



**THE CANADIAN SOCIAL UNION: QUESTIONS
ABOUT THE DIVISION OF POWERS AND FISCAL FEDERALISM**

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THE CANADIAN SOCIAL UNION: QUESTIONS ABOUT THE DIVISION OF POWERS AND FISCAL FEDERALISM

INTRODUCTION

In Canada, since the beginning of the past century, the federal government has exercised considerable influence over social programs, essentially through the mechanism of fiscal transfers. At their annual meeting in 1997, the provincial and territorial first ministers agreed to initiate a process that would lead to renegotiating the terms of a renewed social union with the federal government. Talks among the provincial and territorial governments continued, and numerous interprovincial and territorial meetings were held in an attempt to reach a common position on a proposal for an agreement with the federal government on the social union.⁽¹⁾ In August 1998, at their annual meeting in Saskatoon, all of the provincial and territorial first ministers agreed on a framework for a draft agreement. Subsequently, the federal government joined the negotiations and a federal-provincial agreement was signed on 4 February 1999.

Despite the Government of Quebec's refusal to sign,⁽²⁾ the agreement on the social union between the Government of Canada and the provincial and territorial governments – signed on 4 February 1999 – marked an important step in the renewal of intergovernmental relations. Although it is not constitutional in nature,⁽³⁾ the agreement between the first ministers was essentially intended to: clarify the role of the Government of Canada regarding social programs; circumscribe the federal spending power; and ensure greater accountability in terms of services to the public.

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- (1) In this study, the expression “social union” does not refer to the agreement signed by the federal, provincial and territorial governments on 4 February 1999; rather, it refers to the concept of federal-provincial-territorial cooperation on social programs. Consequently, this paper is not an analysis of the 1999 agreement.
 - (2) Legitimization of the federal spending power in social programs, and the federal government's use of direct transfers to individuals and agencies in order to launch new Canada-wide social initiatives, are the primary reasons behind the Government of Quebec's refusal to sign the agreement.
 - (3) After the successive failures of the *Meech Lake Agreement* (1990) and the *Charlottetown Agreement* (1992), proposals for constitutional reform became much less popular and attractive, in political terms.

In 1998, the Government of Canada summarized its three main objectives in the renewal of the Canadian social union as follows:

- 1) promote equal opportunities for Canadians, regardless of their place of residence;
- 2) improve cooperation between the two levels of government, to better serve Canadians; and
- 3) enhance accountability to Canadians in terms of the results obtained.

The provincial and territorial governments, for their part, reached substantial consensus on the following goals:

- 1) to establish rules governing the role of the federal government in relation to social programs, within a non-constitutional framework;⁽⁴⁾
- 2) to avoid duplication and promote harmonization in social policy; and
- 3) to promote greater intergovernmental cooperation in relation to social policy.

With the exception of Quebec, it seems that the federal and provincial/territorial governments have succeeded, by signing the agreement of 4 February 1999, in meeting the objectives they had set for themselves, although not without compromises having been made by both sides.

This paper will deal with the two main factors that govern the Canadian social union in terms of intergovernmental relations: the division of powers; and fiscal federalism. After a brief history of the Canadian social union, the paper will examine the division of powers in relation to social programs, emphasizing the foundations of the federal government's involvement and role. Lastly, the impact of fiscal federalism on the social union will be briefly examined.

(4) One of those rules is the foreseeability and stability of social program funding, as well as assurance of funding that is adequate and appropriate to the needs of the provinces and territories.

BRIEF HISTORY OF THE SOCIAL UNION

In 1867, the Fathers of Confederation were perfectly well aware that when they signed the pact creating the federation they were taking the route of compromise. In fact, there is not much more that could be said that is already said by the words “pact” and “federation.” Canadian federalism, yesterday and today, is based on the concepts of unity and diversity, shared responsibility and autonomy. Nonetheless, since Confederation, there have been many instances where the Canadian federal system called for clarification and improvement. How can national and regional interests be reconciled in a country as vast and diverse as Canada? How can the two levels of government cooperate without infringing on each other’s spheres of jurisdiction? These are the questions that have long contributed to both the process and the foundations of Canadian federalism.

