doubted that properly collected tax revenues can be spent in any manner the federal executive might choose. See *Reference Re Employment and Social Insurance Act (Can.)*, [1937] 1 D.L.R. 684 (P.C.), (*sub nom. Canada (A.G.) v. Ontario (A.G.)*) [1937] A.C. 326 at 366 [*Unemployment Insurance Reference*].

Presumably, the foundation of this narrowly cast objection was that expenditure of money raised by taxation had negative impacts on the capacity of provincial governments to fund their own programs. Today, however, because concern has shifted to the steering effect of federal expenditure, the objection embraces all federal spending regardless of the revenue source: gifts by Canadians to the federal government; transfers by foreign governments or international agencies to the federal government for redistribution; taxation of offshore taxpayers who do not reside in any particular province; spoils of war; profits of Crown corporations; and so on.[48] Consider the following example. A multimillionaire could set up a charitable foundation and distribute scholarships to post-secondary students as he or she saw fit (subject, of course, to applicable *Human Rights Code* restrictions); the criteria for awarding the scholarship might, conceivably, be identical to those adopted by the Social Sciences and Humanities Research Council of Canada (SSHRC). But on the broad understanding of federal spending, the multimillionaire's foundation could not give the money to a federal agency such as the SSHRC to do the spending, even if the norms adopted by the foundation were identical to those employed by the SSHRC. Nor could the federal government spend even where there was no impact on the capacity of provinces to raise revenue, because the revenue source would be a type of taxation exclusively available to the federal Parliament (for example, indirect taxation) or levies that only the federal government could impose (for example, customs duties). The root of the complaint at this point clearly has only a tenuous connection with a concern about undermining provincial public policy, or even with compromising the possibility of raising provincial revenue. Rather, it has to do with competing understandings of federal citizenship, which is why this argument has particular resonance among Quebec scholars.[49]

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48. For a helpful discussion, see Lajoie, "Federal Spending Power", *supra* note 1 at 153-54.

49. For further development of the idea that federal social spending carries deep implications for the meaning of federal citizenship see Daniel M.Weinstock, "The Moral Psychology of Federalism" in Jean-François Gaudreault-DesBiens & Fabien Gélinas, eds., *The States and Moods of Federalism* (Montreal: Yvon Blais, 2005) 209; Daniel M. Weinstock, "Liberty and Overlapping Federalism" in Choudhry, Gaudreault-DesBiens & Sossin, *supra* note 1 [Weinstock, "Overlapping Federalism"].

From this discussion, it is apparent that there is a significant difference between what might constitute the federal spending power were a sophisticated "tools of governance" analysis to be adopted, and what constitutional critics of federal spending in Canada have traditionally seen as the main issues. This difference has long obscured a number of important substantive inquiries: (1) Why do governments spend? What are the justifications for government spending? (2) What is the nexus between taxation and expenditure? Is the argument really about federal spending or about federal taxation? (3) What is the impact of the changing environment of instrument choice: is federal spending really an issue for the future? These inquiries are addressed in the next sections of this paper.[50]

# IV. Policy Contexts of Federal Spending

All governments spend money; all Canadian governments have done so since 1867. However, the "federal spending power" became a significant issue for most Canadian constitutional lawyers only in the period after World War II. Some believe that the first exercise of the narrowly-defined federal spending power arose in relation to agricultural subsidies in 1912, and that such federal spending was pursued

50. Some scholars see the "federal spending power" problem as (1) a particularly Canadian problem, that (2) is essentially a consequence of the expansion of the welfare state in the mid-20th century. It is neither. The problem of federal spending is present in all federations and has been evident for at least two centuries. Consider the following example. Towards the end of the American Civil War the Confederate government found itself desperately short of soldiers. It proposed to conscript slaves into the army, offering them and their families freedom at the conclusion of the war. While critics of the plan acknowledged that the Confederate government could conscript slaves for war purposes (and even arm them) they contested whether it lay within the power of the government to "free the slaves." Slaves were property, and manumitting them would be an exercise of the spending power: it would be to give away federal property. There was no authority in the Confederate government to do so for any non-federal purpose, and the constitution explicitly forbade the government to interfere with the "institution" of slavery — a power reserved exclusively to the several states. For a discussion of this point, see Donald P. Currie, "Through the Looking-glass: The Confederate Constitution in Congress 1861-1865" (2004) 90 Va. L. Rev. 1257 at 1300-06.

systematically throughout the next quarter century.[51] However, the general deployment of the power to spend in fields of provincial legislative jurisdiction dates from the beginnings of the welfare state, or from what many policy analysts have called Canada's second National Policy.[52]

Two factors account for this, one of them economic and centripetal, one of them ideological and centrifugal. First, the 19th century conception of the role of government, and the consequent allocation of responsibility as between provincial legislatures and the Parliament of Canada in 1867, proved ill-adjusted to the needs of 20th century states. Second, the post-World War I (*Treaty of Versailles*) conception of nationalism, and the claims of nations for political presence, sparked a general desire for self-assertion by provincial governments and especially by the government of Quebec.

Consider the economic, centripetal explanation. Canadian constitutional lawyers typically tell one of two stories of Confederation. One of these stories, dominant among francophone scholars in Quebec, suggests that the *Constitution Act, 1867* was simply a further iteration of a permanent compact between two nations.[53] The second story, dominant elsewhere, suggests that Confederation was simply a means for the Colonial Office to get rid of the burden of England's North American colonies, yet temporarily maintain their colonial status:

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51. See Sécretariat aux affaires intergouvernamentales canadiennes, *Québec's Historical Position on the Federal Spending Power, 1944-1998* (Quebec: Gouvernement du Québec, 1998). See also Commission on Fiscal Imbalance, *The "Federal Spending Power" Report — Supporting Document 2* (Quebec: Bibliothèque Nationale du Québec, 2002) [*"Federal Spending Power" Report*].

52. For a brief discussion, see Fowke, *supra* note 19.

53. I have attempted my own analysis of compact theory — one that emphasizes the difference between a compact between two peoples and a compact between the Government of Quebec and the Government of Canada — in a number of articles. See Roderick A. Macdonald, "... Meech Lake to the Contrary Notwithstanding: Part I" (1991) 29 Osgoode Hall L.J. 253; Roderick A. Macdonald, "... Meech Lake to the Contrary Notwithstanding: Part II" (1991) 29 Osgoode Hall L.J. 483; Roderick A. Macdonald, "Three Centuries of Constitution-Making in Canada: Will There Be a Fourth?" (1996) 30 U.B.C. L. Rev. 211; Roderick A. Macdonald & Steve Szilagyi, "Constitutional Hockey: *Canadiens* and *Habitants* in the *Imaginaire* of Quebec" (2005) 38 U.B.C. L. Rev 451.

