CHAPTER EIGHT

Federalism and Canada's Economic Union

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Economic nation-building was a major rationale for Confederation. Faced with the task of forging an economic union out of different regional economies, there is ample evidence that Canadian governments have succeeded in creating a functioning economic union in Canada. Canadians share a common currency and monetary policy, as well as common policies with respect to external economic relations. Other policies that significantly affect the economic union, such as taxation, are coordinated across the two orders of government. Nonetheless, Canada's internal economic union remains incomplete insofar as uncoordinated federal and provincial government policies impede the interprovincial circulation of goods, labour, capital, and services. There are also chronic complaints in some provincial quarters about the willingness of the federal government to balance fairly the competing interests of different provincial and regional economies. Moreover, the increasing integration of provincial/regional economies into North American and **global supply chains** raises questions about the capacity of Canadian governments to pursue made-in-Canada national and regional economic development policies.

The objective of this chapter is to address the role of Canada's federal system in maintaining and enhancing Canada's economic union. It is important at the outset to emphasize that Canada's federal system is one factor among others that affects the nature of Canada's economic union. Moreover, the effects of federal institutions and practices interact with other factors, most notably the regional structure of the Canadian economy. If it is thus difficult to isolate the independent effects of Canada's federal system on the nature of the Canadian economic union, it is nonetheless still possible to offer some insights into how the constitutional division of powers and their exercise by governments within Canada's federation have shaped the performance, effectiveness, and legitimacy of Canada's economic union.

The first section of the chapter begins by distinguishing among different types of economic associations. It then describes the allocation of constitutional powers in Canada with respect to the construction and functioning of Canada's economic union. This section documents the sole jurisdiction of the government of Canada to establish a customs union and to exercise the most important powers with respect to creating a monetary union. It also clarifies that both orders of government have important and overlapping jurisdictional levers when it comes to promoting individual firms, economic sectors, and provincial/regional economic development goals.

The second section of the chapter provides an historical overview of how governments have exercised the jurisdictional powers and fiscal and regulatory policy instruments to pursue economic development goals. These analyses demarcate governments' shifting roles over time: a predominant role for the Canadian government in the economic union through to the 1960s; intervention by both federal and provincial governments during the 1970s through to the mid-1980s; a transition in the early 1990s away from direct state intervention to assisting firms and industries in the **market economy**; and an emphasis on government support under the auspices of cultivating the "knowledge economy" from the late 1990s to the present.

This second section affirms that the division of powers in Canada's Constitution, in interaction with the regional structure of Canada's economy, has played an important role in the functioning of Canada's economic union. Distinct provincial economic structures have tested the capacity of the federal government to devise economic policies that are perceived as fair by all provinces/regions. Lacking intrastate forums within the government of Canada for representing their regional development ambitions, provinces have been empowered by Canada's federal Constitution to act on their perceptions of unfair treatment by Ottawa. Since the 1960s, several provinces have exercised their considerable jurisdiction to develop their provincial economies to the benefit of local industries at the expense of their neighbouring provinces. Although the resulting disruptions to the internal market have created tensions within the federation, governments have lacked incentives to minimize **interprovincial economic barriers**, including by harmonizing their economic development policies. In recent decades, however, structural shifts in the form of economic globalization and the emergence of the **knowledge-based economy** appear to have created incentives for Canadian federal governments to reorient their economic development policies towards more regionally neutral policies. These same external pressures also appear to be giving provinces incentives to commit to eliminating or harmonizing those of their policies that impede the full functioning of the Canadian internal economic union.

The third section of the chapter summarizes and offers conclusions on the extent to which federalism is implicated in the performance, effectiveness, and legitimacy of the Canadian economic union. In terms of performance, the general pattern is one of weak or non-existent coordination of governmental economic policies, even while there are examples of intergovernmental co-operation and collaboration. In terms of effectiveness, objective economic indicators indicate a well-functioning albeit incomplete economic union. Just how serious interprovincial barriers to the internal market are is a matter of conflicting evidence and debate. Assessments of the legitimacy of federal economic development policies are, nonetheless, marred by perceptions, especially in western Canada, of discriminatory treatment.

CANADA'S CONSTITUTION AND THE CANADIAN ECONOMIC UNION

To determine the nature of Canada's economic union, and how it has been affected by Canada's federal system, it is useful to distinguish different forms of economic association. A customs union exists, such as in Canada, when the entities within it adopt common policies with respect to external economic relations; for example, common tariffs on imports. A common market, such as the European Union (EU), is an association within which goods, capital, services, and labour move freely, without being subject to fiscal or regulatory barriers posed by constituent members. A common market that has a single currency and a central bank to manage the currency is described as a monetary union; the member states of the EU that constitute the Eurozone are an example. As distinguished from a common market, a complete economic union entails deliberate efforts to transform separate economic entities into a single economic space via common or harmonized policies affecting the development and management of the economy. In addition to policies with respect to external and internal trade, a number of other policies are also thereby implicated in the creation and preservation of an economic union. They include monetary policy; fiscal policies (taxation, fiscal transfers); infrastructural policies such as for transportation and communications; financial services and securities regulation; and sectoral policies such as for industry, agriculture, natural resource, and energy development (Canada, 1980; Norrie, Simeon, and Krasnick, 1986: 293). By way of example, the EU, despite its considerable efforts, fails to qualify as a complete economic union because of its inability to harmonize the full breadth of these policies.

The allocation of powers with respect to the economic union in the 1867 *Constitution Act* was heavily influenced by the geopolitical context within which Confederation occurred. The British North American (BNA) colonies that joined politically to form Canada relied upon export markets to purchase their products (principally cod, wheat, and agricultural commodities but also some manufactured goods). When the preferential access these colonies enjoyed to Great Britain ended in the mid-1800s, the solution was a reciprocity agreement with the United States. Between 1854 and 1866, Canadian goods entered the US tariff-free. The end of reciprocity required the united province of Canada and the other BNA colonies (Nova Scotia, New Brunswick, and PEI) to find an alternate market. Defence considerations also reinforced these incentives for an interprovincial union. With the end of the US civil war in 1865, Canada faced a large army on its southern border: a threat that was magnified by the rhetoric of US politicians to expand into the prairie west. Creating a common economic space within Canada – one that joined central Canada to the Maritimes and the west – was a means to further both economic and political/defence goals.