When Canada was created in 1867, the roles played by governments in relation to social programs were relatively limited. At that time, Canada had a population of no more than 3.5 million.⁽⁵⁾ When the country went through a phase of industrial development in the early 20th century, the federal government did not have the power to respond to the public’s social and economic needs. Following the stock market crash in October 1929, Canada fell into an unprecedented economic crisis. That crisis, and World War II several years later, created expectations among the public that the federal government should be more involved in the economic and social life of the country. In those situations, the times and the circumstances were such that federal government involvement became necessary in order to meet the needs created by the financial crisis and the war effort. In addition, the emergence of Keynesian thinking exerted considerable influence in the western nations. There is no doubt that the federal government’s financial capacity, which was far superior to that of the provinces, also contributed to enabling it to follow through on its plans for greater centralization.

In 1940, the Royal Commission on Dominion-Provincial Relations (Rowell-Sirois) made recommendations advocating that powers be centralized in Ottawa, proposing, among other things, that a national equalization program be instituted. After the 1939-1945 war, the reconstruction effort and economic prosperity enabled the Government of Canada to solidify its leadership in the realm of social programs. In most of the western democracies, that period saw

the beginning of the construction and expansion of the welfare state. In that context, the federal government used its spending power to fund social measures, including the family allowance program (1944), unemployment insurance⁽⁶⁾ (1956) and hospital insurance (1957). Most of the initiatives involved cost-sharing, that is, they were funded by contributions from both levels of government. Ottawa also started giving grants to universities, and renewed its commitment to the old age pension program (1951).⁽⁷⁾ It should be noted that other than the opposition from the Government of Quebec, the federal government did not encounter any strenuous opposition from the provinces during that period, despite the fact that it implemented these measures unilaterally.⁽⁸⁾

The 1960s, which were characterized by large-scale economic and social development, were also an important milestone in terms of the development of social programs. In Quebec, the *Quiet Revolution* was characterized by major changes in the development of social policy and in government involvement. A similar phenomenon was observed in most of the Canadian provinces.

Historically, Quebec is the province that has most fiercely opposed the involvement of the Government of Canada in social programs. The primary mandate of the Tremblay Commission, created in 1953, was to study federal-provincial fiscal relations and to make recommendations to guarantee Quebec's fiscal autonomy.⁽⁹⁾ Starting with the Duplessis government in the late 1940s, disagreement between the federal government and the Government of Quebec regarding the division of powers in relation to social programs has been a subject of much heated discussion.⁽¹⁰⁾ At that time, Premier Duplessis strenuously opposed the use of the federal spending power. All of the premiers who have succeeded him have been steadfast in their refusal to give political legitimacy to the federal government's involvement in social programs.

(5) *Report of the Royal Commission on Dominion-Provincial Relations*, Volume 1, 1940, p. 23.

(6) A constitutional amendment made in 1940 gave the federal government responsibility for unemployment insurance.

(7) The *Constitution Act, 1867* (section 94A) gives that power to Ottawa. However, it is a jurisdiction that is shared with the provinces.

(8) R. Watts, *The Spending Power in Federal Systems: A Comparative Study*, Kingston: Institute of Intergovernmental Relations, Queen's University, 1999, p. 2.

(9) D. Kwavnick, *The Tremblay Report*, Ottawa: Carleton University Library, 1973, p. 2.

(10) *Ibid.*, p. 2.

This undoubtedly contributed to the rise of competitive federalism in the early 1980s, which was based on the unilateral federalism of the federal government.⁽¹¹⁾

In other words, since the early 20th century the federal government has exercised considerable influence in the development of public policy, primarily because of its superior financial resources and the size and expertise of the federal bureaucracy.⁽¹²⁾

THE DIVISION OF POWERS IN RELATION TO SOCIAL PROGRAMS

In all federal political systems, the division of legislative authorities is of particular importance in that it determines the degree of autonomy and interdependence of the various levels of government. In recent years, and for most of its history, Canadian federalism has been characterized by definite ambiguity in terms of the division of powers between the two levels of government. In 1867, dividing legislative powers was no small task in the writing of the federal Constitution, as the various interpretations given to sections 91 to 95 of the *Constitution Act, 1867* attest. Over time, the appropriateness of that division was continually being undermined by new technologies, economic development, urbanization and changing aspirations regarding the role of the state. The *Constitution Act, 1867* provides for a number of concurrent legislative powers, including agriculture, immigration and old age pensions.

