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THE SPENDING POWER: SCOPE AND LIMITATIONS

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HISTORICAL OVERVIEW

The concept of a federal "spending power" is a relatively recent constitutional development. It arises from federal government initiatives immediately following the Second World War, and is closely linked with efforts to centralize the taxing power.(1) By providing program funds for a variety of health, education and social development programs, either unilaterally or in co-operation with the provinces, the federal government substantially altered Canada's approach to issues that were essentially within provincial jurisdiction.

The spending power thus became the main lever of federal influence in fields that are legislatively within provincial jurisdiction, such as health care, education, welfare, manpower training and regional development. By making financial contributions to specified provincial programs, the federal government could influence provincial policies and program standards.

Until the 1960s, most of the provinces acquiesced in this expanded federal influence, but Quebec both raised objections and refused to accept certain contributions. With the election of a new provincial government in 1960, Quebec's objections crystallized, and during the early '60s other provinces also began to find the increased federal role objectionable. Accordingly, in 1964

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(1) "In addition to its general policy of reconstruction and a more activist approach, particularly in welfare, the government considered it essential to centralize taxation power to promote the Keynesian economic policies which it proposed to embark upon, and which it followed with considerable success for a long time during the postwar period with a single-mindedness that was probably unmatched in any other country." G.V. La Forest, *The Allocation of Taxing Power under the Canadian Constitution*, (2nd ed.), Canadian Tax Paper No. 65, Canadian Tax Foundation, 1981, p. 28.

the provinces were given the right to "opt out" of programs financed through the spending power with income tax abatements as compensation. Only Quebec took advantage of this provision.(2)

In June 1969, the federal government presented to a Federal-Provincial First Ministers' Conference the paper "Federal-Provincial Grants and the Spending Power of Parliament," which, for the first time, dealt with the evolving nature of the "spending power":

> Ordinarily, one thinks of the "spending power" of governments simply in terms of the spending they do on particular programmes, under the authority of legislation passed by their legislative bodies. Constitutionally, however, the term "spending power" has come to have a specialized meaning in Canada: it means the power of Parliament to make payments to people or institutions or governments for purposes on which it [Parliament] does not necessarily have the power to legislate.(3)

The federal paper noted that there was some disagreement among constitutional lawyers as to the limits of the spending power. Some, such as Bora Laskin and G.V. La Forest,(4) argued that Parliament could make conditional or unconditional grants for any purpose, provided that the program did not amount to legislation or regulation within provincial jurisdiction. Others, including Quebec's Tremblay Commission, argued that Parliament had no power to make grants of any kind in areas within exclusive provincial jurisdiction. Yet others seemed to suggest that unconditional, but not conditional, grants could properly be made in areas within provincial jurisdiction.

The provincial governments had argued that the Government and Parliament of Canada ought not to be able to initiate cost-shared programs without obtaining a provincial consensus, because the operation of such programs fell to the provinces; that cost-shared programs forced the provinces to alter their spending and taxing priorities; and that the citizens of provinces that "opted out" were subjected to "taxation without benefit."

The federal government, on the other hand, stressed the importance of the spending power in maintaining equal opportunity for individual Canadians (e.g., family allowances); in

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(2) *Ibid*., p. 31-33.

(3) Anne Bayefsky, *Canada's Constitution Act, 1982 and Amendments: A Documentary History*, Vol. 1, McGraw-Hill Ryerson, Toronto, 1989, p. 146-162.

(4) Later Chief Justice Laskin and Mr. Justice La Forest of the Supreme Court of Canada.

equalizing provincial public services (e.g., health, welfare, education and roads); in regional economic development; and in carrying out programs of national importance, such as Expo '67.

In the result, the federal government "tentatively advanced" certain principles: (1) the federal spending power should be entrenched in the Constitution; (2) Parliament should have an unrestricted power to make unconditional grants to provincial governments for the purpose of supporting their programs and public services; and (3) Parliament's power to initiate cost-shared programs involving conditional grants in areas within provincial jurisdiction should require both a broad national consensus and *per capita* reimbursement of the people (not the government) of a province whose legislature decided not to participate.