Given this context, not surprisingly, the *Constitution Act, 1867* (formerly the *BNA Act, 1867*) gave the government of Canada significant jurisdictional powers to create a common Canadian economic space. It acquired jurisdiction over trade and commerce in section 91(2) – a power that the courts subsequently interpreted to include both external and interprovincial trade. Federal jurisdiction does not extend to intraprovincial trade; the latter is a matter for the provinces. Its additional jurisdiction over customs and excise laws (section 122) and any mode or system of taxation in section 91(3) gave the federal government the authority to create a customs union, including by imposing tariffs on imported goods.

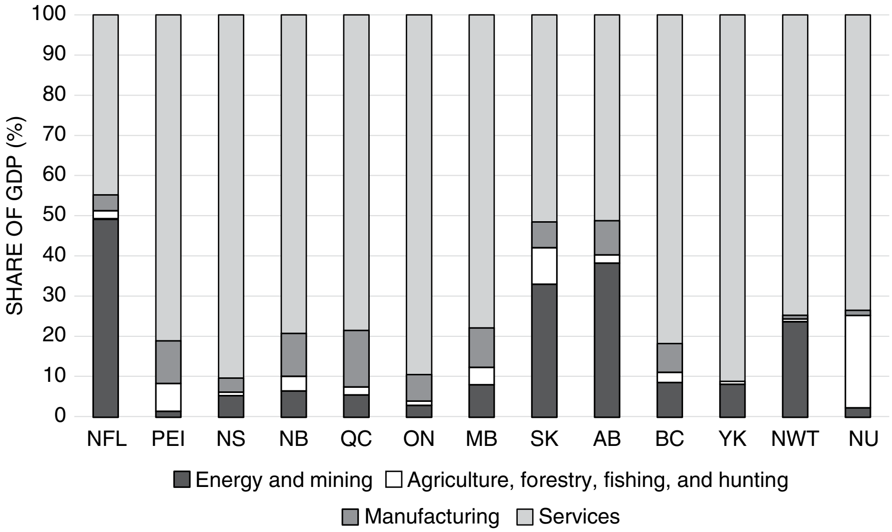
The government of Canada also acquired the jurisdiction to create a monetary union and manage monetary policy (whose objective is to preserve the value of money by keeping inflation low, stable, and predictable). The federal government obtained exclusive authority over currency and coinage (section 91(14)); banking, incorporation of banks, and the issuance of paper money (section 91(15)); savings banks (91(16)); interest (91(19)); legal tender (91(20)); and authority to borrow money on the public credit (91(4)). Provinces cannot establish a separate money system or currency controls. Canadian monetary policy is conducted independently by the Bank of Canada, which, since 1991 under renewable agreements with the government of Canada, aims for an inflation target of 2 per cent. Provinces cannot establish banks; the largest financial services (federally chartered banks) are thus regulated by the government of Canada. However, provinces have over the years incorporated trust companies, credit unions, and insurance companies that also receive deposits and lend money (section 92(11)).[1] The government of Canada's authority over financial institutions is also limited by the right of provinces and territories to regulate the securities industry; that is, firms that raise capital in the form of debt (bonds) or equity (stocks) on stock exchanges. Nor can the government of Canada control provincial governments' borrowing; they have the right to borrow money on the sole credit of the province (section 92(3)) and run budgetary deficits.

The intent at Confederation was to create a common market. Section 121 of the 1867 *Constitution Act* stated: "All Articles of the Growth, Produce and Manufacture of any one of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces." Judicial review has subsequently confirmed section 121 precludes provinces from levying tariffs or import quotas on goods from another province.[2] It does not, however, impose an absolute free trade regime within Canada. As most recently ruled in the 2018 *R. v. Comeau* case, section 121 permits provinces to pass laws that have the incidental effect of impeding the passage of goods over interprovincial borders, providing the law's main purpose is not to prevent the entry of goods from other provinces. Section 121, ruled the Supreme Court of Canada, has to be read in conjunction with sections 91 and 92. Of relevance to interpreting section 121 are section 92(13), which gives the province the right to legislate with respect to "property and civil rights within the province," and section 92(16), which gives the province the right to legislate on "generally all matters of a merely local or private nature in the province." Moreover, insofar as section 121 makes no reference to the free movement of services, capital, enterprises, or persons, provincial governments can implement non-tariff barriers that restrict their internal free movement. The result, as discussed later in this chapter, is an incomplete internal Canadian market.

Besides its allocation of the legal powers that affect Canada's customs union and internal common market, Canada's Constitution has affected the powers of both orders of government to develop and manage the Canadian economy. Both federal and provincial governments are equipped with considerable fiscal (taxing and spending) resources to engage in economic development (see chapter 10). The federal government can raise taxes by any mode (section 91(3)) and spend the monies so raised as it sees fit, including on matters that fall within provincial jurisdiction. Provinces have the ability to raise direct taxes (92(2)) and manage the crown lands they own (92(5)). As discussed further below, for provinces with abundant natural resources, the provinces' right to manage and receive royalties from their resources like forests, hydro power, oil, natural gas, and mineral deposits adds up to appreciable revenue sources.

In sum, Canada's Constitution equips both orders of government with regulatory and financial powers and resources to promote economic development. Structural factors – like Canada's comparatively small population, extensive geography, and a resource-based economy dependent upon export markets – have made Canadian governments reluctant to allow market forces alone to determine the structure of the Canadian economy and its development and growth (Tupper, 1986: 354). The focus in this chapter is on the economic policies of governments that fall into the category of industrial policy, that is, efforts to encourage particular industries and regions to innovate, adjust, and capture economies of scale; to increase employment; to reduce economic vulnerability in the face of falling prices and reduced demand; and to improve the standard of living of Canadians (Leslie, 1987: 187).[3] The two orders of government share a number of policy instruments

Figure 8.1. Share of Provincial GDP by Industry, 2018



Source: Authors' calculations based on Statistics Canada Table 36-10-0400-01, "Gross Domestic Product (GDP) at Basic Prices, by Industry, Provinces and Territories, Percentage Share."

to deploy in pursuit of industrial policy, namely fiscal instruments in the form of subsidies and tax incentives; direct delivery of goods and services through government-owned enterprises; regulations and incentives that nudge economic actors to behave in ways consistent with government goals; policies that facilitate information exchange and coordination among economic actors; export and marketing assistance; and regulations that can protect and privilege Canadian businesses vis-à-vis foreign competition.