Both levels of government have attempted to extend their legislative powers *de facto*, at the expense of the other level. The courts have regularly been asked to rule on the scope of the legislative powers assigned to each level of government. In the first half of the 20th century, the judgements handed down by the Judicial Committee of the Privy Council generally favoured the provinces. Constitutional changes relating to the division of powers occurred only rarely, and were hard-won and hotly debated, despite the fact that in the first 30 years there was no shortage of proposals to amend the Constitution. The most recent effort to

(11) Royal Commission on the Economic Union and Development Prospects for Canada, *The State, the Evolution of Federalism and Canadian Society*, 1985, p. 308.

(12) J. Stilborn, *National Standards and Social Programs: What the Federal Government Can Do*, Background Paper BP-379E, Ottawa: Parliamentary Research Branch, Library of Parliament, September 1997.

achieve large-scale constitutional reform, the *Charlottetown Accord* (1992), in fact provided for powers to be decentralized and the federal spending power to be circumscribed.⁽¹³⁾

A. Foundations of federal government involvement in social programs

The federal government's involvement in social programs is essentially fiscal in nature. Nonetheless, some provinces – such as Ontario and Quebec – have frequently spoken out against federal government intrusion into their fields of jurisdiction. This grievance is not a recent development. At the time of Confederation, Honoré Mercier and Oliver Mowat – the premiers of Quebec and Ontario respectively – had vigorously argued for the principle of provincial autonomy. What, then, are the foundations of federal government involvement in social programs?

1. The federal spending power

The majority of federal systems have a federal spending power.⁽¹⁴⁾ Although this paper will not give an exhaustive analysis of Canadian constitutional law as it relates to the division of legislative powers, it would seem wise to clarify a few points concerning the principal foundations of the spending power, which has often been denounced by the most autonomist provinces.⁽¹⁵⁾

The federal spending power is not expressly described or recognized in any legislation, not even in the Constitution of Canada. In the opinion of some legal experts, it derives from, and finds its source in, other powers listed in sections 91(1A), 91(3), 102 and 106 of the *Constitution Act, 1867*⁽¹⁶⁾ and in section 36 of the *Constitution Act, 1982* (regional disparities and inequality).⁽¹⁷⁾ The courts and learned opinion have also recognized the Government of Canada's

(13) K. McRoberts and P. Monahan, *The Charlottetown Accord, The Referendum and the Future of Canada*, Toronto: University of Toronto Press, 1993, p. 85.

(14) On this point, see Watts, 1999.

(15) Quebec is, in fact, the province that has most vigorously opposed the federal spending power. On this point, see the document produced by the ministère du Conseil exécutif of the Government of Quebec entitled *Québec's Historical Position on the Federal Spending Power 1944-1998*, Quebec: 1998.

(16) Section 91(1A): legislative authority in relation to the public debt and property; 91(3): the raising of money by any mode or system of taxation; 102: creation of a consolidated revenue fund; 106: use of the consolidated revenue fund.

(17) G. Beaudoin, *La Constitution du Canada*, Ed. Wilson-Lafleur, Lennoxville: 1991, p. 503.

spending power.⁽¹⁸⁾ In various decisions, the Supreme Court of Canada has established a distinction between the three following powers: the power to tax (section 91(3)); the power to spend; and the power to legislate. The three powers are not connected in the Constitution. In the Court's opinion, the power to allocate money (spending power) is separate from the power to legislate.⁽¹⁹⁾ Simply put, the federal government may spend the money that it collects under its power of taxation as it pleases. As long as it does not legislate directly in relation to matters within the provincial jurisdictions defined by sections 91 to 95 of the *Constitution Act, 1867*, the federal government may use its spending power and that power will not be found to be unconstitutional.