The debate over the spending power continued on a muted but steady level through various constitutional negotiations in the 1970s and the 1980s. In 1986, limitations on the federal spending power became one of Quebec's five conditions for support of the *Constitution Act, 1982*. As a result, the Meech Lake Accord of 1987 would have added a new section, section 106A, to the Constitution, immediately after the federal power to appropriate funds. Section 106A would have provided for reasonable compensation to the government of any province that chose not to participate in a cost-shared program in an areas of exclusive provincial jurisdiction, provided that the province carried on a program compatible with the national objectives.

THE LEGAL BASIS

The spending power is not difficult to understand as a fiscal mechanism, but has always been controversial as a constitutional concept. E.A. Dreidger has suggested that the "spending power" first emerged in a constitutional context with the publication of the federal paper at the June 1969, Federal-Provincial Constitutional Conference. As recently as 1981, however, Dreidger was "unable to find the expression 'spending power' in any Canadian judicial decision or statute."(5) Arguably, the "spending power" is simply the expansion of the taxing power to the point that the federal government has sufficient revenues to underwrite national programs, in addition to fulfilling its more specific constitutional mandate.

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(5) E.A. Dreidger, "The Spending Power," *Queen's Law Journal*, Vol. 7, 1981, p. 124.

Peter Hogg agrees that the spending power is nowhere explicit in the *Constitution Act, 1867*, but says it must be inferred from the powers to levy taxes (section 91(3)); to legislate in relation to "public property" (section 91(1A)); and to appropriate federal funds (section 196).(6)

The nature of the spending power is as disputed as its origins. Those who, like Dreidger, question the independent constitutional existence of the spending power note that the federal government needs no additional constitutional authority to disperse its money as it wishes, so long as it does not effectively regulate areas within provincial jurisdiction. Dreidger notes that "the Salvation Army has no power to make laws respecting hospitals, but it can and does establish and operate such hospitals."(7) Presumably, it can also make grants to hospitals, on conditions, provided that it does not interfere with their provincial regulation.

The provinces are always free to refuse to enter into a cost-shared program. Indeed, in 1975 no province accepted the federal government proposal that provincial governments extend social services to Indians, with the federal government covering 100% of the cost for services to on-reserve Indians and sharing with the provinces the costs for services to off-reserve Indians. Additionally, there seems to be no technical reason why the spending power should be discussed only in terms of the federal government. Theoretically, the 10 provinces could band together and adopt a uniform position on a field within federal jurisdiction (for example, fisheries), and then offer to cost-share a common program if the federal government would administer it. Similarly, although international trade is exclusively within federal jurisdiction, many provinces maintain at least one trade office abroad.

From one viewpoint, therefore, the federal spending power is simply the ability of the federal government to generate revenue, and therefore spend money, above and beyond the amounts required to fulfil its specific constitutional responsibilities.

On the other hand, others consider "the magnitude and nature of intergovernmental cash and tax transfers [to be] essentially *de facto* redistributions of power under the Constitution."(8)

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(6) Peter W. Hogg, *Constitutional Law of Canada*, 2nd ed., Carswell, Toronto, 1985, p. 124.

(7) Dreidger (1981), p. 125.

This view of the spending power as an independent constitutional concept was well summarized in a recent court decision:

> Shortly put, the position of the appellants is that Canada, by the powers of its purse, has unconstitutionally coerced the provinces to participate in certain programmes proposed by Canada, with standards and criteria established by Canada, although such programmes lie exclusively within the jurisdiction of the provinces...
>
> In sum, the appellant's argument is that Parliament is indirectly legislating in respect of matters within provincial jurisdictions. It argues that Parliament cannot directly prohibit extra-billing (over and above health care payments) by doctors, so it cannot achieve the same end by the conditions attached to funding.(9)

ADVANTAGES AND DISADVANTAGES

Regardless of the constitutional status of the spending power, most commentators agree that its use has both potential advantages and disadvantages:

Advantages:

- It can assure a minimum acceptable level of public services in different regions;
- Only national government standards and financing can compensate for mobility effects between regions (e.g., most graduates of a particularly expensive educational program may disperse across the country); and
- It enhances the mobility that an integrated common market requires.