Figure 8.1 provides a profile of current provincial economies, demonstrating the extent to which their gross domestic product (GDP) is derived from different industries. It shows the far greater significance of the energy and mining sectors to Newfoundland and Labrador, Alberta, Saskatchewan, and the Northwest Territories as compared to other provinces and territories. Compared to other provinces, Ontario and Nova Scotia are more reliant on service sectors, and Quebec on manufacturing. Differences in provincial economies are long-standing. Since Confederation, Canadian provinces/regions have varied, often significantly, in the extent to which their economic fortunes have depended on agriculture, forestry, fishing and hunting, manufacturing, and energy and mining.

Not surprisingly, then, federal efforts at economic development policy have frequently faced the challenge of reconciling the disparate interests of different provinces/regions. Intergovernmental conflict has ensued amidst charges of federal policy providing benefits to one region at the expense of the economic well-being of another. Illustrative examples are the **National Policy** and the **National Energy Program**, discussed below. Provincial industrial policies aimed at promoting local industries are also susceptible to the same charge of discrimination – and hence, a source of interprovincial conflict.

The next section of the chapter provides an historic overview of the different regulatory and financial policy instruments used by federal and provincial governments to promote economic development, and the extent to which their largely uncoordinated efforts have engendered intergovernmental conflict.

FEDERAL DOMINANCE: CONFEDERATION TO THE 1970s

In the post-Confederation period, the federal government assumed leadership in constructing a national economy. The 1879 National Policy represented a deliberate effort to use federal jurisdictional powers to create an internal Canadian market. It imposed tariffs on imported manufactured goods, thereby protecting Canadian manufacturers from foreign competition in the Canadian market. The federal government used its authority over interprovincial transport to finance and regulate the construction of interprovincial railways to the Maritimes and western Canada, and its authority over immigration policy to settle prairie Canada in the late 1800s and early 1900s. Together, tariffs, national railways, and a populated western Canada created the basis for an east–west trading system.

The National Policy was widely viewed as discriminatory in western Canada and the Maritimes, where it was perceived as benefitting central Canada at their expense (Gibbins, 2007). The tariff protected domestic manufacturers, wherever located in Canada, while its costs were borne by consumers. Although both the manufacturing sector and most consumers were located mainly in central Canada, consumers in central Canada could still be seen to benefit from the tariff because of the knock-on effects of manufacturing activity. The situation was different for the primary producers in western and Maritime Canada whose major markets were external. Not just their consumer costs, but also their production costs were driven up by higher priced input goods, like farm machinery, as a result of the federally imposed tariff (Leslie, 1987: 113). It is thus not surprising that the legacy of the National Policy was to undermine the credibility of the federal government to represent the economic aspirations of regions other than central Canada (Atkinson and Coleman, 1989: 65).

Besides tariffs on costly imports like farm machinery, other aspects of federal economic development policy also created perceptions of western regional discrimination. A major bone of contention was that, contrary to the situation of other provinces, the governments of Manitoba, Saskatchewan, and Alberta did not acquire ownership of their Crown lands and natural resources when they became provinces. The government of Canada had retained ownership of prairie Crown lands on the grounds that it needed the funds from the Crown lands to finance prairie settlement and railway building. The transfer of their Crown lands and natural resources to the three prairie provinces in 1930, states Leslie (1987: 4), "symbolically closed" the National Policy.

Notwithstanding its role as the major architect of the Canadian economic union, the federal government has never been the only order of government to promote economic development. It shares its authority to do so with the provinces/territories. Beginning in the nineteenth century, Ontario, for example, used its ownership of provincial Crown lands and resources to promote the mining, forestry, and hydroelectricity sectors within the province (Nelles, 1974). At various times, the courts have checked Ottawa's economic development efforts. Most notably, its effort during the 1930s Great Depression to create a national marketing scheme for crops and other agricultural products – in order to enhance the competitiveness of Canadian farmers vis-à-vis domestic and foreign buyers – was struck down by the Judicial Committee of the Privy Council as an intrusion into provincial jurisdiction over intraprovincial marketing (see chapter 4).

The federal government continued to assume the dominant role in developing the economy through to the late 1960s. As chapter 10 on fiscal federalism discusses, the centralization of fiscal policy that began during the Second World War continued in the post-war period.

Keynesian policies were adopted to smooth out the inherent instability of a market economy that was heavily dependent on the export of unprocessed primary products (Leslie, 1987: 5). The government of Canada's direct aid to industry increased over the 1960s, as it gave incentives to industry to locate in the slow-growth regions of Quebec and the four Atlantic provinces of Newfoundland and Labrador, Nova Scotia, New Brunswick, and Prince Edward Island. Although Ottawa usually developed these regional development programs on its own, at times Ottawa has co-operated with provinces in managing them (Norrie, Simeon, and Krasnick, 1986: 297; Bakvis, 1991).

ACTIVIST FEDERAL AND PROVINCIAL GOVERNMENTS: 1970s–MID-1980s

Both orders of government underwent an important transition in their role in economic development via industrial policies in the 1970s (Haddow, 2008). Nationalist governments in Quebec, and subsequently other provincial governments, revved up their efforts to develop their local economies by providing grants, loans, tax allowances, and other incentives to local industries. Governments in Alberta and Saskatchewan, highly dependent upon extractive resources, pursued policies to spin off new industries from their fossil fuel and potash sectors (Richards and Pratt, 1979). In addition to seeking greater control over and credit for the economic development activities it engaged in under agreements with provinces, the federal Liberal government led by Prime Minister Pierre Trudeau also became more interventionist in promoting structural changes in the economy. Using fiscal policy (taxation, spending) and by restricting foreign investment, the Trudeau government aimed at positioning Canadian manufacturers to withstand foreign competition in the domestic market and expand their exports of higher value, processed goods (Leslie, 1987: 8–9). Both federal and provincial governments also established public (government-owned) enterprises to produce and deliver goods and services (Laux and Molot, 1988). These different federal and provincial initiatives were usually taken unilaterally, and without coordination with other governments (Tupper, 1986: 375; Leslie, 1987: 187; Simeon and Robinson, 1990: chap. 10).

