CHAPTER II

THE FIRST THIRTY YEARS

1. THE ECONOMIC AND CONSTITUTIONAL BACKGROUND

The enactment of the British North America Act did not of itself assure that balance between national loyalties and interests and provincial loyalties and interests which an effective federal system requires. The Act merely provided a framework within which such a balance might be established. During the first thirty years, Canada had to search for an equilibrium between these two sets of forces. In the early part of the period, the internal and external influences which brought about Confederation continued to operate and their momentum carried the nation-builders through to the main objectives of the union. The Dominion Government vigorously attempted to bring into being the centralized federalism which it recognized as the intention of the Fathers of Confederation. In the later part of the period, provincial loyalties arose in the new provinces and reasserted themselves in the old. Provincial governments contested the dominance of the Dominion and won a signal victory for "provincial rights". The optimism and buoyancy of the first years fixed men's eyes on the broader horizons. In the continued depression of the later years, the visions faded and Canadians were compelled, in the urgent need for adjustment, to turn to the older and more obvious realities of provincial and local community life. In the tug of these forces, the relative strength of national and provincial sentiment gradually became clear and the working principles of Confederation began to emerge.

Rounding Out the Union—Dominion's aggressive program to build a transcontinental economy; all-Canadian transportation and western settlement

The Fathers of Confederation were the agents of the unifying forces. It was they who had the visions of expansion and they who took the helm of government in 1867. As federal cabinet ministers and lieutenant-governors of provinces, they pressed on without serious challenge to round out the union. The attitude of the United States was still aggressive and no settlement of its serious differences with Great Britain had been reached. In the face of these alarming circumstances, the Dominion Government was forced prematurely into the race for the West. In 1870, the lands of the Hudson's Bay Company were acquired and the new Province of Manitoba was created. The burden of debt in British Columbia was, by this time, more oppressive than ever and the final collapse of the gold boom made it difficult to hope for or to justify the continued separate existence of the colony. Thus the promise of a railway easily brought British Columbia into Confederation and the Dominion from sea to sea became a reality in 1871.

In the meantime, Prince Edward Island had succumbed to the lure of railway building. In 1863, the public debt of the Province had been little over $250,000. Ten years later, the total provincial liabilities including the commitments for the construction of the Prince Edward Island Railway were more than $4 million. This was a paralyzing load and the island province which had resisted persuasion in 1866 now accepted the promise of salvation through the remission of debts and entered the Dominion in 1873.

Economic conditions were favourable to the completion of these political objectives. The new Dominion was launched on a rising tide of world prosperity and the assumption of the debts of the new provinces was no excessive burden to the federal treasury. In Great Britain, economic activity was stimulated by easy money and a booming foreign trade; in the United States, by tremendous railway expansion and post-war reconstruction. Between 1868 and 1874 Canadian exports to Great Britain were doubled and, with growing demand and higher prices, a 30 per cent increase in exports flowed into the United States over the trade barriers which had replaced the Reciprocity Treaty. Larger markets for lumber benefited New Brunswick and the Ottawa Valley. Nova Scotia greatly increased its exports of fish and recovered its markets for coal in the United States. Shipbuilding in the Maritimes approached, in 1874, the high peak attained during the Civil War. Agriculture, the most important industry in Ontario and Quebec, nearly doubled its exports in this period.
In this atmosphere of general expansion and prosperity, the Federal Government undertook without hesitation the territorial rounding out of the Dominion, and the transportation developments which were to promote trade between the separate regions. The Intercolonial was built and the canal system of the St. Lawrence was deepened. Expenditures on public buildings, harbours and wharves were greatly increased. With the entrance of British Columbia into the Union in 1871, the building of the Pacific railway became a definite commitment and by 1873 the Dominion had pledged generous assistance to Sir Hugh Allan and his associates in building the railway over an all-Canadian route.

The decision to build the railway entirely through Canadian territory was of fundamental significance. Before Confederation, the colonies had been faced with two broad alternatives. One was to be drawn into the economic orbit, and probably also into the political system, of the United States. This would have led to integration, in each area according to its particular characteristics, with the common neighbour. The economic development of each region would have been determined by the relationships it managed to establish with the country to the south. On the eve of Confederation, it seemed that the price of such relationships would not be less than political assimilation. This consideration turned the colonies to the other alternative which was to ensure political independence through a union of their own and to seek strength and prosperity by a national economic integration based on an expanding inter-regional trade. The pull to the south was strong. The establishment of an east-west integration would require bold and far-sighted policies of national development.