Disadvantages:

- Intergovernmental transfers blur the lines of electoral responsibility;
- Conditional transfers interfere with the decision-making powers of the recipient government; and

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(8) Thomas J. Courchene, "The Fiscal Arrangements: Focus on 1987," *Ottawa and the Provinces: The Distribution of Money and Power*, Vol. I, Ontario Economic Council Special Research Report, 1985, p. 4.

(9) *Winterhaven Stables Ltd.* v. *Canada* (1988), 53 D.L.R. (4th) 413, at 415.

- Conditional transfers allow the donor government to make policy in areas where it is not constitutionally competent.(10)

LIMITATIONS ON THE SPENDING POWER

Regardless of how the constitutional status of the spending power is perceived, there are definitely limitations on the way in which the money is raised and the way in which it is spent.

Despite the general taxing powers of the federal government, tax legislation could be questioned if it were explicitly combined with a spending program outside federal jurisdiction. For example, environmental issues are largely within provincial jurisdiction. The federal government can nonetheless spend money on environmental programs that affect local concerns within the provinces. Federal government legislation implementing a tax for the express purpose of enforcing or funding a local environmental objective might well be struck down, however. Similarly, a federal tax surcharge for the specific purpose of establishing a scholarship fund would be problematic.

> All taxation ultimately involves regulation: "to some extent [taxation] interposes an economic impediment to the activity taxed as compared with others not taxed." Lord Atkin's oft repeated statement draws attention to that fact: it underlines that there must be a dividing line between regulatory effects created by taxation which are tolerable, and regulatory effects which are not tolerable.
>
> What is the dividing line? Ultimately, that question falls to be decided in this way: if a taxing statute effects, in addition to taxation, clearly discernible regulatory results, the validity of the statute depends on whether the subject matter of the regulation falls within, or is necessarily incidental to, the regulatory powers of the jurisdiction levying the tax.(11)

(10) Joseph E. Magnet, *Constitutional Law of Canada: Cases, Notes and Materials*, 5th ed., Éditions Yvon Blais Inc., 1993, p. 381-2.

(11) *Ibid*., p. 380-381.

Even when money is raised through a proper exercise of the federal taxing power, there are limits on how it can be used. The federal government can spend or grant its money as it chooses,(12) but it may not directly regulate activities within the provincial sphere of jurisdiction.

> Parliament ... is entitled to spend the money that it raises through proper exercise of its taxing power in the manner that it chooses to authorize. It can impose conditions on such disposition so long as the conditions do not amount in fact to a regulation or control of a matter outside federal authority.(13)

It is easy to see, however, why the provinces can be irritated by the use of the spending power. Once the federal government takes the initiative by offering to share the cost of a proposed program to be administered by the provinces, provincial options are seriously circumscribed. If a provincial government does not provide its inhabitants with the same benefits as are enjoyed by people in other provinces, there are likely to be political consequences. If the province does join the program, however, it may not be able to afford the necessary expenditure or may have to neglect other budget priorities. There is also the possibility that the federal government may pull out of the program, leaving the province with increased financial responsibilities. Political reality also places major constraints on the initiation or alteration of national cost-shared programs. There would clearly be difficulties in abandoning a major cost-shared program once it was underway. Thus, for political reasons, the province itself can seldom close down such programs, although it may be increasingly unable to afford the increased expenditure. The Government of Canada, through its spending power, has at its disposal a powerful political lever.(14)

The constraints upon the federal government, however, are almost as strong. By imposing stricter conditions, or even enforcing loose ones, it runs the risk of overstepping the division of powers; withdrawing, or even limiting, funding has significant political risks.

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(12) A number of cases confirm that the federal government can spend its revenue on subject matters outside its legislative competence: *Angers* v. *M.N.R.*, [1957] Ex.C.R. 83 sustains the validity of federal family allowances; and *CMHC* v. *Coop College Residences* (1975), 13 OR (2d) 394 (OCA), sustains the validity of federal loans for student housing.

(13) *Winterhaven Stables*, at p. 434.

(14) Dreidger (1981), p. 134.

Since 1977, for example, the federal government contribution to the EPF programs (Established Programs Financing, or post-secondary education, hospital insurance and medicare) has been determined by a formula tied to the growth of the gross national product and the provincial population rather than the actual costs. Theoretically, this gives the provinces a greater incentive to reduce expenditures and the federal government less interest in controlling or auditing provincial expenditure. Recent attempts to put a similar ceiling on the growth of Canada Assistance Plan transfers, however, provoked criticism and a court challenge.