However, there were notable instances of federal and provincial co-operation. In the early 1970s, the federal government pooled its legal authority over interprovincial and export marketing with provincial governments' rights to regulate marketing within their province in order to establish national systems of supply management in the dairy, poultry, and egg sectors. Supply management limited the domestic production of these commodities to domestic demand, regulated these commodities' prices, and protected Canadian producers of these commodities from foreign competition (Skogstad, 1987, 2008).

The development and pricing of oil and gas resources brought the Pierre Trudeau Liberal government into sharp conflict with Newfoundland and Labrador (Blake, 2015) and the western Canadian provinces of Saskatchewan and Alberta (Simeon and Robinson, 1990: 236–49). Tensions reached the boiling point when the Pierre Trudeau government implemented the National Energy Program (NEP) in 1980. It imposed new taxes on the oil and gas industry – thereby increasing the revenues of the federal government – as well as controls on oil and gas prices. The latter were seen to serve the interests of industrial and other consumers located mainly in central Canada. The NEP also sought to increase federal control over oil and gas exploration by providing incentives for exploration and development in northern Canada and on federal Crown lands. The federally owned **Crown corporation**, Petro Canada, acquired a 25 per cent interest in all Canada Lands discoveries. Alberta and Saskatchewan, heavily dependent on oil and gas revenues, viewed the NEP as a direct attack on their jurisdiction over the development of their natural resources, as well as a discriminatory policy that favoured central Canada at their expense. The NEP was widely blamed for undermining investment in oil and gas exploration and development in provinces. The intergovernmental conflict and threat to Canadian unity triggered by the NEP were resolved by changes in federal government policy (deregulating domestic oil prices) and the affirmation of provinces' jurisdiction over their non-renewable resources in section 92A of the 1982 *Constitution Act*.[4] Notwithstanding this important constitutional victory, the NEP continues to cast a long and dark shadow over intergovernmental relations between Alberta and Liberal governments in Ottawa.

Provincial dissatisfaction with centralized decision-making at the federal level has also been attributed to the 1984 restructuring of the federal Department of Regional Industrial Expansion (DRIE), formerly the Department of Regional Economic Expansion (DREE). The new framework witnessed the creation of several regional ministries to serve western Canada, the Atlantic Region, northern Ontario, Quebec, and – following the 2008 recession – southern Ontario (see further, below). Yet, as noted by Conteh (2013), federal regional development expenditures were, until recently, dwarfed by their provincial counterparts.

1990–2000: FROM INTERVENTIONIST TO MARKET-ORIENTED ECONOMIC DEVELOPMENT

Major changes occurred in the 1990s concerning the management of the Canadian economy, a catalyst for which was the report of the Royal Commission on the Economic Union and Development Prospects for Canada (also known as the Macdonald Commission). Convened by the Trudeau Liberal administration in Ottawa in 1982 to assess, among other things, economic governance in Canada, the commission's report to the Mulroney Progressive Conservative government in 1985 favoured non-intervention in the market and free trade with the United States. The ideas underlying the commission's position were strongly influenced by **monetarist economic theory** and the problem of persistent inflation that characterized the 1970s and 1980s. In a rejection of classical **Keynesianism**, which justifies government intervention to achieve full employment, the commission endorsed the concept of the non-accelerating inflation rate of unemployment (NAIRU), which tolerates a rate of unemployment (about 8 per cent, at the time) that keeps inflation in check (Macdonald et al., 1985: 276).

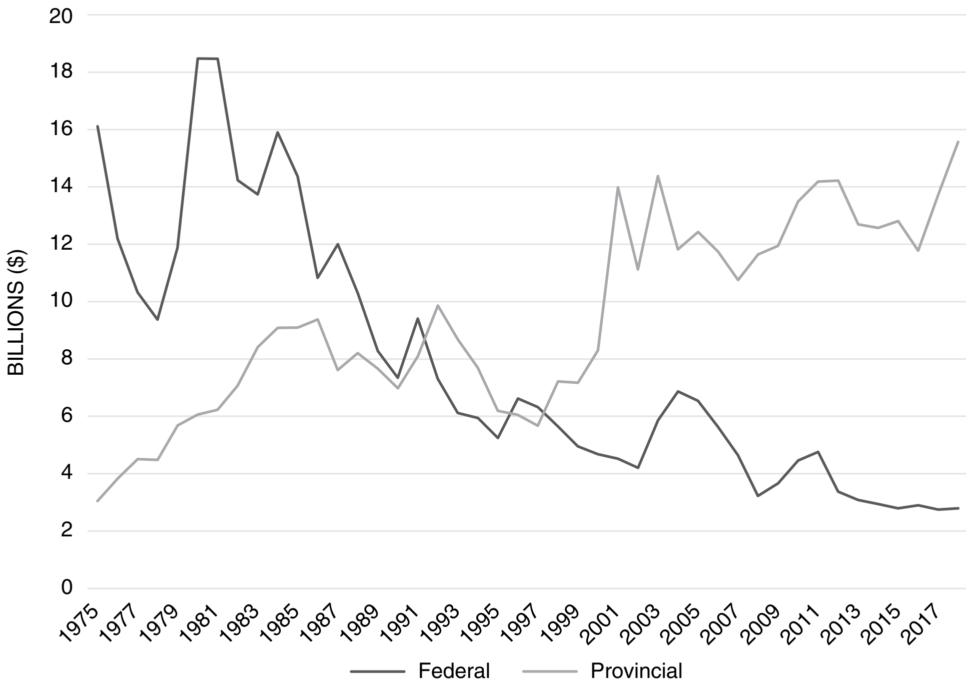
Although provincial administrations were divided on the free trade issue, most governments in Canada (and the rest of the world) were experiencing fiscal crises by the early 1990s. Indeed, for many governments the state of affairs was such that they could no longer afford to borrow money to fund government programs (MacKinnon, 2003). Most governments were therefore pre-empted from taking or resuming an activist stance on economic matters. Those that did, like the Ontario NDP government under Bob Rae, did not fare especially well politically or economically (Bradford, 2003). The problem was that the global economy in the early 1990s was undergoing major restructuring, with traditional manufacturing industries relocating to developing countries where labour costs were much lower. In many cases, governments that tried to resist the trend incurred costs only to delay the inevitable (Blais, 1986).