It should be noted that the provinces also spend in areas that are not under their jurisdiction. For example, the governments of Quebec and Ontario have spent substantial sums on international relations over the past 30 years, and in the process have sent a number of delegations outside Canada. The Constitution does not expressly give the provinces that authority, but this does not mean that it is unconstitutional for them to do this. Despite the fact that these provinces are spending within a field of jurisdiction that is not assigned to them by the Constitution of Canada, the effect is not the same as if they were to legislate in relation to a field of jurisdiction that was not assigned to them. From the constitutional point of view, then, spending does not mean the same thing as legislating.⁽²⁰⁾ In reality, both levels of government have given out a wide variety of grants and payments to individuals and agencies, and have acted as if their spending power were essentially unlimited.

In the 1996 Speech from the Throne, the federal government gave a commitment to work closely with the provincial and territorial governments on renewing the social union, and expressed its desire to limit its power to spend on social programs.⁽²¹⁾ That announcement marked an important change in the federal government's approach to the social union, and suggested that a more cooperative federalism might be practised.

(18) There are a significant number of decisions by the Supreme Court recognizing the existence and constitutionality of the federal spending power, the most well-known being *Reference Re Canada Assistance Plan*, [1991] 2 S.C.R. 525.

(19) See *Reference Re Canada Assistance Plan*, *ibid.*

(20) P. Hogg, *Constitutional Law of Canada*, 3rd edition, Toronto: University of Toronto Press, 1985, p. 152.

(21) Speech from the Throne of the Thirty-Sixth Parliament of Canada, 1996.

It is essential to understand that the nature of the differences of opinion between the provinces and the federal government lies essentially in the fact that in addition to providing partial funding for programs that are not within its constitutional jurisdiction, the federal government has, in most cases, taken a unilateral approach in establishing new initiatives.⁽²²⁾ The federal government has always contended that it would be difficult to preserve consistency and national standards in the area of social programs without using its spending power. When it is presented in this light, the federal spending power comprises a national instrument of social development that also enables the federal government to reduce disparities among provinces within the federation.

When the spending power is used, it enables the federal government to establish priorities in the sphere in which it thinks it wise to invest. Political scientist Daniel Cohn summarizes the current situation as follows:

While they (the provinces) are responsible for meeting the rules that govern the terms of the federal gift of funds and for actually providing health care, they have no official input into the interpretation of the rules they must meet.⁽²³⁾

Although the provinces and territories receive a not insignificant amount of funding under the shared-cost programs, they do not always support the aims that Ottawa adopts. In the February 1999 agreement on the social union, the signatory governments agreed to work collaboratively to identify Canada-wide priorities and objectives. The federal government, for its part, agreed not to introduce new initiatives without the consent of a majority of provincial governments. It must also be noted that in the past, the federal government has often taken advantage of a favourable situation, whether political or financial, to launch new social program initiatives. Historically, that was the case when the federal government found itself with a budget surplus.

Although the provincial and territorial governments hold the principal constitutional powers regarding the delivery of social services (including health care and education), the federal government has always exerted considerable influence on social policy, whether by using its spending power or by establishing national standards. According to economist Robin Boadway, the federal spending power has economic and social virtues, the two main ones being efficiency

(22) The classic example is the program for direct federal grants to universities (1951).

(23) D. Cohn, in P.C. Fafard and D.M. Brown (Eds.), *Canada: The State of the Federation 1996*, p. 168.

and equity.⁽²⁴⁾ The redistribution of collective wealth is the main method used by the federal government for achieving those objectives.

2. The 1982 *Charter of Rights and Freedoms*

With the advent of the *Canadian Charter of Rights and Freedoms* in 1982, the federal government expanded its social responsibilities to Canadians. In section 36(2), the Government of Canada committed itself to making equalization payments to the provinces to ensure that they have “sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.”⁽²⁵⁾ The purpose of that section is to promote equal opportunities and guarantee mobility rights. Prof. Hogg argues that this is also a justification for the federal spending power.⁽²⁶⁾

3. National standards

National standards are a contested aspect of the Canadian social union. They enable the federal government to establish and maintain uniform Canada-wide standards in relation to social programs. Other than the five principles set out in the *Canada Health Act*,⁽²⁷⁾ there are relatively few national standards. In fact, health and social assistance are the only spheres where they exist.⁽²⁸⁾ Legal author Steven Kennett expresses the issues involved in national standards in terms of federal-provincial-territorial relations as follows:

The division of powers ensures that the federal government can at best hope to bring a national perspective to social policy decisions; it cannot displace the provinces from primary responsibility for program design and delivery.⁽²⁹⁾

(24) R. Boadway, *The State of the Federation 1999-2000: Recent Developments in the Economics of Federalism*, Kingston, Ontario: Institute of Intergovernmental Relations, Queen’s University, p. 54.