REFERENCE RE CANADA ASSISTANCE PLAN (B.C.)

The provisions of the Canada Assistance Plan[15] authorize the Government of Canada to enter into agreements with provincial governments on federal contributions towards social assistance and welfare costs. Section 5 of the Plan, broadly speaking, allows for federal contributions equal to 50% of each province's eligible expenditures. Agreements signed under the Plan continue in force as long as the provincial social assistance and welfare plans remain in effect, unless terminated by mutual consent or by one year's notice from either party.

In 1990, the federal government decided to reduce expenditures, in part by putting a limit on Plan contributions to the financially stronger provinces. Accordingly, legislation was introduced to provide that federal contributions to certain provinces would not increase by more than 5% for the years ending on 31 March 1990 and 1991.[16] The provinces affected were those not qualifying for an equalization payment in any given year, initially British Columbia, Alberta and Ontario.

In February 1990, the Government of British Columbia referred two questions to the British Columbia Court of Appeal:

> 1. Can the Government of Canada limit its obligation under the Plan and the subsidiary Agreement with the Government of British

(15) Enacted by S.C. 1966-67, c. 45, now R.S.C. 1985, c. C-1.

(16) Bill C-69, An Act to amend certain statutes to enable restraint of government expenditures, was introduced on 15 March 1990, received Royal Assent on 1 February 1991, and is now the *Government Expenditures Restraint Act*, S.C. 1991, c. 9.

> Columbia to contribute 50 per cent of the cost of assistance and welfare services?
>
> 2. Do the provisions of the Plan, the Agreement between Canada and the British Columbia, and the subsequent conduct of the Government of Canada raise a legitimate expectation that the Government of Canada would not introduce a bill to limit its obligations under the Agreement or the Plan without the consent of British Columbia?

The British Columbia Court of Appeal answered "No" to the first question and "Yes" to the second question. The Supreme Court of Canada, however, gave the opposite answer to each question.(17)

On appeal, the Supreme Court of Canada dealt first with the issue of whether the questions were justiciable at all, or whether, as the Attorney General of Canada submitted, being political in nature they were not subject to judicial intervention. The Court found that both questions had a sufficient legal component to justify a judicial determination:

> The first question requires the interpretation of a statute of Canada and an agreement. The second raises the question of the applicability of the legal doctrine of legitimate expectations to the process involved in the enactment of a money bill. Both these matters are in contention between the so-called "have provinces" and the federal government. A decision on these questions will have the practical effect of settling the legal issues in contention and will assist in resolving the controversy.(18)

The Court noted that the contribution formula was to be found only in section 5 of the Plan, and not in the subsidiary Agreement with British Columbia, which simply refers to the contributions "that Canada is authorized to pay to that province under the Act [Plan], and the Regulations." Therefore, the contributions are subject to amendment to the extent that the Plan is subject to amendment.

Section 42(1) of the federal *Interpretation Act* states that every Act "shall be construed so as to reserve to Parliament the power of repealing or amending it," which reflects the principle of parliamentary sovereignty. By virtue of both this principle and the *Interpretation Act*,

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(17) *Reference Re Canada Assistance Plan (B.C.)*, [1991] 2 S.C.R. 525.

(18) *Ibid*., p. 546.

Parliament was entitled to amend the Plan, and therefore the payment formula. Thus, British Columbia's first question was answered in the affirmative.

As for the second question, the Court first restated its concept of the doctrine of legitimate expectations:

> The principle developed in these cases is simply an extension of the rules of natural justice and procedural fairness. It affords a party affected by the decision of a public official an opportunity to make representations in circumstances in which there otherwise would be no such opportunity. The court supplies the omission where, based on the conduct of the public official, a party has been led to believe that his or her rights would not be affected without consultation.(19)

However, the doctrine of legitimate expectations is part of the rules of procedural fairness, and cannot create substantive rights. At most, therefore, British Columbia could legitimately have expected that the federal government would *consult* the province before acting, but not that the federal government would obtain the province's *consent*. Moreover, the rules governing procedural fairness do not apply to a body exercising purely legislative functions, and the court will not meddle in the legislative process.