The first of these policies was to provide east-west channels of trade independent of the United States by building a transcontinental railway wholly over Canadian territory. Such a railway would open the undeveloped lands of the West for settlement and fix the political and economic destiny of the area. But the construction of such a line over empty distances and forbidding mountains could not be undertaken without extensive public assistance. This fact pointed to the second policy which was indeed an essential complement of the first. The public lands of the Northwest were to be used by the Dominion to promote railway expansion and rapid settlement. Land grants would provide the greater part of the public assistance required by the railways. The railways, in turn, would make the lands valuable and a free homestead system would attract a rush of settlers. The decisions to build an all-Canadian railway and to establish a vigorous Dominion land policy were basic national decisions which, together with the adoption of the protective tariff which was soon to follow, fixed the pattern of subsequent economic development in the Dominion.

The technique of combining railway construction and settlement had already been devised and demonstrated in the United States where Canadians had observed the results with envy. Its main features were railway land grants and the free homestead system. The Dominion assured the application of these to the Canadian frontier by the Manitoba Act of 1870. This statute withheld the public lands from the control of the Province and provided that all "ungranted or waste lands" in the entire Northwest should be "administered by the Government of Canada for the purposes of the Dominion". These purposes were made manifest by the free homestead provisions of the Dominion Lands Act of 1872 and the grant of 50 million acres of western lands to the Pacific railway syndicate in 1873.

By 1873, in the short space of six years, the framework of the new transcontinental economic and political system had been erected. The continued rapid expansion of the United States had given the enterprise an urgency it might otherwise have lacked. The "race to the Pacific" had been won and the vital railway and settlement policies had been launched. These were ambitious policies for a small and scattered people but the nation-builders were undeterred by such reflections. "We must not be dribblers in this matter", said the Minister of Finance in 1869. "The opening up of that territory [the Northwest] must be accomplished in a large and comprehensive way."¹ The charge of dribbling could scarcely be laid against them. In six years the Federal Government had committed itself to capital expenditures of almost $100 million,² as compared with the total debt of $93 million accumulated by all the colonies in their century of existence before Confederation. But the Government was confident of the ability of the country to carry this burden with ease once the magic of its policies began to work.³

1. Budget Speech, May 7, 1869, p. 34.
2. $30 million for the Canadian Pacific Railway, $144 million more for the Intercolonial and Maritime railways, almost $44 million for canals and $8 million for miscellaneous works.
3. Budget Speech, April 1, 1873.
possible. Between 1868 and 1874, Dominion revenues nearly doubled, most of the increase coming from customs duties. This buoyant financial condition enabled the new Federal Government to consolidate the union and assume the dominant and aggressive role which the Fathers of Confederation had assigned to it. The greatness of its enterprises caught the imagination and evoked the beginning of a national consciousness.

The Dominion’s Paternalism toward the Provinces—its claim to dominance

The Dominion Government not only asserted its leadership in economic development; in its attitude toward the provinces, there was much of the old paternalism which had marked the actions of the Imperial Government in colonial days. It maintained that the Lieutenant-Governor was a Dominion officer whose duty it was to reserve bills according to instructions from the Governor General in Council. In 1868 Sir John A. Macdonald, as Minister of Justice, declared that the Federal Government would be called upon to consider the propriety of allowance or disallowance of provincial enactments much more frequently than the Imperial Government had done in the recent past.

In accordance with this policy, 51 bills were reserved and 65 acts disallowed in the first thirty years and, of these, 39 were reserved and 29 disallowed in the first ten years of assertive Dominion leadership. The federal authority proposed to refuse assent on reserved bills and to disallow legislation on several grounds. Thus, it claimed the substantially judicial function of deciding whether provincial legislation was ultra vires. It stood ready to invalidate provincial enactments which it thought unjust or contrary to sound principles of legislation. It was prepared to veto legislation which, according to its view, conflicted with imperial treaties or policies, or with Dominion interests and policy.