(25) *Constitution Act, 1982*, section 36 (2).

(26) Hogg, *Constitutional Law of Canada*, *op cit.*, 1985, p. 151.

(27) The five principles are universality, comprehensiveness, accessibility, portability and public administration.

(28) Stilborn, *op cit.*

(29) S. Kennett, *Securing the Social Union: A Commentary on the Decentralized Approach*, Kingston: Institute of Intergovernmental Relations, 1997, p. 39.

Advocates of national standards believe that Canadians are justifiably entitled to comparable levels of service, regardless of where they live, under the principles of mobility and equity. In their view, section 36 of the *Constitution Act, 1982* legitimizes the creation of national standards for social programs.

It seems that national government social programs are increasingly a reflection of a vision of Canadian citizenship that is inspired by what might be called social liberalism. The numerous social programs initiated by the federal government since World War II have had a significant influence on the construction of a unique Canadian identity.⁽³⁰⁾ Some Canadians take great pride in being part of a country that has promoted the ideals of social sharing, redistribution of wealth and equity by establishing national programs.⁽³¹⁾

On the other hand, those who advocate abolishing or limiting national standards generally argue the following reasons for their opposition: failure to respect provincial and territorial jurisdictions; the importance of transparency; and the need to innovate. In their view, national standards have the effect of centralizing powers in the federal government's hands, and tend to place significant limitations on the latitude available to the provinces and territories in relation to social programs. Obviously, those arguments are heard particularly often in the most autonomist provinces.

4. Opting out with compensation

The right to opt out with compensation is expressed in a province's or territory's ability to opt out – with full financial compensation – of any new Canada-wide social program in an area under provincial/territorial jurisdiction, as long as the province or territory offers a program or initiative that meets the Canada-wide objectives. Under the 1999 social union agreement, the provinces and territories have an implied right to opt out (which could be characterized as a partial right to opt out), that applies strictly to new Canada-wide initiatives funded by transfers to the provinces/territories, and thus to shared-cost programs:⁽³²⁾

(30) On this point, see the study by Jane Jenson entitled *Mapping Social Cohesion: The State of Canadian Research*, Ottawa: Canadian Policy Research Networks, 1998.

(31) H. Lazar, *Canada: The State of the Federation 1999-2000: Toward a New Mission Statement for Canadian Fiscal Federalism*, Chapter entitled "In Search of a New Mission Statement for Canadian Fiscal Federalism," Kingston, Ontario: Institute of Intergovernmental Relations, Queen's University, 1999, p. 22.

(32) It is important to point out that the right to opt out does not apply to direct transfers to individuals and/or agencies.

A provincial/territorial government which, because of its existing programming, does not require the total transfer to fulfill the agreed objectives would be able to reinvest any funds not required for those objectives in the same or a related priority area.⁽³³⁾

Because social programs come within provincial and territorial jurisdiction, the right to opt out amounts to a political compromise by the federal government that enables the provinces and territories to exercise the autonomy given to them by the Constitution for developing and delivering numerous social programs. Nonetheless, this key provision of the Canadian social union agreement may help to emphasize the existence of asymmetrical federalism.

THE SOCIAL UNION AND FISCAL FEDERALISM

Because of its broad powers of taxation and its fiscal capacity, the federal government has always had a considerable advantage over the provinces and territories in this regard. Consequently, the federal spending power continues to be an extremely powerful instrument in the hands of the Government of Canada for involvement in that sphere. It should be noted that the social union agreement in February 1999 lent considerable legitimacy to the exercise of the federal spending power.