Confederation was a step on the road from "colony to nation."[54] There is also a third story, offered mainly by political economists and historians: Confederation was the vehicle by which the Montreal anglophone bourgeoisie were enabled to pursue policies of high tariffs, immigration to the prairies and transportation infrastructure in furtherance of building what has come to be called "the commercial empire of the St. Lawrence."[55] On this interpretation, the primary question was how to generate the political authority necessary to build a coast-to-coast economy against the natural north-south economic flow. The Canada of the *British North America Act* — the particular configuration of political institutions and the particular allocation of legislative jurisdiction — can be seen as an instrument of economic policy, rather than economic policy being seen as an instrument deployed by the federal government in a state-building endeavour.[56]

By the mid-1930s, however, all governments of the Atlantic area were confronted with the Great Depression and the need to deploy macro-economic levers to resuscitate the economy and protect the welfare of citizens. Hence, the Rowell-Sirois Commission and its

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54. See A.R.M. Lower, "Theories of Canadian Federalism — Yesterday and Today" in A.R.M. Lower *et al.*, eds., *Evolving Canadian Federalism* (Durham: Duke University Press, 1958) 3; George F.G. Stanley, "Act or Pact? Another Look at Confederation" in John S. Moir, Adrien Pouliot S.J. & Leopold Lamontagne, eds., *Report of the Annual Meeting Held at Montreal, June 6-8, 1956* (Ottawa: Canadian Historical Association, 1956) 1; A.R.M. Lower, *Colony to Nation: A History of Canada* (Toronto: Longmans, Green, 1946).

55. See generally J.H. Dales, *The Protective Tariff in Canada's Development* (Toronto: University of Toronto Press, 1966); K.H. Norrie, "Agricultural Implement Tariffs, the National Policy and Income Distribution in the Wheat Economy" (1974) 7 Canadian Journal of Economics 449; Donald V. Smiley, "Canada and the Quest for a National Policy" (1975) 8 Canadian Journal of Political Science 40; Lorraine Eden & Maureen Appel Molot, "Canada's National Policies: Reflections on 125 Years" (1993) 19 Can. Pub. Pol'y 232; Allan Tupper, "Canada's National Policies: Reflections on 125 Years — A Commentary" (1993) 19 Can. Pub. Pol'y 252; Donald G. McFetridge, "Rent-Seeking as Nation-Building: A Comment on Canada's National Policies: Reflections on 125 Years'" (1993) 19 Can. Pub. Pol'y 255.

56. In this light, Lesage's *Maîtres chez nous* rallying cry of 1962 was fundamentally no different from Macdonald's National Policy slogan of 1879. See R.D. Wolfe & Roderick A. Macdonald, "The Real Constitutional Question: Canada's 21st Century National Policy" [forthcoming in 2008].

attendant second National Policy's strong federal spending on social welfare and the institutions of cultural and economic nationalism. In pursuing this twin policy of open global markets to ensure that trade was not a source of conflict, and as a concomitant local counterbalance, the creation of a robust welfare state in Canada followed a similar course to that of other North Atlantic states.[57] But economic and political stability required more. It also called for a central bank to manage economic shocks coming from outside Canada, and for the formal instruments needed to allow resources to flow gracefully between slower-growing and faster-growing regions of the country. This federal action was not achieved easily, given the reluctance of the Privy Council to adopt an expansive reading of Parliament's jurisdiction.[58]

The economic shock of the 1930s was accompanied by the political shock of the early 1940s, in the form of World War II. The federal government found itself politically unable to raise the revenue needed to finance the war in the absence of provincial cooperation. On both the spending and taxation fronts, the arrangements of 1867 appeared to be inadequate to deal with these two crises.[59] Apart from occasional constitutional amendments,[60] the preferred vehicles of the second National Policy became tax rental agreements, direct federal spending through subsidies to citizens, groups and corporations, multiple shared-cost programs, inter-provincial equalization transfers and, increasingly, complex tax expenditures.[61]

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57. This idea is based on the "double movement" elaborated in Karl Polanyi, *The Great Transformation* (Boston: Beacon Press, 1967). See also John Gerard Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order" (1982) 36 International Organization 379.

58. See *Labour Conventions Case*, *supra* note 39; *Unemployment Insurance Reference*, *supra* note 47.

59. Abel, "Constitutional Charter", *supra* note 44, especially Part III entitled "Taxation" at 293 and Part IV entitled "Spending: Scope of the Spending Power" at 313.

60. See *Constitution Act, 1867*, *supra* note 9, ss. 91(2A) (added in 1940), 94A (as originally enacted in 1951). These amendments related to unemployment insurance and old age pensions, respectively.

61. For a good review of these initiatives, see Thomas J. Courchene, "Proposals for a New National Policy" in Tom Kent, ed., *In Pursuit of the Public Good* (Montreal: McGill-Queen's University Press, 1997) 65.

From the federal response to these crises, and particularly from the refusal of the federal government to desist from such policy initiatives once the economic and political crises were met, came the second explanation of concern about federal spending — the ideological and centrifugal explanation. The components of the first National Policy were national in the sense that they applied to the whole country. Any action not required for building a transcontinental state and economy was left to the provinces. The story of the second National Policy, however, is one of continual conflict between orders of government. The 1867 arrangement did not imagine that the state, whether provincial or federal, would enter onto the social terrain occupied by religious and charitable institutions and by rural and neighbourhood collective assistance organizations. Nor were the Fathers of Confederation prescient as to the policy instruments and jurisdictional allocations necessary to manage a national economy in the mid-20th century. When Canadians and their governments felt the need to create the institutions and programs of what became the welfare state, few provinces had the tax base, the population and the governance capacity to manage them. As a result, with the concurrence of most provinces, Ottawa took the initiative in developing social welfare policy initiatives.[62]

Many Quebec scholars see all these instruments of the second National Policy, and not just the spending power as understood in the classical sense, as an unwarranted and unjustifiable trespass upon provincial jurisdiction.[63] The principal normative argument, most often implicit, is governing structure for diverse and dispersed political

62. For a perspective on the creation of many of these initiatives by an insider at the time, see Tom Kent, "The Harper Peril for Canadian Federalism" *Policy Options* (February 2008) 12, online: Institute for Research on Public Policy <http://www.irpp.org/po/archive/feb08/kent.pdf> [Kent, "The Harper Peril"].

63. To my knowledge, the only non-Quebec scholars who take an uncompromising position against the "unlimited" federal spending power are Abel, "Constitutional Charter", *supra* note 44 and Petter, *supra* note 33. Most acknowledge both the existence of and the necessity for federal spending that goes beyond the jurisdictional constraints of federal legislative authority, even though some also attempt to find normative justifications for constraining its exercise. On the latter point, see particularly, Hoi Kong, "The Spending Power, Constitutional Interpretation and Legal Pragmatism" (2008) 34 Queen's L.J. 305.

communities. Scholars who argue that social spending programs which directly emanate from, or are seen to originate with, the federal government should be curtailed often make the argument primarily because they cannot conceive of Canada as their nation — only as their state.[64] The basic premise is that the initial allocation of social policy to the provinces should be maintained even when Canadian state-building calls forth a more thickly-conceived conception of federal citizenship.[65] Nowhere has this understanding of federal-provincial relationships been better explored than in the *Tremblay Commission Report* of the 1950s.[66] While the policy goals of the first National Policy benefited Quebec, neither the goals nor the instruments encroached on provincial legislative powers. They did not, moreover, challenge the ability of Quebec City to hold itself out as the political centre for francophone identity. The tools and objectives of the second National Policy, by contrast, brought to light differing conceptions of the role of the state, initially, and differing conceptions of the locus of responsibility for nation-building, subsequently. Until the 1950s, Quebec resistance to federal action was grounded in ideological conflict between a small-government regime in Quebec and a welfare-state regime in Ottawa about the respective roles of the state and the institutions of civil society. After 1960, the conflict was about which government should

64. This is a recurring theme in much scholarship emanating from Quebec. For an insightful reflection from a jurist see José Woehrling, "La reconnaissance du Québec comme société distincte et la dualité linguistique du Canada: conséquences juridiques et constitutionnelles" (1988) 14 Can. Pub. Pol'y 43. For an equally insightful reflection from a political scientist, see Christian Dufour, *Le défi québécois* (Montreal: L'Hexagone, 1989).