The free trade agenda and fiscal crisis of the state also ushered in a wave of privatization. On one hand, many governments in Canada were eager to relinquish inefficient and unprofitable state-owned enterprises in exchange for quick cash. On the other, the principles of free trade and the general ethos of **liberalization** held that economic affairs are generally best left to market actors. Thus, consistent with trends elsewhere in developed countries, Canadian and provincial governments have privatized or dismantled many, but not all, of their state-owned enterprises (Bird, 2015).

With respect to the economic union, trade agreements have strengthened north–south and global trade ties and weakened east–west linkages. Canada's regions are more loosely connected to one another in terms of their sources of prosperity; most provinces export more to international markets than they do to other provinces (Statistics Canada, 2018). Accordingly, devising policies for a national Canadian economy on the premise of economic linkages that mutually benefit its constituent political (provincial) units has become ever more problematic.

Despite the growing importance of international markets to most Canadian provinces, the government of Canada has not retreated from economic development/adjustment. It funds economic development agencies in all regions of Canada: the Western Economic Diversification Fund in western Canada; the Federal Economic Development Initiative for Northern Ontario (FEDNor); the Atlantic Canada Opportunities Agency (ACOA); the Canadian Northern Economic Development Agency (CanNor) in the three territories; and, since 2009, the Federal Economic Development Agency for Southern Ontario (FedDev). It directs funding to creating the infrastructure of a nation-wide knowledge-based economy: increasing funding for research-granting agencies and research and development (R&D) in innovative industrial sectors, such as agriculture and food, digital technology, and clean (green) technologies (Bakvis, 2008; Haddow, 2008: 232; Philipps et al., 2018; Philipps and Hertes, 2019). As indicated by Figures 8.2 and 8.3, although the extent to which the federal government subsidizes economic activity has diminished steadily since the 1970s, it continues to inject several billion dollars into the Canadian economy every year. The 2019–20 budget also indicates a strong federal commitment to economic development.[5]

Figure 8.2. Federal and Provincial Subsidies, 1975–2018

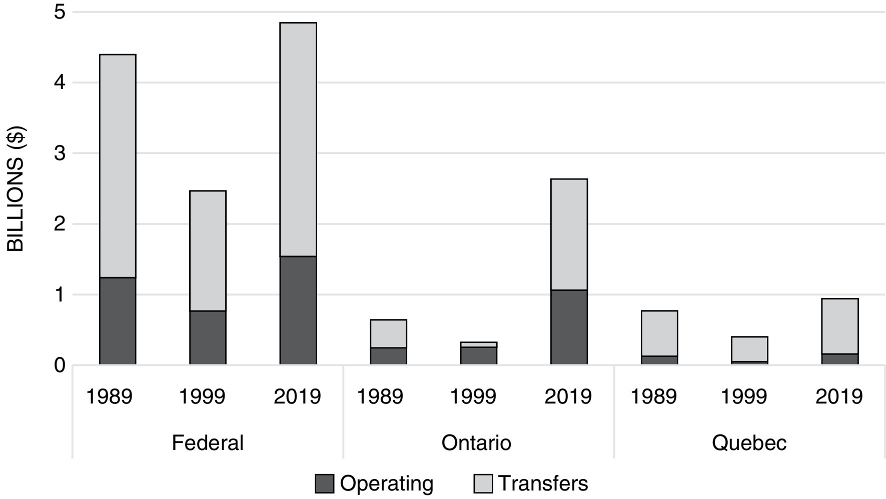


Source: Authors' calculations based on Statistics Canada Table 36-10-0477-01, "Revenue, Expenditure and Budgetary Balance - General Governments." Inflation adjusted, 2018 Canadian dollars. Provincial series includes all provinces, excludes territories.

2000–PRESENT: INDIRECT INTERVENTION AND THE KNOWLEDGE ECONOMY

While the liberalization agenda was no doubt forcefully pursued in the late 1980s and early 1990s, its underlying ideas never reached hegemonic status. Indeed, by 2000, the so-called "Washington consensus" that favoured market-based policies had unravelled as economists and policymakers became attentive to market failures that hinder innovation – namely, non-appropriable knowledge spill-overs and imperfect markets for skills development (Stiglitz, 1998; Williamson, 2000). Canadian governments thus adopted, and in some sense overstepped, OECD recommendations to cultivate the knowledge economy by way of indirect interventions (OECD, 1999). Consequently, the post-2000 era has

Figure 8.3. Comparison of Expenditures through Economic Development Ministries



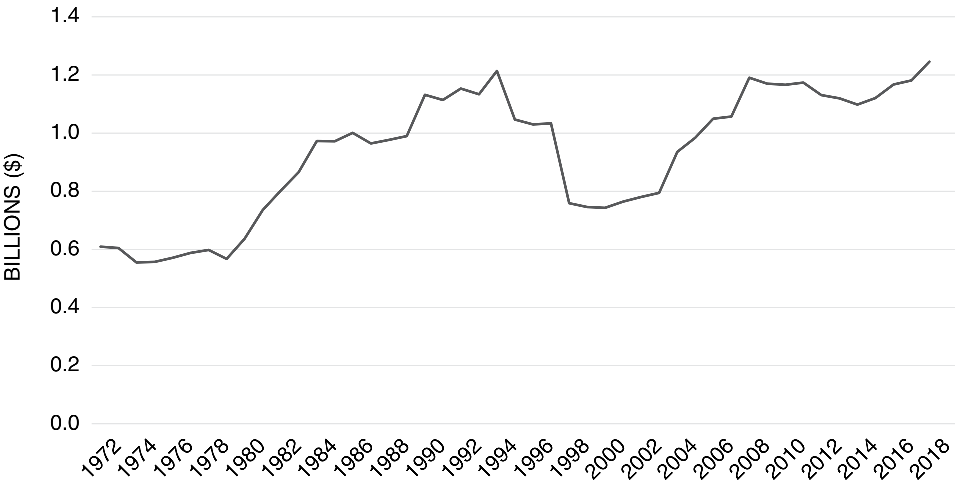
Source: Authors' calculations based on budget estimates. Inflation adjusted, 2018 Canadian dollars.