The Attorney General of British Columbia had argued that the province's legitimate expectations should prevent the government from introducing the bill, if not Parliament from passing it. The Supreme Court dismissed the argument, holding that "Parliamentary government would be paralysed if the doctrine of legitimate expectations could be applied to prevent the government from introducing legislation in Parliament."(20) Further, such an interpretation of the doctrine would place a fetter on the fundamental principle that a government is not bound by the undertakings of its predecessor.

The provinces and the Native Council of Canada raised various other arguments with which the Court dealt briefly, even though they were outside the scope of the two questions referred by the British Columbia government. The question of legislative jurisdiction, raised by the Attorney General for Manitoba, specifically referred to the "spending power":

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(19) *Ibid*., at p. 557; cited from the reasons of the majority in *Old St. Boniface Residents Assoc. Inc.* v. *Winnipeg (City)*, [1990] 3 S.C.R. 1170, at p. 1204.

(20) *Ibid*., at p. 38.

> The argument begins with the observation that the federal spending power is wider than the field of federal legislative competence. So, as with the Plan, Parliament can authorize the disbursement of federal funds to the provinces for use in areas within provincial jurisdiction. Manitoba said that once Parliament authorized the federal government to enter into an agreement with British Columbia and such an agreement was executed, Parliament became disabled from unilaterally changing the law so as to change the Agreement.(21)

The Court held that the simple withholding of federal money that had been previously granted to fund a matter within provincial jurisdiction does not amount to the regulation of that matter. The fact that Bill C-69 would "impact" upon an area within provincial jurisdiction is "clearly not enough to find that a statute encroaches upon the jurisdiction of the other level of government."(22)

Finally, the Attorney General of Manitoba also argued that the "overriding principle of federalism" should prevent Parliament from interfering in areas of provincial jurisdiction, and that the court should supervise the exercise of the spending power to protect provincial autonomy. The Supreme Court concluded simply that "supervision of the spending power is not a separate head of judicial review. If a statute is neither *ultra vires* nor contrary to the *Canadian Charter of Rights and Freedoms*, the courts have no jurisdiction to supervise the exercise of legislative power."(23)

CONCLUSION

The spending power involves the transfer of money or tax points rather than jurisdiction, and the areas most affected by it (health, education, welfare, employment training, and regional development) are already within provincial jurisdiction. Theoretically, at least, the elimination of the spending power could involve simply the elimination of such federal transfers to

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(21) *Ibid*., at p. 45.

(22) *Ibid*., at p. 48.

(23) *Ibid*.

the provinces. In practice, the provinces would almost certainly in return insist upon a transfer of tax points or actual funds.

By funding national programs, even those within provincial jurisdiction, the federal government has some ability to equalize national standards. With EPF programs, even although there is no federal control over actual expenditures, the amount transferred is on a *per capita* basis. If, however, the federal government removed its funding and turned over tax room or tax points,(24) the result could easily be inequitable from one province to another. Poorer provinces would receive less *per capita* than richer provinces, though they would be applying the same percentage increase in provincial taxation. If actual funds were transferred on a *per capita* basis, the results would be fairer but national standards might still suffer.

Overall, it seems that little has changed since La Forest wrote his landmark text; the issue remains one of standards, funding and co-ordinating mechanisms, rather than of constitutional change.

> What the foregoing reflects is that in Canadian federalism, the real battleground in the constitutional distribution of fiscal powers is not the taxing power. ... Rather, it is in connection with the federal spending power that the most incisive thinking must be directed to determine how the legitimate claims of the federal government (regarding, for example, the control of the economy, mobility of Canadians, equalization and the alleviation of disparities) can be accommodated to the equally legitimate claims of the provinces in seeing to the maintenance of the character of provincial society. But whatever changes may be made at the constitutional level, these will not displace the need for ongoing practical arrangements to meet the evolving needs of society.(25)

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(24) "Tax room" or "tax points" are difficult concepts with limited practical application. To oversimplify, the total capacity of Canadians to bear tax is seen as a large pie divided between the two levels of government. Thus, if the federal government reduces its portion of the total pie, the provinces have "tax room" available to them to fund additional programs.

(25) La Forest (1981), p. 38.