65. The point is nicely explored in Charles Taylor, "Why Do Nations Have to Become States?" and "Alternative Futures: Legitimacy, Identity, and Alienation in Late-Twentieth-Century Canada", both in *Reconciling the Solitudes: Essays on Canadian Federalism and Nationalism*, Guy Laforest, ed. (Montreal: McGill-Queen's University Press, 1993) 40 and 59 respectively.

66. See *Report of the Royal Commission of Inquiry on Constitutional Problems,* vol. 1 (Quebec: Government of Quebec, 1956) [*Tremblay Commission Report*]. The Report is often seen as an intention to justify the establishment of a provincial income tax to generate revenues to compensate universities for the government's refusal to permit them to receive federal money directly. Nonetheless, the overall thrust of the Report aims at justifying the role of the provinces as the centre of gravity for social citizenship.

take responsibility for providing the policies and programs of the welfare state that were definitive of a nation.[67]

This discussion of ideological conflict around federal spending raises more fundamental questions. One might begin by asking, "why do states act?" It is obviously beyond the scope of this paper to essay a theory of the state and the citizen, but insight into the character of the issue can be gained by thinking about spending as a question of instrument choice. Here there are two broad explanations. One is the public choice explanation: governments in liberal democratic states imagine and pursue policies to get elected. When financial resources are thin, governments tend to spend *law*, enacting statutes that ostensibly solve a problem by externalizing and redistributing the costs of dealing with it onto someone else. When financial resources are more plentiful, governments tend to spend *money*, establishing programs that overtly involve redistributing benefits. The other explanation is less conspiratorial: governments in liberal democratic states imagine and pursue policies that ensure a fair balance between market liberalism and social welfare. When social welfare can be assured by building externalities directly into the costs of production, governments act by way of regulation, and by according franchises and contracts. When social welfare cannot be assured in that way, governments act by means of taxation, spending, state corporations and similar instruments. When neither of these forms of direct governance is possible, states act by way of indirect regulatory instruments.[68]

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67. This latter conception of the role of the State is true as much for Liberal Party premiers Lesage, Bourassa, Johnson (2) and Charest as for Parti Québécois premiers Levesque, Johnson (1), Parizeau, Bouchard and Landry. After 1960, any federal action that appeared to challenge the ability of the Quebec government to shape patterns of interaction or to promote Canadian citizenship necessarily ran counter to Quebec self-affirmation, whether merely nationalist or overtly sovereigntist. In this light, the fundamental problem with the Patriation endeavour of 1982 was less the amending formula than the attempt to use the *Canadian Charter of Rights and Freedoms* as a Canadian nation-building strategy. The best contemporary analysis of this point remains, Peter H. Russell, "The Political Purposes of the *Canadian Charter of Rights and Freedoms*" (1983) 61 Can. Bar Rev. 31.

68. See B. Guy Peters, "The Politics of Tool Choice" and Lester M. Salamon, "The Tools Approach and the New Governance: Conclusion and Implications" in Salamon, *supra* note 16, 552 and 600 respectively.

The desire of the Quebec government to act as a state (implicitly denying that it is a province within a federal state) is manifest in both these strategies. The Duplessis government of the 1950s spent law to act as a state; the promotion of a socially conservative and largely Roman Catholic rural society was not an issue of expenditure as much as it was an issue of control of public morality.[69] However, the very different view of the state adopted by the Lesage government and its successors required resources and money; on this view, it was possible to assert a national project of state-building in diverse regulatory fields by spending money within the traditional jurisdictional framework of section 92, and without trespassing on federal jurisdiction. The only constraint upon state-building action in Quebec was the provincial government's capacity to raise revenue.

Expenditures, especially direct program expenditures, are a powerful policy instrument. They can be used for economic projects, whether by a province or by the federal government. They can be used for political projects, as in the competition to put either the Quebec or the Canadian flag on a cheque, in Quebec's spending in support of extra-provincial francophonie and in Ottawa's promotion of the "no" option in Quebec's referendum. They can be used to serve social projects, whether local, provincial or pan-Canadian. Historically, neither the federal government, nor scholars favouring federal social spending, have objected to non-section 92 provincial spending.[70] But federal spending evokes a different response. Increasingly, both in Quebec and in the newly-minted "have" provinces in Canada, the objection is not to the existence of federal spending, but to its scope, its scale and especially its modalities. Unilaterally imposed shared cost programs, non-negotiated conditional transfers and abusive exploitation of tax room ground the

69. Many of these attempts to control public morality — notably the control of religious and political speech — were found by the Supreme Court to trench upon the exclusive jurisdiction of the Parliament of Canada in matters of criminal law, and more generally, upon certain constitutional principles relating to civil liberties. See Peter W. Hogg, *Canadian Constitutional Law*, 5th ed., vol. 2 (Toronto: Thomson Carswell, 2005), c. 34.1-34.4.

70. See *e.g.* F.R. Scott, "The Constitutional Background of Taxation Agreements" (1955) 2 McGill L.J. 1. It is a different question whether a citizen might object to provincial expenditures for non-section 92 purposes. For one unsuccessful attempt to constrain provincial spending on this basis, see *Dunbar*, *supra* note 37.

current concerns. But the present Canadian constitution offers little room for normative arguments addressing these objections. Only arguments about the constitutional division of powers appear to provide a meaningful bulwark against federal fiscal and regulatory imperialism. And these prophylactic arguments have most purchase when combined with an originalist conception of federal constitutional jurisdiction as constrained within watertight compartments.[71] This essay now turns to a brief consideration of the relationship between federal spending and federal jurisdiction.

## V. Federal Jurisdiction, Federal Taxation and Federal Spending

Many of the most persistent critics of the federal spending power are also among those from Quebec who contest the very idea that Canada is, or ever was, a federation.[72] For these critics, there is irrefutable evidence that Sir John A. Macdonald's initial ambition to create a unitary state is slowly being realized, which can be found in various features of the *Constitution Act, 1867*, in various practices of the federal government since then and in various interpretive doctrines of the Supreme Court.[73] There are two key normative concerns: formally, that the original distribution of legislative powers was a binding contract between "two founding peoples"; and substantively, that the expansion of federal jurisdiction undermines the government of Quebec's pursuit

71. For a thoughtful and balanced review of the arguments for and against this mode of constitutional interpretation, see Jean Leclair, "The Elusive Quest for the Quintessential 'National Interest'" (2005) 38 U.B.C. L. Rev. 353; Jean Leclair, "The Supreme Court of Canada's Understanding of Federalism: Efficiency at the Expense of Diversity" (2002) 28 Queen's L.J. 411.

72. This is not the occasion to explore what exactly the claim "Canada is not a federation" means in the light of federalism theory. For a recent exploration, see generally Jean-François Gaudreault-DesBiens & Fabien Gélinas, "Opening New Perspectives on Federalism" in Gaudreault-DesBiens & Gélinas, *supra* note 49 at 51.

73. For the best summary of this position see Lajoie, "Federal Spending Power", *supra* note 1 at 145-51. For a further elaboration, see André Tremblay, "Judicial Interpretation and the Canadian Constitutional Reform Dilemma" (1991-2) 1 N.J.C.L. 163.

of its distinctive mission as heartland and homeland of Canada's francophone population.