It was quite in harmony with this theory of its superior position that the Dominion maintained its sole right to supplement the original financial arrangements of 1867 or to fix the terms of admission of new provinces. In 1869, the Dominion Parliament itself increased the subsidies to Nova Scotia. A protest by the Ontario Legislature to the Imperial Government against this unilateral action of the Dominion was of no avail, drawing from the Colonial Secretary a reply that the Dominion Parliament had power to make such adjustments. In 1870 and 1871, Parliament, of its own motion, gave Manitoba and British Columbia a larger representation in its councils than the principle of population would have warranted. Arguments that these modifications were contrary to the constitution and required the consent of the provinces were brushed aside and the request for imperial legislation to validate the large scheme of the Manitoba Act of 1870 was made, in accordance with the proposal of the Opposition, by joint address of both Houses of Parliament without consulting the provinces.

However, the forces which made this Dominion leadership and predominance possible waned rapidly after 1870. In that year, the Red River Rebellion ended and the last Fenian Raid failed. In 1871, with the entrance of British Columbia, the Dominion tightened its hold on the West. The outstanding disputes between the United States and Great Britain were settled by the Washington Treaty in the same year and the Republic accepted, by implication, the accomplished fact of a transcontinental Dominion. It is significant that the departure of the last imperial troops from Quebec in 1871 did not bring any sudden and vigorous measures for Canadian defence by the Dominion Government. The Dominion was not compelled, after all, to battle for its existence. The political and military purposes which had helped to justify its creation slipped from the minds of a pacific and unapprehensive people.

The Great Depression—check to the Dominion’s aggressive program of development and the adoption of the National Policy of protective tariffs.

At the end of 1873, the boom broke and was followed by world-wide depression. In the United States, it involved a sharp contraction in railway and building construction; in Great Britain, a severe contraction of credit and a steep decline in foreign trade. The fall in prices and international lending brought an abrupt check to economic expansion in new countries. In Canada, the first effect of this general depression was a decline in the demand for lumber. Between 1873 and 1879,
exports of forest products fell by one-half. The prices of manufactured goods fell more rapidly than those of agricultural products but by 1876 the country was generally enveloped in depression which grew slowly worse until 1879. In the latter year, both the price level and the physical volume of exports had fallen by 20 per cent from the peak of 1873.

The depression was rapidly translated into falling public revenues while the public debt continued to mount. The Federal Government was driven to serious reconsideration of the extensive projects which had been launched in the preceding prosperous period. Boundless optimism was succeeded by unrelieved gloom. The Government had reaped but little reward for its huge expenditures and it could see no hope of generous returns for years to come. Alarmed at the mounting burden of debt, the Federal Government retreated from its aggressive program of development. The Intercolonial, the Prince Edward Island railway and the canal improvements were carried to completion. But no new projects were undertaken and, following the Pacific scandals, the agreement for the construction of the Pacific railway was dropped. The new government of Alexander Mackenzie announced a policy of building the railway as a public work but only as the resources of the country would permit.

The Great Depression, which continued almost unrelieved for over twenty years, had serious consequences for the entire country. As time went on, the national policies of the Dominion,9 which were to have brought abounding prosperity through western expansion and settlement, were discredited by failure. The men, money and markets, necessary for the successful operation of the expensive national machinery, failed to materialize. The great community equipment lay almost unused, an oppressive burden on the country.

As the depression continued, the old agitation for a policy of protection to domestic industries gathered increasing force and acquired a wider appeal. The tariff policy during the first twelve years was primarily designed for revenue purposes. There was much resentment and dissatisfaction over Confederation in the Maritimes. Among other things, the Maritimes feared an upward revision of tariffs and the Federal Government was anxious to conciliate them by removing any ground for such fears. Furthermore, the Dominion was anxious not to provoke tariff retaliation by the United States with which Canada enjoyed a growing trade in this period.10

Thus the early Canadian tariff structure retained the main features, though not the exact rates, of the pre-Confederation tariffs in the provinces. Luxuries paid high rates, the great bulk of finished manufactures paid 15 per cent, raw materials and most semi-finished goods entered free. The only general change in the tariff before 1879 occurred in 1874 when the 15 per cent schedule was raised to 17½ per cent in an effort to maintain revenues in the face of falling imports.