witnessed a significant increase in the use of non-tariff barriers – such as subsidies, government procurement, and tax incentives – many of which are not directed to knowledge-based or innovative industries. Whereas Figures 8.2 and 8.3 display cash expenditures, Lester (2018) calculates that, with tax measures and Crown corporation activity included, federal subsidies amounted to $14.0 billion while those of the four largest provinces (BC, Alberta, Ontario, and Quebec) reached $14.6 billion in 2014–15.

While it is arguable that subsidizing industry under the pretence of correcting market failures is a guise used to justify **protectionism**, Figure 8.4 offers some support for the contention that federal commitments to funding research have rebounded after a lull in the 1990s. On the other hand, the fact that current amounts scarcely exceed the previous peak in the early 1990s means that the question of whether rhetoric surrounding the knowledge economy matches government action remains.

Policy initiatives to render Canadian enterprises – and the economy as a whole – more competitive do not appear to be any better coordinated with provincial governments than in the past. At the same time,

Figure 8.4. Federal Expenditure on Research and Scholarship Grants, 1972–2018



Source: Statistics Canada Table: 36-10-0477-01, "Revenue, Expenditure and Budgetary Balance - General Governments." Inflation adjusted, 2018 Canadian dollars.

they produce less overt conflict between Ottawa and the provinces (Haddow, 2008: 231). There are, nonetheless, examples of intergovernmental co-operation and collaboration in quest of adjusting and protecting Canadian industries from the ups and downs of the global economy. Housing, transportation and infrastructure, labour market training, and, especially, agriculture are all examples. In agriculture, governments at both orders have worked together since the early 1990s to design cost-shared programs to help Canadian farmers manage their income and business risks (Skogstad, 2008: chap. 3). The formula they have struck on in this area of concurrent jurisdiction entails an overarching multilateral framework that defines a set of shared goals and programs for all provinces. It is accompanied by bilateral agreements specific to individual provinces and territories under which the latter have flexibility to design and implement programs tailored to the distinct needs and goals of their local agri-food sectors (Schertzer, McDougall, and Skogstad, 2018). Yet another example of intergovernmental co-operation was the coordinated response of the governments of Canada, Ontario, and Quebec to bail out the two auto manufacturers, Chrysler and GM, during the 2008 economic recession (Constantelos, 2014).

The auto bailout is a potent reminder of how the federal government's exercise of its fiscal powers continues to be important to regional economic development. Its exercise of its exclusive regulatory powers also remains significant to regional development. In 2010, the Harper government indicated to BHP Billiton that it would back the Saskatchewan government's opposition to its hostile bid to acquire the Potash Corporation of Saskatchewan. BHP Billiton subsequently withdrew its bid. Besides its exclusive powers to regulate foreign investment, the government of Canada also affects the economic development of provinces by virtue of its management of the Canadian–American relationship, including on trade issues (see chapter 9), and, as discussed further below, by virtue of its legal authority to approve (or not) oil and gas pipelines that cross provincial or national borders.

As mentioned above, provincial governments continue to be fully engaged in industrial policy on behalf of local industries. Resource-dependent provinces like Alberta use the full array of their policy instruments – advantageous tax, royalty, and regulatory regimes – to support their oil and gas sector (Urquhart, 2018). Yet, provinces' economic building goals, too, face the legal and political constraints of federalism – as Alberta's efforts to export its bitumen (from the oil sands) to extra-provincial markets and consumers illustrate. The proposed Northern Gateway pipeline project to ship Alberta bitumen out of Kitimat, British Columbia, was first approved by the Harper Conservative federal government in 2014 only to be rejected by the Justin Trudeau Liberal government in 2015. The minority BC NDP government of Premier John Horgan (2017–), reliant on the support of the Green Party for its legislative proposals, has opposed the twinning of the Trans Mountain pipeline. A proposed Energy East pipeline to transport diluted bitumen from Alberta and Saskatchewan to refineries and ports in New Brunswick was abandoned by TransCanada.[6] By early 2020, the Federal Court of Canada had given its approval to the Trans Mountain pipeline, purchased by the Government of Canada in 2018 in an effort to salvage the project. Still, Indigenous peoples' opposition to the pipeline continued to raise questions about the pipeline's timely completion.

SUMMARY AND DISCUSSION

A wide range of government policies affect the performance of the Canadian economy. It is, accordingly, important to refer to other chapters of this book to arrive at a full judgment of how federalism has affected the performance, effectiveness, and legitimacy of the Canadian economic union. The focus of this chapter has been narrower: an examination of how federal governments, and to some extent provincial governments, have exercised their jurisdictional powers to further national and regional economic development goals. As the overview has revealed, Canadian governments have not been averse historically to producing goods and services themselves, via state/public enterprises or Crown corporations. However, for the most part, governments have been loath to interfere with the autonomy of individual firms; accordingly, their economic development policies have been geared to supporting private economic actors, including by assisting them to adjust to changes in the external political economy (Atkinson and Coleman, 1989).