As evidence of the "un-federal" character of the very terms of the *Constitution Act, 1867*, these critics cite, notably these facts: (1) the Lieutenant-Governors of the provinces are vested with a power of disallowance of legislation or reservation of Royal Assent for the pleasure of the Governor-General; (2) the Parliament of Canada may declare a work or undertaking to be for the "general advantage of Canada," and therefore assume jurisdiction over it; and (3) the federal government has an unlimited power to acquire property for public purposes, and when it does so, it can largely subject such property to exclusive federal jurisdiction. Had they wished, they might also have noted that: (4) the Lieutenant-Governors are appointed by the Governor-in-Council; (5) the Governor-in-Council, and not the courts, has jurisdiction to hear appeals in education matters; (6) all superior court judges are appointed by the Governor-General; and (7) some matters central to the concept of "property and civil rights," and unconnected with the national economy — notably marriage and divorce — are vested in the federal jurisdiction.[74]

The brief goes further. Since 1867, the situation has deteriorated as a result of three interconnected sets of developments. The first set consists of unwise or inappropriate amendments to the constitution. Among them are: (8) amendments relating to unemployment insurance and pensions that transfer provincial jurisdiction to the Parliament of Canada.[75] The second set consists of amendments to the constitution that are not only unwise, but also arguably unconstitutional in the sense that they violate other, more fundamental principles of the constitution. Among them is: (9) the "unilateral" patriation of the constitution in 1982. The third set consists of amendments that are inconsistent with

74. On these seven points, see respectively the *Constitution Act, 1867*, *supra* note 9, ss. 90, 92(10)(c), 91(2), 58, 93(3), 96, 91(26). While the point has not been previously raised in critical commentaries, it is also the case that the power of the Parliament of Canada to establish courts for the better administration of the laws of Canada under s. 101, permits the federal government to unilaterally withdraw vast areas of jurisdiction from the competence of provincial courts established under s. 92(14).

75. See *Constitution Act, 1867*, *supra* note 9, ss. 91(2A) (as added in 1940), 94A (as initially added in 1951).

the constitution. Among these: (10) the federal government's constant encroachment on provincial jurisdiction through unilateral interventions, such as what is disparaged as the "Canadian Social Union without Quebec"; (11) Parliament's use of the spending power to encroach upon provincial jurisdiction; and (12) Parliament's abuse of its taxation power to create a fiscal imbalance that paralyzes provincial initiatives. The normative judgments reflected in this enumeration reflect the richer view of the constitution as always and necessarily more than text.

Finally, critics contend that over the past half-century the constitution has been interpreted in a manner that consistently enhances the legislative powers of Parliament at the expense of the provinces. For example, it is noted that: (13) the Supreme Court now has final constitutional authority, and unlike the Privy Council its members are appointed exclusively by one of the necessary parties to division of powers litigation; (14) interpretive doctrines such as federal paramountcy, the extended residuary power, the national dimensions doctrine and the emergency power provide cover for federal legislation that intrudes upon areas believed to have been assigned exclusively to provincial jurisdiction; and (15) the relatively recent change from an exclusive category theory of federal and provincial jurisdiction to a much looser ancillary powers doctrine opens the door to jurisdictional overlap, and because of the doctrine of federal paramountcy, it potentially subordinates provincial legislative authority to federal initiatives across almost the entire range of provincial jurisdiction.[76]

What, then, can be made of this inventory of concerns about the undermining of Canadian federalism through enlargement of federal powers? More particularly, what is the relationship of federal spending and federal taxation to this alleged expansion of federal jurisdiction?

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76. Given the policy justification for the national dimensions (*R. v. Crown Zellerbach Canada Ltd.*, [1988] 1 S.C.R. 401), emergency power and ancillary power (*General Motors*, *supra* note 41) doctrines, the only heads of provincial legislative competence that would probably be immune from interference by federal legislation would be those relating to the provincial constitution, direct taxation within the province, the borrowing of money on the credit of the province, the establishment, tenure and remuneration of provincial officers, and the management and sale of provincial lands and resources (*Constitution Act, 1867*, *supra* note 9 at ss. 92(1)-(5)).

Several observations about the character of the critique are pertinent. I will offer six. First, the arguments are essentially formal. Rarely are either substantive or normative questions addressed. Take the declaratory power, for example. One might ask how many of the almost 500 exercises of that power have been beneficial to Canadians and how many have not. Or whether the existence of the declaratory power is compatible with the theory of federalism as a mode of political governance. Or whether the declaratory power is simply another way of exercising Crown ownership or operating a Crown corporation. Or one might ask whether the exercise of the power has ever prevented a provincial government from pursuing its own regulatory purposes.

Second, the arguments are, for the most part, textual and historically frozen. Only some variant of "creationism" or "original omniscience" theories of constitutionalism can justify the claim that the vision of the state adopted in 1867, and the vision of the legislative, executive and judicial powers necessary for building that state, are unchanging and unchangeable by practice. But the frozen constitution is frozen only insofar as the frontiers of federal power are concerned. Is it consistent to claim, for example, that the power of reservation and disallowance is evidence of an imperfect federalism simply because it exists (although it is unused), and at the same time to claim that other governance actions are illegitimate because they are non-textual?[77]

Third, the arguments have little reference to the implicit constitution, and they occasionally appear to attribute an *animus* that does not seem to have been present at the time of action. Is it true, for example, that federal power caused provincial incapacity to deal with the Depression? The assumption is that explicit amendment is the only way in which the assumptions and practices of a constitution may change. Were this the case, there would be no idea of a cabinet (as opposed to a Privy Council), there would be no role for the Prime Minister in nominating judges of superior courts or Senators, and there would have been no consequence for Canadian federalism flowing from the *Balfour Declaration*. All constitutions are in constant evolution to

77. In other words, it is not obvious that "originalism" is coherent as an intellectual position when the type of polycentric political negotiation of the type that led to the enactment of the *Constitution Act, 1867* is at issue.

meet the felt necessities of the time and changing perceptions of political authority.[78]

Fourth, the arguments presume a univocal theory of citizenship, which sees the lives of Canadians as sharply divided between orders of government. This is especially apparent where the arguments shift from a critique of shared cost programs and conditional spending mediated through provincial governments, to a critique of direct federal expenditure on citizens. The claim is that the federal government has no authority, by way of tax expenditures, subsidies and payments, to enhance the meaning of Canadian citizenship beyond the formal (as reflected in a passport) or the economic. This means that people can be full citizens only of provinces, and that their relationship with the federal government must be mediated exclusively through the provinces. On this view, there is no true federal citizenship, and all nation-building by the Parliament of Canada necessarily diminishes a person's "root" or "true" provincial citizenship. Even the "states-rights" reservation of the 10th Amendment to the United States' Constitution does not rest on such a thin and intermediated view of federal citizenship.

Fifth, the arguments are vaguely conspiratorial. The assumption is that the common thread of all federal action since 1867 has had no purpose other than to diminish the power of the provinces. Every exercise of the federal spending power is meant to reduce provincial sovereignty. Admittedly, some federal spending is designed to enhance the presence of the government of Canada. After 1995, for example, the federal government has spent massively in support of its own nation-building project. Why should it not have? Has not the Quebec government spent massively for exactly the same purposes, often seeking to mirror the institutions and trappings of a sovereign state?