The main object of policy through the period was to get a renewal of the Reciprocity Treaty with the United States. However, the persistent advances to Washington were of no avail. The Washington Treaty of 1871 did not include a renewal of reciprocal trade relationships and the treaty which George Brown negotiated in 1874 was not ratified by the United States Senate. The Washington Treaty gave the Americans free access to Canadian Atlantic fisheries, free navigation of the St. Lawrence and the use of the canals on equal terms. Canada had hoped to bargain for reciprocity with these privileges but the British Government used them to advance the general interests of the Empire. All efforts to secure closer trade relations with the United States failed and the rebuffs aroused in Canada a desire for retaliation.

“Reciprocity of trade or reciprocity of tariffs” became the slogan. There was still no doubt, however, that the former alternative was preferable. American industry had not yet grown up to the protective tariff. It had not yet achieved the special advantage of mass production, and it was handicapped by the high cost of iron and steel and by the inflated wage levels inherited from the Civil War. Canadian manufacturers were agreed that they could compete successfully with the United States producers on the basis of a North American market.11 If, however, they were to be denied this wider market, they insisted that they could not share the limited market at home. If Canadian industry could not develop in relation to an industrial integration of North America, then conditions must be created to enable it to develop in relation to the opportunities of an economic integration of Canada.

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9 The expression “national policies” as used throughout this Report refers to federal economic policies such as western settlement, all-Canadian transportation and protective tariffs. In the capitalized singular form, the “National Policy” refers solely to the policy of protection adopted in 1879.

10 This policy was announced in 1868 by the Minister of Finance in his speech on the Budget.

11 See Canada, Journal House of Commons, (1878), Appendix (3).
The price decline which began in 1873 was much more pronounced in manufactured goods than in raw materials. Between 1873 and 1879 the price level of Canadian imports (mostly manufactures) dropped 26 per cent while the price level of exports fell by 8 per cent. This, together with the loss of natural shelter resulting from the decrease in transportation costs, bore heavily upon domestic industry and commerce. Declining inventory values inflicted heavy losses upon the distributive trades. The pressure of falling prices and increasing competition led to a general outcry against what was called the "slaughtering of goods" by the United States and Great Britain. Higher tariffs were urged to maintain the balance between imports and the local manufactures. And, of course, there was a more general demand for a protective policy as the panacea for depression.

The high hopes for rapid development of the country and for the commercial and industrial benefits expected to flow from such development were frustrated. While the previous Federal Government had been aggressive in the work of development, the new Ministry was now timid and out of sympathy with the program. In the face of this apparent failure and hesitation, the policy of industrialization by means of the protective tariff was offered as the way out of stagnation, and as a new basis for economic expansion. Under existing conditions, this proposal had a wide popular appeal.

After Confederation, attempts were made to foster a Canadian national spirit, and industrialization by high tariffs was vigorously advocated as an important step in this direction. This particular aspect of the policy was expressed by the Minister of Finance when he submitted the new tariffs to Parliament in 1879. He insisted that "the time has arrived when we are to decide whether we will simply be hewers of wood and drawers of water; . . . The time has certainly arrived when we must consider whether we will allow matters to remain as they are, with the result of being an unimportant and uninteresting portion of Her Majesty's Dominions, or will rise to the position, which I believe Providence has destined us to occupy . . ."12 The policy which was to transform the economy and make a great nation was impressively labelled "The National Policy".

These various factors combined to bring about a vigorous policy of tariff protection in 1879. The upward revisions of the tariff were comprehensive and were designed particularly to promote domestic production where imports were large. "We have endeavoured to meet every possible interest . . ." said the Finance Minister. In general, if luxuries be excluded, the highest duties were imposed on finished consumers' goods of widespread consumption, the rates being in the neighbourhood of 30 per cent. The typical rate on fully manufactured industrial equipment and machinery was 25 per cent. Semi-finished goods and industrial materials paid from 10 to 20 per cent. The fact that many of the duties, particularly the most protective, were specific rather than ad valorem reflected the recent experience with falling prices.