Transfers from the federal government to the provinces have been taking place since Confederation. They have played an important role in funding the public expenditures of the provinces and territories throughout Canada's history, and particularly since World War II. As noted earlier, there are economic arguments that justify federal/provincial/territorial grants, and, by extension, the use of the federal spending power.

A. Transfer mechanisms

Since the earliest days of Confederation, but mainly since the 1950s, Ottawa has implemented a variety of fiscal transfer mechanisms. Two main types may be identified: transfers to the provinces, which are paid in cash and in tax points; and transfers to individuals. The main types of fiscal transfers that are currently paid to the provinces and territories are:

(33) Canadian Social Union Agreement, February 1999.

- 1) the Canada Health and Social Transfer (CHST);
- 2) the equalization program;⁽³⁴⁾ and
- 3) territorial formula financing.

The CHST includes a cash transfer component and a tax points transfer component. In the case of tax points transfers, the federal government surrenders some of its tax room by reducing its taxes to enable the provinces to raise theirs by the same amount. The result is an increase in provincial revenues, with no increase in the total tax burden borne by Canadians.

The CHST is paid to all of the provinces and all of the territories, to fund health care programs, post-secondary education and social assistance. Certainly the less affluent provinces are more dependent on transfers, in terms of their tax revenues. For example, in 2000-2001, transfers paid to Nova Scotia, Newfoundland and Prince Edward Island accounted for more than 40% of their total revenues.⁽³⁵⁾ The following table shows the transfers for each of the provinces and territories for fiscal 2000-2001.

Federal transfers to the provinces and territories, fiscal 2000-2001

Province/territory	Total transfers ⁽³⁶⁾ (in billions of dollars)	Proportion of provincial/territorial revenues represented by transfers (in %)
Newfoundland	1.5	42
Prince Edward Island	0.373	42
Nova Scotia	2.2	43
New Brunswick	1.8	39
Quebec	11.9	25
Ontario	11.8	19
Manitoba	2.2	35
Saskatchewan	1.0	16
Alberta	3.0	16
British Columbia	4.1	19
Northwest Territories	0.581	77
Yukon	0.358	74
Nunavut	0.584	91

Source: Department of Finance of Canada

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- (34) Equalization payments and Territorial Formula Financing are paid to the provinces and territories in cash.
- (35) Source: Department of Finance of Canada.
- (36) The transfers shown include the CHST, equalization and Territorial Formula Financing.

In addition to fiscal transfers to the provinces and territories, the federal government also allocates money directly to individuals and agencies. For example, this is true for the Canada Pension Plan,⁽³⁷⁾ Employment Insurance (formerly Unemployment Insurance) and, more recently, the Canadian Foundation for Innovation and the Millennium Scholarships.

Often, introducing this type of initiative has resulted in overlap with already-established programs in the provinces. Some measures that were introduced recently have been severely criticized by the Government of Quebec which has accused the federal government of acting unilaterally and failing to take into account the unique characteristics of its programs. One example is the Millennium Scholarships, which were announced in 1997. The current federal government, on the other hand, has contended that by virtue of its constitutional obligations, it had a duty to improve Canadians' welfare and to redistribute the collective wealth to individuals in need.

On the question of federal-provincial-territorial transfers designed to finance shared-cost programs, the provinces and territories have complete autonomy in managing the programs and spending the money allocated. This does not apply to transfers made directly to individuals, where the federal government handles the administration and delivery of the programs.

1. The Canada Health and Social Transfer

Since the 1960s, the Canadian federation has adopted numerous mechanisms for intergovernmental cooperation. The proliferation of roles played by government has resulted in a significant increase in the number of responsibilities borne by governments, and has consequently increased cooperation between the two levels of government. It must be noted that this has often happened as a result of the federal government wanting to establish its own priorities, without being overly concerned about the provinces' demands. In 1996, the federal government instituted a new funding formula for transfers to the provinces. The Canada Health and Social Transfer (CHST) signified a major change in federal-provincial relations. As Harvey Lazar put it:

The Canada Health and Social Transfer was perhaps the most important decision taken by the federal government affecting relations with the provinces.⁽³⁸⁾

(37) Pursuant to an agreement with the federal government, Quebec has its own pension plan. However, that plan is funded in part by federal transfers.