How have Canadian governments fared against the benchmarks used in this text to measure performance? Have federal principles been upheld in the sense that jurisdictional powers of governments are respected? The answer to this question is "yes"; governments have been able to exercise their constitutional authority with respect to economic development free of unilateral action by the other order of government. Are federal institutions – formal and informal – present and working in the sense of providing forums "conducive to negotiation, consultation, or simply an exchange of information" (Dupré, 1985)? Here the answer is "no." Provinces have lacked an intrastate forum within which to articulate their interests inside the government of Canada. Although provinces were initially willing to allow the federal government to take the lead in establishing nation-wide policies, once they intervened more actively to promote the development of their local economies, the need arose for coordination of government actions. Provinces have created regional, as well as multilateral, forums (the Annual Premiers Council succeeded by the Council of the Federation) within which to address cross-provincial boundary issues. However, their effectiveness appears to be limited to producing voluntary, non-binding agreements (Simmons, 2017).[7] Intergovernmental forums that bring federal, provincial, and territorial governments together to coordinate economic development and adjustment policies have been lacking. The result is that provinces and the federal government have largely acted in an uncoordinated fashion, with little accountability to one another.

As Norrie, Simeon, and Krasnick (1986: 295) observe, "there is a fundamental tension with federalism that will underlie all specific efforts at policy harmonization." The reason is that federal systems are created to enable their constituent units to exercise jurisdiction over the policy spheres important to preserving the very diversity that ruled out a unitary form of government in the first place. **Policy harmonization** through coordinated action is perceived as necessary, though, when constituent units' jurisdiction extends beyond policy spheres in which diversity is valued over uniformity. Even when harmonization is perceived to be desirable, the challenge remains of balancing the gains (in efficiency, effectiveness) from coordination with sensitivity to regional/provincial concerns. When provincial economic structures vary considerably, as they do in Canada, common economic policies will also have differential regional effects, with some provinces perceiving gains from them and others, losses (Norrie, Simeon, and Krasnick, 1986). The need to balance unity and diversity goals in economic adjustment policies leads Haddow (2008) to argue for the constitutional status quo: that is, neither centralizing policies controlled by Ottawa nor devolution to provinces, insofar as the latter would serve only the interests of larger and more affluent provinces but not smaller and poorer provinces.

How have Canada's federal institutions fared when it comes to the effectiveness of their public policies and programs? That is, are substantive problems being dealt with? And are policies efficient in marshalling resources, allowing for asymmetry as warranted, and enabling international commitments to be met? There is no single answer to the effectiveness question. Some point to evidence of a well-functioning Canadian economy, citing, for example, the fact that Canada's financial institutions proved robust during the 2007–8 Great Recession and that Canada enjoys one of the highest standards of living in the world. The latter can obviously be attributed not just to domestic policies but to liberalizing trade agreements pursued by Canadian governments (see chapter 9). Trade agreements, particularly **NAFTA**, have integrated a diverse range of Canadian producers and products into regional supply chains, even while they have not made us exceptionally dependent, by comparative standards, on a single (US, in the case of Canada) market (Beaulieu and Song, 2015).

In contrast to such macro-level indicators of economic performance, others emphasize the economic costs and inefficiencies that result from barriers to the interprovincial movement of goods, services, capital, and labour (Standing Senate Committee on Banking, Trade and Commerce, 2016; Canadian Chamber of Commerce, 2018). The federal government is responsible for some of these barriers, as the Macdonald Royal Commission (1985) observed, citing the federal government's regional development agencies, its regionally tailored unemployment insurance programs (see chapter 11 in this text), and supply management as examples of federal barriers to the common economic union. Several barriers are the result, however, of provinces' active use of their jurisdictional powers to promote local industries and residents. As early as 1980, a position paper by the government of Canada highlighted the economic costs of provincial procurement policies that gave preference to provincially produced goods and services, local hiring restrictions and professional licensing requirements that differed across provinces and so impeded labour mobility, and provincial restrictions on out-of-province investment and takeover bids that impeded the free movement of capital across provinces (Canada, 1980).

Recent estimates of the economic costs of these barriers differ. Critics say unharmonized regulatory policies cost industry as much as $50 billion annually (Standing Senate Committee on Banking, Trade and Commerce, 2016; Canadian Chamber of Commerce, 2018). Others argue the figure is much lower, and, moreover, that it is entirely appropriate in a federal system for provinces to vary in their approaches to such things as environmental protection, regional economic development, public services, and consumer protection (Sinclair, 2017).[8] Canada's bilingual character and the dominance of the French language in Quebec also explain and justify the persistence of internal trade barriers in Canada relative to Australia, another federal system (Smith and Mann, 2015).

Efforts of provincial, territorial, and federal governments to co-operate to reduce and eliminate barriers to the free movement of goods, persons, services, and investment date back to the voluntary 1995 Agreement on Internal Trade (AIT). In 2016, the four western Canadian provinces bound themselves to reducing non-tariff (regulatory) barriers in the New West Partnership (Kukucha, 2015). Nonetheless, by 2015 Canada had made significantly less progress in eliminating internal trade barriers over three decades than had Australia (Smith and Mann, 2015). The most recent display of the willingness of governments at the two orders to remove and/or reconcile policies that currently discriminate in their treatment of workers, goods, services, and investment is the Canadian Free Trade Agreement (CFTA). It replaced the AIT when it entered into force in July 2017. Under the CFTA, governments agree to not provide more favourable treatment to goods, services, investments, and workers from their own province or territory than is accorded to other Canadian jurisdictions (Canadian Free Trade Agreement, 2018). The CFTA nonetheless lists a total of 144 specific exemptions, including in energy sectors, natural resource development, and trade in alcoholic beverages.[9]

The CFTA comes in the wake of Canada's entering into a Comprehensive Economic and Trade Agreement with the European Union. Some of its provisions, including the access of EU firms to public (government) procurement of goods and services, fall into provincial areas of jurisdiction. The international trade agreement has thus increased the incentives for Canadian governments to remove and/or harmonize remaining impediments to interprovincial movement of goods, labour, capital, and services. To the extent such policy harmonization occurs, intergovernmental tensions within the Canadian economic union can be expected to be reduced, albeit not eliminated entirely.

Finally, how do different Canadians evaluate the legitimacy of the governing arrangements for the economic union and the outcomes they produce? Evaluations of legitimacy revolve overwhelmingly around perceptions of the fairness of federal economic development policies. Even while "a credible grand 'balance sheet'" of the range of federal economic policies may defy systematic analysis (Norrie, Simeon, and Krasnick, 1986: 323), there can be little doubt that perceptions of unfairness and regional discrimination, particularly in western Canada, surround federal economic development policies.