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78. The argument is, fundamentally, that there is no clear, unambiguous meaning that can be given to constitutional texts that advert to the power of the federal government to disburse money. As earlier sections have attempted to show, there are good textualist arguments in favour of the unlimited spending power. Those who assert that the *Constitution Act, 1867*, *supra* note 9, contains a clear "bright-line" rule limiting federal spending are, in short, using what purports to be a textualist argument to shore up an unarticulated normative agenda. On this point see, *e.g.*, Weinstock, "Overlapping Federalism", *supra* note 49.

Sixth, the arguments are sometimes cast in very strong terms. The language tends to be either warlike or uncompromising, with expressions like "invasion" and "complete absorption" characterizing the motives and predicted outcomes of federal action.[79] Rather than being a reasonably balanced attempt to think through the exercise of federal power over time, and to assess the benefits and detriments of the spending power as exercised to date, the arguments are invariably teleological. While framed as arguments about federalism and the proper exercise of powers by orders of government in Canada, for some scholars the arguments are really about Quebec nationalism, if not the achievement of Quebec's independence.

To summarize, the arguments involve, at once: (1) textual comparison of the *Constitution Act, 1867* to some idealized model of compact confederalism; (2) a critique of a particular theory of constitutional interpretation that has become predominant in Western democracies over the past half-century; and (3) a state-building aspiration which involves a particular unitary vision of citizenship, nation and state action. The significance of this last point may be best appreciated by comparing the shifting ground on which arguments about federal spending have been most recently built. Until the mid-1980s, the major critique of implicit federal incursion into provincial jurisdiction was directed at the federal spending power itself.[80] Ottawa was compromising provincial autonomy by committing provincial governments to massive investments in programs that they could not thereafter control, or scale back as the need arose. Following the cutbacks of the early 1990s, the ground of complaint changed.[81] Rather

79. See *e.g.* Jean Leclair, "Vers une pensée politique fédérale: la répudiation du mythe de la différence québécoise 'radicale'" in André Pratte, ed., *Reconquérir le Canada: un nouveau projet pour la nation québécoise* (Montreal: Voix parallèles, 2007) 39 at 39-40.

80. Occasionally, other themes not related to fiscal policy were evoked. For an illustrative example, see Andrée Lajoie, *Le pouvoir déclaratoire du parlement: augmentation discrétionnaire de la compétence fédérale au Canada*, (Montreal: Presses de l'Université de Montréal, 1969).

81. Some argue that Ottawa first began to renege on its commitments in the late 1970s and that the massive readjustments of the 1990s merely exacerbated the trend. See Tom Kent, "The Federal Spending Power Is Now Chiefly for People, not Provinces", 34 Queen's L.J. 413 [Kent, "People, not Provinces"].

than simply being an evil in and of itself, the spending power was also an evil because it produced what has come to be called a fiscal imbalance. To take a classic statement from the *Séguin Commission*:

> . . . fiscal imbalance exists when the federal government invokes a "spending power" to intervene in the provinces' fields of jurisdiction. . . . [T]his power limits the decision-making and budgetary autonomy of the provinces, has a direct influence on their level of spending and is facilitated, on practical terms, by excess revenue of the central government in relation to its spending within the jurisdictions allocated to it by the Constitution.[82]

The argument is somewhat more complex than this statement suggests. To begin with, the argument is that federal spending by conditional transfers for federally designed programs undermines provincial policy-making.[83] Second, the argument is that transfers under shared-cost programs not only commit the provinces to federal policy, but also to expenditures they might otherwise not make.[84] Third, the argument is that whenever the revenue raised from general federal taxation strategies within a province is over and above the amount required for federal purposes, the province's capacity to levy taxes for its own purposes will be paralyzed. Viewed in this light, one of the fundamental problems with the federal spending power is that it can only be exercised today through the tax system, which has a significant impact on the ability of provinces to manage their own fiscal policy.[85]

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82. *"Federal Spending Power" Report*, *supra* note 51 at 16.

83. Whether this is in fact the case is an empirical question that would require asking the following questions: is it the case that: (1) these programs are unilaterally imposed by Ottawa? (2) they are so detailed in their requirements that provinces have no room to manoeuvre? (3) they do not meet a need that citizens of a province actually want fulfilled? To my knowledge, none of the studies for the *Séguin Commission* actually sought answers to these questions.

84. This too is an empirical question. Here the evidence of an improper federal influence is easier to marshal. Even if a shared cost program were to pass the tests for a legitimate conditional grant program just noted, once the federal government began to renege on its funding commitments, there would be an illegitimate downloading of expenses onto the provinces. On this point, see Kent, "The Harper Peril", *supra* note 62.

85. For one of the earliest expressions of this concern, see the *Tremblay Commission Report*, *supra* note 66. An excellent assessment of the tax-expenditure nexus in diverse

This observation helps to situate the normative basis for limiting federal spending and federal taxation.

Imagine the following situation. The Parliament of Canada unwinds all shared-cost programs, eliminates conditional transfers (except, for the sake of argument, unconditional equalization grants to provinces under section 36 of the *Constitution Act, 1982*),[86] and withdraws completely from direct program spending in relation to provincial jurisdiction and even in relation to federal jurisdiction grounded in the ancillary power, the residuary power, or the national dimensions doctrine. Instead, Parliament directs the federal government to maintain current levels of taxation, but to double spending on the Canadian Armed Forces, upgrade Canada's rail network, airports and harbours, substantially increase Old Age Security payments and so on. Or imagine that Parliament directs the federal government to deploy such newly freed up revenue to eliminating the accumulated federal debt, and thereafter to building a federal equivalent to the Alberta Heritage Fund. In these situations, on the assumption that Ottawa continues to raise revenue to the same extent as it has so far, but uses all such revenue for indisputably federal purposes, there is no exercise of the federal spending power, no attempt to direct provincial expenditures or shape legislative policy and no indirect exercise of federal jurisdiction under expansive interpretive doctrines. Yet there is just as significant a potential (if not actual) paralysis of provincial taxation power, as if Parliament had directed the federal government to embark on new shared-cost, conditional grant or even unconditional transfer programs.

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federal states is offered in Abel, "Constitutional Charter", *supra* note 44, especially Part III entitled "Taxation" at 293 and Part IV entitled "Spending: Scope of the Spending Power" at 313.

86. The argument to be presented is no less persuasive even if equalization payments were to be curtailed or eliminated. Indeed, it is doubtful that s. 36 provides provinces with any justiciable rights to claim in the federal treasury. Moreover, when the government of Canada transferred tax room to the provinces in 1995, there was little provincial uptake, which suggests that the real problem of fiscal imbalance may be that provinces are reluctant to raise provincial tax rates for fear of having economic activity flee to another jurisdiction. If this is the case, then there is a strong argument to be made for having Ottawa occupy most tax room for raising revenue, and then acting as a transfer agent to the provinces. See Part VI, below.

A similar conclusion could be reached in relation to tax expenditures. Presumably, the Parliament of Canada could continue to tax citizens at source (or through instalments) at a very high marginal rate, and then, at the moment of filing, return large sums to citizens as tax expenditures. The return to citizens could be in the form of basic personal deductions, targeted deductions for designated expenditures, Canada Savings Bonds, a tax-refunded guaranteed annual income or interest-free (and ultimately forgivable) draws on a general loan fund similar to the Alberta Heritage Fund. Here again, as long as this type of tax remission were directed to all taxpayers without distinction, the federal government would be acting within its constitutional powers, even on the most restrictive of interpretations heretofore advanced. Yet, given the high rate of initial taxation required to raise the revenue and the return of revenue in the form of non-taxable benefits (gifts, loans and guarantees), tax expenditures of this kind would have an equally significant impact on provincial revenue sources.