(38) H. Lazar, *Canada: The State of the Federation 1997: Non-constitutional renewal*, Kingston: Institute of Intergovernmental Relations, 1997, p. 9.

The CHST replaces the two former schemes for transfers to the provinces and territories: Established Programs Financing (EPF), which covered health care and post-secondary education; and the Canada Assistance Plan (CAP), which dealt with social services and social assistance.

Unlike EPF and CAP, the CHST is a single block funding method that brings together all transfers to the provinces and territories for social programs. In 2000-2001, the federal government will pay out \$18.3 billion to the provinces and territories under the CHST.⁽³⁹⁾ There is also federal legislation that sets out the funding framework, which includes cash and tax point transfers to the provinces.

When the CHST was established, it received a somewhat chilly reception from most of the provinces. The federal government claimed that it had established this new funding formula to respond to pressure from the provinces for more autonomy in social programs. Under the old EPF and CAP formula, the federal government gave out conditional and unconditional funding. The fact that EPF and CAP funding was subject to conditions was a source of annoyance for the provinces and territories (in 1977, the federal government had introduced conditional block funding, half of which was paid by cash transfers, and the other half by tax point transfers).

With the creation of the CHST, the provinces gained greater freedom to use the funds for their own health, education and social services priorities. This meant that Ottawa waived its right to impose conditions on the funding it gave the provinces and territories for social programs, with the exception of the national standards set out in the *Canada Health Act* and the right of access to social assistance without a minimum residency requirement.⁽⁴⁰⁾

In addition, when the CHST was introduced in 1996, the Liberal government's fiscal agenda was clearly one of its priorities. Major budget cuts had been made, and transfers to the provinces had not been spared. In fact, if the total combined amount of EPF and CAP transfers in 1995-1996 is compared to the amount of the CHST in 1996-1997, it shows the provinces had to face up to lost earnings of about \$1.5 billion for the 1996-1997 fiscal year and \$4.5 billion for the 1997-1998 fiscal year.⁽⁴¹⁾ Compared to the rights established under EPF and CAP, which amounted to \$29.7 billion in 1995-1996, the amounts associated with the CHST were about \$25.8 billion in 1997-1998.

(39) Source: Department of Finance of Canada.

(40) *Ibid.*

(41) Lazar, 1997, p. 175.

The desire of the provinces and territories to lay down the rules of the game with the federal government concerning social program funding heightened considerably after the substantial cuts that took place in 1996. Although the establishment of the CHST had demonstrated the federal government's intention of giving the provinces more flexibility and autonomy in relation to social programs, the massive cuts in transfer payments rapidly became a source of tension in federal-provincial relations.⁽⁴²⁾

Under the agreement that was signed by the first ministers of Canada and of the provinces and territories on 11 September 2000, concerning health services funding, the federal government will pay out an additional \$21.1 billion dollars over the next five years under the CHST. The following table shows the rising value of the funds allocated under the CHST from 1997 to 2003.

Increases in transfers relative to CHST

Year	CHST (in \$billions⁽⁴³⁾)
1997-1998	25.8
1998-1999	26.7
1999-2000	29.4
2000-2001	30.8
2001-2002	31.3
2002-2003	32.0

Source: Department of Finance of Canada

It should be noted that over the next few years, the proportion of transfers in the form of tax points will rise considerably in relation to cash transfers under the CHST. This suggests that the federal government will have less latitude for playing its role as an agent of wealth redistribution within the federation.

2. The equalization program

The equalization program makes it possible for the less prosperous provinces to provide their inhabitants with high-quality public services that are substantially similar, at

(42) *Ibid*, p. 21.

(43) The amounts shown include cash and tax point transfers.

substantially similar taxation levels. Equalization payments are not subject to conditions. Accordingly, the provinces may spend them according to their own priorities for public services. The program was renewed in 1999 for five years. In 2000-2001, the provinces will receive \$9.8 billion in equalization payments from the federal government. At present, seven provinces are eligible for equalization payments: Newfoundland, Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Manitoba and Saskatchewan.