Whether these perceptions pose a threat to the Canadian economic union itself is unclear. An online survey conducted in December 2018–January 2019 of 5,732 Canadians found that a strong majority of Canadians (nine in ten) agree that workers in Canada should have the right to move to another province or territory, while only three in ten say their province or territorial government should be allowed to favour local businesses by preventing businesses from elsewhere in Canada selling their products in their province or territory (Environics Institute for Survey Research, 2019). More than half, as well, want their provincial or territorial government to try to find a balance between its economic interest and that of other parts of Canada even if it means compromising on some of the policies that might be best for them.

However, Albertans are an outlier in terms of these sentiments. Fully 45 per cent of them believe the province should put the provincial interest first even if it weakens the economies of other parts of Canada. Moreover, Alberta is the only province in which a majority (55 per cent) favours each province/territory making its own policy (Environics Institute for Survey Research, 2019). The extent to which Albertans share these sentiments is likely heightened by the economic distress experienced by many residents of the province in the wake of the global downturn in oil prices after 2014, and their frustration with obstacles to approval for pipelines to transport the province's bitumen through other provinces and to tidewater. However, the Alberta sentiments undoubtedly also reflect an enduring perception that the province has been chronically unfairly treated by federal governments dependent upon vote-rich central Canada.

If the government of Canada has had difficulty – as it has – in devising policies that do not appear to discriminate against one or more regions of the country, does that mean there should be no federal role in regional economic development? The answer to this question must be "no." Ottawa abdicating a role in regional economic development would not serve the needs of the smaller and less wealthy provinces and regions of the country, whose firms and citizens often need assistance beyond what their provincial governments can afford when it comes to adjusting to technological and other challenges that affect their competitiveness. At the same time, however, given their expertise regarding the functioning of their local economies, it is important for provincial governments to maintain a role in regional economic development. As such, further collaboration of governments at the two orders is desirable.

NOTES

1 These provincially incorporated financial institutions do not need to maintain reserves (money on hand) with the Bank of Canada, to which

the government of Canada has delegated the right to adjust interest rates. Accordingly, the Bank of Canada's authority over monetary policy, which depends upon its ability to affect lending practices by changing reserves, is weakened when these near banks comprise more than a small share of total banking (Norrie, Simeon, and Krasnick, 1986: 303).

2 *Manitoba (A.G.) v. Manitoba Egg and Poultry Association* (the Manitoba Egg Reference) [1971] S.C.R. 689.

3 Blais (1986: 4) defines industrial policy as "the set of selective measures adopted by the state to alter industry organization."

4 It affirmed exclusive provincial jurisdiction over exploration for non-renewable natural resources and over the development, conservation, and management of all resources, including electric power. Section 92(A) also gave the provinces concurrent power over trade in natural resources, subject to federal paramountcy, and the right to levy indirect taxes on non-renewable natural resources and electricity.

5 Although the Superclusters program has attracted more attention than any other, the Strategic Innovation Fund receives the plurality of program dollars paid out by the Ministry of Innovation, Science and Economic Development. Major investments involve industrial research and development in food processing and health diagnostic technology.

6 While TransCanada cited economic reasons, political opposition to the pipeline, including from the premier of Quebec, explains why the government of Canada did not attempt to rescue the pipeline as it did by purchasing Trans Mountain.

7 An exception is the role the Council of the Federation played in securing agreement among provinces to engage with the government of Canada in the negotiation of a free trade agreement with the European Union.

8 Sinclair (2017) states that most empirical studies find the costs of internal trade barriers range from 0.05 per cent to 0.10 per cent of GDP.

9 Examples of items on which governments agree to work towards reconciliation/harmonization can be found at https://www.cfta-alec.ca/wp-content/uploads/2019/06/RCT-2019-2020-Workplan-List-of-Measures-Final-May-29-2019.pdf.

GLOSSARY

Crown corporation An enterprise wholly owned by a federal or provincial government. The extent to which Crown corporations operate independently of government oversight is laid out in the legislation that establishes them.

global supply chains Also called value chains, they are the network of firms involved in producing a good or service through to the consumer. Goods produced in global supply chains have inputs from firms located in different countries.

interprovincial economic barriers Also called interprovincial trade barriers, they are any policies that have the effect of impeding the free flow of goods, services, labour, and money across provinces.

Keynesianism The theory that governments should maintain demand for goods and maintain employment by using their monetary and fiscal policies.

knowledge-based economy Emphasizes the importance of scientific knowledge, research, and information/computer-based technologies as a source of economic competitiveness through innovation.

liberalization Changes that move towards a market economy by relying more on prices to clear markets, and reducing government policies that control the economic activities of private firms.

market economy An economy in which most economic decisions are taken by the use of markets, rather than, as in a planned economy, by governments. In a market economy, private firms compete freely (with minimal government restrictions) and prices for goods and services are determined by supply and demand.

monetarist economic theory An economic theory that states that the supply of money in an economy is the main determinant of economic performance. Accordingly, lowering interest rates is considered the appropriate means of stimulating the economy, while raising interest rates is considered the appropriate means of combating inflation.

NAFTA Under the North American Free Trade Agreement (1994–), Canada, the United States, and Mexico agreed to the progressive reduction of most barriers to trade and investment between their countries.

National Energy Program (NEP) The initiative by Liberal Prime Minister Pierre Trudeau to secure a larger share of federal revenues from the oil sector, increase Canadian ownership of the oil industry, and reduce Canadian dependence on imported foreign oil through greater Canadian self-sufficiency. It embittered relations between the government of Canada and the western oil-producing provinces, especially Alberta.

National Policy Refers to the government of Canada's effort to construct a nation-wide economy through the use of tariffs on imported goods, the construction of an interprovincial railway, and attracting immigrants to populate western Canada.

policy harmonization Refers to rendering the policies of different jurisdictions more similar. Harmonization can occur with respect to policy objectives or specific rules and regulations prescribing how activities are to be carried out.

protectionism The belief that restricting international trade is desirable in order to reach goals such as preventing unemployment, promoting particular kinds of industrial development, affecting the distribution of incomes within a country, and/or improving a country's terms of trade.

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