The above examples are, of course, implausible in today's economic and political climate. But their implausibility is for political reasons, not constitutional reasons. The current federal government seeks to reduce expenditure, not transform it. Resource-rich provinces do not want to see revenue from their resources being deployed to finance current account expenditure. Resource-poor provinces do not want to see their entire federal subsidy reduced to the intergovernmental equalization formula, but wish to maintain federal transfers to their residents through shared-cost programs. Moreover, these examples illustrate that the fundamental problem of managing the revenues and disbursements in a federal state is not simply one of federal spending *per se*, nor simply one of federal taxation *per se*. The central problem, common to both unitary and federal states, arises when the democratic impulse induces governments to disanchor any power or any regulatory instrument from its normative moorings. Within a federation, there is an additional problem. Neither an inventory of legislative powers assigned to each order of government, nor the democratic impulse itself, provides any mechanism for determining the appropriate fiscal share that each unit of

government should receive.[87] How then might taxation and spending by the federal and provincial governments be brought into line? Are there normative principles and institutional fora that can serve this goal? This is the topic of the final section of this essay.[88]

## VI. The Changing Environment for Instrument Choice

Today, a number of commentators argue that welfare state politics of the type that gave rise to the conflict over the spending power have now just about run their course. Canadian perspectives on regulatory governance are moving away from the approaches characteristic of the second National Policy and towards an emerging third National Policy.[89] It was not insignificant to the framing of the *Constitution Act, 1867*, and to the conception of government it instantiated, that the first

87. In addition, the decision about expenditure is not simply tributary to ordinary politics. Sometimes extraordinary events require a (temporary?) readjustment to accepted distributional principles: on occasion the shift may flow to the federal government (as in the case of financing a war); on occasion it may flow to the provinces (as in the case of a health pandemic). On the complexity of these federalism rules, see Richard E. Simeon, "Criteria for Choice in Federal Systems" (1982-83) 8 Queen's L.J. 131.

88. Political economists and historians have tracked various mechanisms by which issues of fiscal federalism have been managed in the past in Canada. See *e.g.* Thomas J. Courchene, "Reflections on the Federal Spending Power: Practices, Principles and Perspectives" (2008) 34 Queen's L.J. 75 [Courchene, "Reflections"]; Ronald L. Watts, *The Spending Power in Federal Systems: A Comparative Study* (Kingston: School of Policy Studies, Queen's University, 1999). To my knowledge, none have sought to explore issues of institutional design: by what instruments and through what institutional processes should distributive determinations be made. Moreover, the only example of where a constitutional lawyer has offered a proposal for achieving such a balance is Abel, "Constitutional Charter", *supra* note 44, Part V entitled, "Spending: The Canadian Equalization Fund and Council" at 338.

89. See *e.g.* Courchene, *ibid.*; Choudhry, *supra* note 33; Tom Kent, *Federalism Renewed* (Ottawa: Caledon Institute of Social Policy, 2007) [Kent, *Federalism Renewed*]. However, the above authors do not explicitly use the notion of a third National Policy, nor do they relate their analyses to emerging trends noted in contemporary governance theory (see *e.g.* Lester M. Salamon, "The New Governance and the Tools of Public Action: An Introduction" in Salamon, *supra* note 16 at 1). For an initial attempt to do so explicitly, see Wolfe & Macdonald, *supra* note 56.

National Policy of the late 19th century was the project of an imperial colony seeking to locate its frontiers and to stitch together its diverse units into a single economy. Likewise, constitutional adjustments in Westminster and in Canada, as well as the social programs of the second National Policy that accompanied them, were a project of an emerging state defining itself as politically independent and sovereign while coming increasingly under the economic hegemony of the United States. The third National Policy emerges in the eras of (1) globalization — when the links between sovereignty and territory are becoming ever more problematic and (2) identity politics — where personal assertion through language, culture, religion and ethnicity are predominating over conceptions of multi-cultural citizenship.[90]

Any national policy is a story about how members of a political state (or for that matter, any political community that collectively self-identifies as a political community)[91] frame or characterize problems of governance, as much as it is about how they tackle those problems. Even though multiple political communities can coexist within the same geographic boundaries, there is often a high degree of commonality in how they imagine the aspirations and instruments of policy. So, for example, just as the policies of Mercier and Taschereau in Quebec mirrored those of Macdonald and Laurier, so too the policies of Lesage, Johnson and Bourassa mirrored those of St. Laurent, Pearson and Trudeau. The same observation applies to the policy pursuits of Bouchard, Landry and Charest and those of Chrétien, Martin and Harper.[92] To date, however, no politician, no poet and no pundit has

90. On these complementary valences, see John Gerard Ruggie, "Territoriality and Beyond: Prolematizing Modernity in International Relations" (1993) 47 International Organization 139; and Audie Klotz & Braden Smith "State Identity as a Variable" (2007) [unpublished, presented at the American Political Science Association, August 2007, Chicago].

91. The *caveat* is necessary because, from a governance perspective, the state is one institutional option for political communities, and not all such communities have such institutions (whether as UN States or as sub-states, provinces, autonomous regions, *etc.*). For a legal pluralist perspective on post-national governance, see Macdonald, "Metaphors", *supra* note 14.

92. In other words, the political stripe of a government (PQ or Liberal in Quebec; Liberal or Conservative in Ottawa) has little bearing on the construction of what is

yet come up with an enduring label for this new National Policy for the 21st century. Still, we can detect its elements emerging in the actions of governments across the political spectrum in all parts of Canada. The end of redistributive programs based on large aggregates managed by large mediating bureaucratic structures, and an increasing use of targeted programs focused on individuals is suggested by the constraints of the *Canadian Charter of Rights and Freedoms*, the FTA and NAFTA, by the GST, by the end of block program funding, by the transformation of the concept of marriage and by signals from the Supreme Court about the design of the *Canada Health Act*.[93] These developments do not necessarily mean the end of Canada as a collective project which seeks to put an east-west continental economy and the institutions of the welfare state to the service of the dreams and aspirations of every Canadian. Rather, they invite scholars to ask what conceptions of citizenship will drive governance in the future, and what principles are likely to guide instrument choice over the next few decades.[94]

Too much policy analysis is premised on economic efficiency being the litmus test of acceptability, perhaps with some subsidiary consideration of effectiveness.[95] An awareness of the importance of public administration might also lead one to consider whether a proposed action is actually manageable.[96] But the first governance

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described as a National Policy and on conception of policy instruments by which that policy is pursued. Likewise, the issues are addressed in broadly similar terms whatever the province — be it Danny Williams' Newfoundland and Labrador, Dalton McGuinty's Ontario, Ed Stelmach's Alberta or Gordon Campbell's British Columbia. On this point, see generally Wolfe & Macdonald, *supra* note 56.

93. It follows that I am not convinced by the "Chicken Little"-type arguments that followed the decision in *Chaoulli v. Quebec*, [2005] 1 S.C.R. 791. See *e.g.* Colleen M. Flood, Kent Roach & Lorne Sossin, eds., *Access to Care, Access to Justice: The Legal Debate over Private Health Insurance in Canada* (Toronto: University of Toronto Press, 2005).

94. In this respect, I think that Choudhry, *supra* note 33, asks the right questions, although I disagree with some of the answers. Similarly, Tom Kent is right to contest how the Harper government is using the issue of "federal spending" to emasculate the redistributive social-welfare role that the federal government must promote. See Kent, "The Harper Peril", *supra* note 62 and Weinstock, "Overlapping Federalism", *supra* note 49.