Equalization payments are calculated using a formula laid down by federal statute and regulations. The provinces with a capacity to generate revenue below the average established are entitled to equalization payments from the federal government, to bring their fiscal capacity per inhabitant up to the average. Each province's fiscal capacity is calculated using more than 30 sources of revenue (tax bases), including personal income tax, corporate tax, sales tax, property tax and numerous other sources, assuming that the province has used average tax rates for each source.

B. Unresolved issues in Canadian fiscal federalism

In its current form, Canadian fiscal federalism involves two major unresolved issues:

- 1) vertical fiscal imbalance between the federal government and the provincial/territorial governments; and
- 2) horizontal fiscal imbalance among the provinces and territories.

1. Vertical imbalance

It seems clear that the 1867 constitutional division of taxing powers does not reflect the modern-day responsibilities of the provinces and territories in terms of spending. In 1867, the Fathers of Confederation opted for a quasi-federal system, assigning broad responsibilities to the central government. At that time, as well, they could not have foreseen the substantial expansion in the sphere of provincial government activity. That has doubtless resulted in the opening up of numerous fields of public policy. At the same time, starting in the 1960s, the provinces and territories acquired a skilled public service that expanded to cover the larger role being played by government in people's lives.

Had it not been for the less fortunate provinces' dependence on federal transfers, it would have been difficult for the federal government to pursue its involvement in social programs quite so doggedly over the past 20 years. But because of the tax base and the broad taxing powers assigned to the federal government, the provinces and territories were never able to become totally autonomous in financial terms.

2. Horizontal imbalance

In addition to the problem of the division of taxation powers between the two levels of government, there are also significant differences among the provinces and territories in terms of their own tax bases, and consequently their financial capacity. This consideration becomes particularly significant when it comes to fiscal federalism. For example, even if the Atlantic provinces were to secure greater autonomy in the area of social program funding, they would not have the financial capacity to support those programs at the same cost levels as the more well-off provinces. Equalization payments would not be sufficient to enable them to overcome the difficulty they have in increasing their revenues. Ontario and Alberta, on the other hand, are much more independent in fiscal terms, because they have a much more impressive tax base. It is therefore easy to understand why the provinces and territories which have diminished fiscal capacity are more receptive to the exercise of the federal spending power. Without the support of the federal government, the Canadian provinces might find it hard to offer comparable services, at similar costs, in the social program sphere.

CONCLUSION

The legal vacuum that is created by the *Constitution Act, 1867* means that the roles of the two levels of government in relation to social programs cannot be easily delineated. Despite the fact that the courts have spoken repeatedly in this area, there are still many grey areas. By exercising its spending power, which has been expressly recognized by the courts, the federal government plays a significant role in relation to social policy. Because the central government's role focuses on funding social programs, obviously the fiscal directions it takes will have a major impact on the Canadian social union. In this respect, the Canadian government has access to fiscal capacity that, to date, has made it possible for it to fulfill its function of redistributing wealth

among the provinces and territories. However, that fiscal capacity is being increasingly affected by the growing transfer of tax points to the provinces and territories.

The effect of the *Charter of Rights and Freedoms*, and more specifically section 36, has been to foster a more direct relationship between the federal government and Canadian citizens. That relationship is expressed in an increase in direct transfers to individuals, such as in the recent federal initiatives for children (National Child Benefit), for post-secondary students (Millennium Scholarships), and for researchers (Canadian Foundation for Innovation). Moreover, while the national standards imposed by the Government of Canada are still hotly debated, they are relatively restrained.

Although it suggests that an increasingly collaborative federalism might be practised, the federal-provincial-territorial agreement of 4 February 1999 has not managed to solve the vertical and horizontal fiscal imbalance problems. In political terms, the agreement has contributed to widening the gulf between the federal government and the Government of Quebec, and in large measure to legitimizing the practice of an increasingly asymmetrical federalism.⁽⁴⁴⁾

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(44) On this point, see the article by political scientist Alain Noël entitled "Without Quebec: Collaborative Federalism With a Footnote?" *Policy Matters*, Institute for Research on Public Policy, March 2000, p. 15.

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