95. This, of course, is the message of the "instrument choice" literature of the early 1980s. See Trebilcock, *supra* note 20.

96. See the essays in Eliadis, *supra* note 18.

question should be about the relations between citizens, and the second should be about their relations with the state. Citizens constitute the state, and they do so to serve their purposes. Some efficient policy choices demean citizens by imagining them only as individuals, while other equally efficient tools enable citizens to lead self-directed lives by enhancing their capacity to act in concert with others. Analysis of contemporary trends in policy proposals and governance instruments, whether by political parties of the left or right, suggests that there are four normative pillars of Canada's third National Policy, and that government programs will increasingly privilege those pillars: (1) self-directed citizen agency rather than status or territory driven entitlements; (2) real choice about personal identity; (3) the mediation of multiple, fluid and overlapping commitments through the life-span of citizens; and (4) lateral interest-based affiliations rather than totalizing institutions.[97] Consequently, the formal instruments of the third National Policy will increasingly be those of "indirect" rather than "direct" governance: (1) programs and services managed by centralized bureaucracies (both public and private) will be unbundled; (2) equalization of life chances will be explicitly pursued, along with the dismantling of entrenched institutions that distribute rights and entitlements differentially; and (3) networks will be built among public, private, NGO, domestic and international agents to accommodate a plurality of perspectives, and these networks will overtake state monopolies.[98]

Some years ago the Law Commission of Canada commissioned a series of studies on the governance challenges confronting Canadians at the outset of the 21st century. Five challenges, none of which is

97. The argument in the text does not presume either that other aspects of earlier National Policies will disappear or that the instruments by which policy was then implemented will whither away. Economic management, transportation and communications infrastructure, and population policy (including immigration) will remain preoccupations, and instruments like crown corporations, franchises, regulatory agencies and aggregated spending programs will still be found. They will, however, be less important in the overall policy and instrument mix. For a longer discussion, see Wolfe & Macdonald, *supra* note 56.

98. A fine study of the challenges is Donald F. Kettl, "Managing Indirect Government" in Salamon, *supra* note 16, 490.

controversial today, were explicitly identified: (1) urbanization and the rise of global cities; (2) immigration and its attendant diversity of ways of being and expectations of government (new identity claims); (3) significant differentials in growth rates among provinces, and in particular the declining percentage of the population of Canada speaking French as a first language and residing in Quebec; (4) increasing citizen concern about issues relating to quality of life, health and the environment; and (5) an aging population and issues of intergenerational equity.[99] The common thread running through these challenges is the problem of marginalized populations and inequality of life chances — whether for an urban underclass, religious, ethnic and racial minorities, discrete language communities, youth and the elderly, or those of lesser education and poorer health status.

What does this mean for instrument choice, and especially for the future of the federal spending power? A first point is that these issues all raise what Tom Courchene characterizes as the "national dimension/provincial jurisdiction" (ND/PJ) dilemma;[100] the governance challenges today simply do not map easily onto discrete subject-matter constitutional jurisdiction.[101] Moreover, many of the identified exclusions are cumulative, but they are cumulated differently across the population.[102] Furthermore, in contrast to crises, these challenges are almost all non-episodic, and they do not lend themselves to once-off or

99. These five challenges were recognized by the Law Commission of Canada in a working document entitled *The Governance of Human Agency* (1999). This document appeared on the Commission's website until December 2006, when the Government of Canada terminated funding for the Commission and closed its website.

100. Courchene, "Reflections", *supra* note 88.

101. Inescapably, constitutional doctrines like "national dimensions" will be increasingly significant in defining federal authority; inescapably, courts will tolerate provincial trespass on the criminal law power, will continue to expand the category of direct taxation, and will validate provincial adjudicative bodies that exercise s. 96 powers.

102. The point is hardly new and has been a commonplace in the "access to justice" literature for at least forty years. Moreover, the implications for institutional design to facilitate access to justice have also been long recognized. For an overview of the literature, see Roderick A. Macdonald, "Access to Justice in Canada Today: Scope, Scale, and Ambitions" in Julia Bass *et al.*, eds., *Access to Justice for a New Century: The Way Forward* (Toronto: Law Society of Upper Canada, 2005) 19.

even transitional interventions.[103] This means that the appropriate responses are likely to be highly individuated: some challenges will require the type of territorial response appropriately managed by provinces; others call for a response more appropriate to local or municipal intervention; and yet others require a direct response to particular citizens, whether from the federal or the provincial government.[104]

It follows that the policy rhetoric of Canada's second National Policy — national standards, monopolistic delivery systems, conditional grants — is inapt to deal with the continuing ND/PJ dilemma. In the overall framework of Canada's third National Policy, Ottawa should tax and spend only at the ends of the policy response spectrum whenever a proposed fiscal measure cannot be justified by a direct appeal to a head of legislative power assigned to Parliament. In my view, section 36 of the *Constitution Act, 1982* now provides both the idea of, and ample justification for, so constraining federal spending: the federal role is to ensure that all provinces have sufficient resources to *be* provinces (section 36(2)), and that all citizens have sufficient resources to *be* citizens (section 36(1)). It is nothing more.[105] In other words, while the text of the constitution does not explicitly constrain federal spending, for the reasons given in the previous section, I believe that there is both a policy argument and a moral argument for limiting federal spending along the lines suggested by Section 36.

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103. On the differences between strategies for addressing these differences, see Edward M. Iacobucci, Michael J. Trebilcock & Huma Haider, *Economic Shocks: Defining a Role for Government* (Toronto: C.D. Howe Institute, 2001).

104. For my attempt to address this multiplicity of necessary responses, see Roderick A. Macdonald, "Kaleidoscopic Federalism" in Jean-François Gaudreault-DesBiens & Fabien Gélinas, eds., *The States and Moods of Federalism* (Montreal: Yvon Blais, 2005) 261. The point is also captured in the *Framework to Improve the Social Union for Canadians: An Agreement between the Government of Canada and the Governments of the Provinces and Territories*, Canada, 4 February 1999, Part 5: "These transfers support the delivery of social programs and services by provinces and territories in order to promote equality of opportunity and mobility for all Canadians and to pursue Canada-wide objectives. " Not surprisingly, this thought — spending to achieve pan-Canadian "social citizenship" — is anathema to some in Quebec. For a helpful discussion, see Tremblay, *supra* note 33.

105. As grounding for policy analysis with regard to s. 36, see Kong, *supra* note 63.

In the case of spending under section 36(2), the expenditure must be unconditional, for the end in view is equality of governance opportunity (not uniformity of outcome) and the instrument — the allocation of money — is to be used to empower provincial agency (not to impose regulatory discipline of provinces). The focus of equalization spending directed to provinces should be on ensuring the management of core governmental functions; there should be no conditional transfers to provinces, nor any shared cost programs where the provinces are conscripted as disbursing agents for money collected through federal taxation.[106]

Given the policy challenges of overcoming inequality of life chances and providing support to marginalized populations, a different approach should be taken to section 36(1) equalization spending: the spending will typically be conditional, not unconditional. The focus of citizen-equalization spending should be on opportunity: early childhood and family support; young adult educational and vocational training; a negative income tax for all citizens; and a targeted focus on preventative health measures.[107] In other words, direct transfers to citizens should be conditional and should enhance the capacity of all citizens to participate equally in the life-chances that define Canadian citizenship. This means, in particular, that equalization transfers to citizens should explicitly seek to occupy tax room to ensure that pan-Canadian norms are not defeated by competitive economic pressures on provinces. The problem with prohibiting this type of federal spending and permitting provinces to tax and spend with such an end in view is that it creates a fiscal race to the bottom as provinces compete to reduce provincial taxation and expenditure. Conceiving the federal government as a collection agent for provinces under a broadly conceived citizen-focused equalization

106. The core governmental funding functions through s. 32(2) would include the costs of running a legislature, a public service, policing, the judiciary, key administrative agencies, retransfers to municipalities and like institutional measures.

107. Interestingly, others (including some of the architects of Canada's second National Policy) have reached similar conclusions. See notably the works of Tom Kent: *Federalism Renewed*, *supra* note 89; "Priorities for a progressive Canada" *Policy Options* (April-May 2006) 43, online: Institute for Research on Public Policy <http://www.irpp.org/po/archive/apr06en/kent.pdf>; "People, Not Provinces", *supra* note 81.

scheme facilitates the provision of a minimum level of economic well-being consistent with the history, practices and aspirations of Canada as a political community. Only where a province or territory can assert a unique interest in defining what equal citizenship might mean in a manner that cannot be accommodated by a direct federal transfer should an opt-out against tax room be permitted. Such distinctive claims are most likely to arise in Quebec and in territories like Nunavut, although the simple fact of Quebec being a "distinct society" on one dimension does not necessarily mean that it has a relevant distinctiveness for any particular federal direct expenditure program. Nor does it necessarily mean that no other province may have its own "distinctiveness" on a particular issue sufficient to sustain an opt-out. Each claim for a special autonomy interest must be addressed on its own merits, and in the light of its specific relationship to the proposed expenditure.[108]

These arguments for a renewed and refocused federal spending power deal with only half of the contemporary fiscal nexus: disbursements. The other half is taxation: how to ensure that the federal government does not then try to achieve an indirect regulatory agenda by expropriating available tax room from provinces. This is an issue that has been unsuccessfully addressed in almost every federation. It is almost impossible to resolve through detailed constitutional rules or even through a formula. Like the question of whether a particular provincial claim for a distinctive autonomy interest is sufficient to sustain an opt-out, the question of the appropriate tax room does not lend itself to constitutional adjudication.[109] Indeed, no better proposal seems today to be on offer than the imperfect idea advanced by Albert Abel to establish an "Equalization Fund and Council," which would serve as another

108. This second-order decision-rule to determine if direct spending under s. 36(1) is legitimate coheres with Nancy Fraser's vision of resource distribution to facilitate recognition, not just egalitarian redistribution. See Nancy Fraser, "From Redistribution to Recognition? Dilemmas of Justice in a 'Postsocialist' Age" in *Justice Interruptus: Critical Reflections on the "Postsocialist" Condition* (New York: Routledge, 1997) 11.

109. It follows that, although I agree with the normative foundations for federal spending that he asserts, I am sceptical about the approach to institutional design — referring the matter to the courts under a set of *ex ante* decision rules backed with default presumptions. See Kong, *supra* note 63.

constitutional forum like the Senate (in theory) and the Supreme Court (in practice).[110]

# Conclusion

The fundamental premise of this paper has been that contemporary preoccupation with the spending power contributes to a constellation of myths: about the nature and purposes of constitutions; about the central features of constitutional interpretation; about the relationship between regulatory instruments and fiscal instruments; about the rationales for government action in Canada since the 19th century; about the policy tools that governments should now deploy; and about the policy role of the federal government in the early 21st century.

It may be that Canadians generally (perhaps even including a majority of francophone Canadians in Quebec) supported successive federal interventions by way of the "spending power." This merely attests to a failure of political wisdom and statesmanship among federal leaders. After all, history teaches that bad policies (even many egregious or genocidal policies) have attracted popular support. The rhetoric of many discussions of the spending power is also flawed. To say that Quebec is opting out of programs that Ottawa has no constitutional authority to impose by legislation is Orwellian. In reality, in tolerating these federal programs other provinces are indirectly delegating authority upwards to Ottawa. Moreover, attempts by Ottawa to herd provinces, generally by threatening a bilateral deal with one or more provinces individually, are an abuse of the federal principle. Either the one-off deal is equity-disrupting as between the provinces — the difficulties caused by the attempt to buy Nova Scotia and New Brunswick with "revenue-replacement grants" in 1867 are an object-lesson — or it is jurisdictionally invasive because it coerces participation through the fear of "losing out."

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110. See Abel "Constitutional Charter", *supra* note 44, Part V entitled, "Spending: The Canadian Equalization Fund and Council" at 338. The concern, of course, is to find an institutional forum to provide stability and genuine policy exchange in relation to matters now dealt with episodically through "first ministers' conferences" or federal-provincial territorial sectoral meetings on economic issues.

In the years ahead, Canada may at last move beyond the simplistic formula by which "deux nations" as a founding myth has been corrupted into a "deux états" condominium of Quebec and the Rest of Canada (ROC). If anything, a primary consequence of coming to terms with the aspirations and instruments of a third National Policy will be the recognition that there is no ROC. There are multiple ROCs, and many of them are within Quebec. If there is merit in the analysis of the goals and instruments of Canada's third National Policy, it will apply to programs of provincial governments as much as to programs of the federal government. The policy future does not imagine a "weakened" third National Policy federal state and a "strengthened" second National Policy provincial state. It points to strengthened federal and provincial governments appropriately deploying appropriate policy instruments.

Thirty years ago, Albert Abel discerned the central features of constitutionalism in Canada.[111] The underlying argument of this paper flows from his analysis, although it deviates from his prescriptions. That argument can be summarized in the following series of propositions:

- States are the product of peoples, not the inverse. Once states are established, however, they tend to re-create peoples.
- Constitutions have both explicit and implicit elements, neither of which is fixed, and they intersect to modify each other.
- Federal constitutions are the result of particular conjunctural processes, and the distribution of powers they envision is historically contingent.
- Legislative power, judicial power and executive power in the form of taxing and spending do not always track the same logic.
- All tools of government are both normative (directly or indirectly regulatory) and have fiscal implications.
- If the sum of regulation in a state is constant, so is the sum of fiscal activity. Only the forms and justifications for political action change.
- The bane of federal constitutionalism — direct program spending by the central government in fields of primary

111. See *ibid.*

provincial responsibility — is only a small part of the fiscal dimensions of federalism.

- Spending is a function of political bidding between levels of government, and in Canada at least, the arguments against the federal spending power today are political and moral, not constitutional.
- The key question for a federation is the relationship between sources of revenue and the policy empowerment left to provinces after federal taxation has been levied.
- Overt welfare state program spending is a product of a particular historical moment which is rapidly passing (or has already passed).
- The changes in the world economy, in Canada's socio-demographics and in citizen perceptions of the goals and instruments of government are irreversible.
- Governments will increasingly undertake actions that focus on citizen empowerment, fluid identities, unbundled delivery mechanisms and a multiplicity of policy networks.
- Section 36 of the *Constitution Act, 1982* provides a textual basis for a normative argument about the aims and instruments of federal spending.
- The central issue for the future will be how to design a federal-provincial-territorial institution to discipline the allocation of taxation and borrowing room as between the federal and provincial governments.
- Current controversies about the federal spending power in support of shared-cost programs and conditional transfers are yesterday's news, and have little bearing on the design of tools and policies necessary for the flourishing of Canada's third National Policy.