Textiles, which made up nearly 30 per cent of total imports and in which domestic manufacturing, with the exception of coarse woollens, had made virtually no progress, were specially singled out for a substantial measure of protection.13 The added protection given to iron and steel and their products, the domestic production of which was appreciable only in the case of farm implements and the sheltered Items (foundry products, certain rolled products and heavy machinery) was confined chiefly to the finished and highly fabricated articles.14 In the case of primary iron and steel, where imports were heavy, the duties imposed were small.15 Important items such as furniture, manufactures of glass, chinaware and boots and shoes were given considerable increases in duties.16 While the bulk of miscellaneous manufactures paid 20 per cent there were many cases of rates equivalent to 30 per cent or over.

The increases in tariffs were also extended to agricultural products but in this case were largely ineffective, because, in most items, the country was on an export basis. A duty of 50 cents per ton was placed on coal and coke to enable Nova Scotia coal to reach the markets of Central Canada which were then being supplied entirely from the United States.

It is clear from this brief analysis that the National Policy tariff of 1879 would be a powerful

12 Cotton was given protection at all stages of manufacture with duties ranging from 20 per cent on yarns to 34 per cent on piece goods. The tariff on woollens ranged from 29 per cent on yarns to 34 per cent ready-made clothing. Silk piece goods and clothing paid 30 per cent.
13 Carriages, wagons and railway cars, as well as miscellaneous hardware and tools paid 30 per cent. A rate of 23 per cent was imposed on machinery, farm implements, boilers, tanks and engines, locomotive engines, bridge and structural steel, stoves and castings of all kinds. The duties on equipment and semi-finished articles such as chains, wire, galvanized sheet iron, tin plate and tubing ran from 10 per cent to 20 per cent.
14 Pig iron paid 12 ¹/₂ per cent, the principal rolled items (except steel rails) 17 ½ per cent, but steel ingots, rails, bars and fish plates remained free.
15 Furniture and clocks paid 35 per cent, refined petroleum 38 per cent, manufactures of glass 30 per cent, chinaware 25 per cent, woodeware 25 per cent, boots and shoes 25 per cent.
instrument for promoting domestic production in a wide range of articles and for diverting trade from international into interprovincial channels. With the extension of the protective principle to primary iron and steel by the introduction of bounties in 1883 and higher duties in 1887, the application of the policy was complete. The protective system thus established during 1879-87, although modified and refined, and from time to time changed in its emphasis, has never since been basically altered. It was a drastic change in the conditions under which the economies of the British North American colonies had grown up, and subsequently was a major factor affecting the development and structure of the transcontinental economy which Confederation had created. It became, in truth, a national policy.

Stagnation—unfavourable external influences and the disappointing results of the national economic policies

During the years 1867-79, the three basic national economic policies were adopted. By settlement of the Northwest, transcontinental transportation through all-Canadian territory and industrialization by protective tariffs, the Federal Government planned to bring about economic expansion and complete the unification of the country. Because of the dependence upon exports, foreign capital and immigration, they could become effective only if stimuli came from abroad. For over two decades, however, the external factors were unfavourable. The collapse of the boom in 1873 brought on the Great Depression which continued for twenty-three years. A persistent decline in prices, a sharp shrinkage in international lending and a low level of investment caused general economic stagnation. The Canadian economy, strongly affected by these influences, virtually stood still, although there were many internal shifts and changes.

### Table 8.—Canadian Price Indices, 1871-96

<table>
<thead>
<tr>
<th>Year</th>
<th>Wholesale Prices of 70 Commodities (a)</th>
<th>Export (a)</th>
<th>Import (a)</th>
<th>Grains and Flour (a)</th>
<th>Animals and Meats (a)</th>
<th>Iron (d)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1871-73</td>
<td>100</td>
<td>100</td>
<td>100(d)</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>1885</td>
<td>79</td>
<td>91</td>
<td>73</td>
<td>93</td>
<td>90</td>
<td>61</td>
</tr>
<tr>
<td>1891-93</td>
<td>78</td>
<td>97</td>
<td>69</td>
<td>83</td>
<td>94</td>
<td>83</td>
</tr>
<tr>
<td>1896</td>
<td>65</td>
<td>86</td>
<td>60</td>
<td>62</td>
<td>68</td>
<td>48</td>
</tr>
</tbody>
</table>

(a) Ibid., p. 6.
(d) 1872-75 = 100.

The price level, which fell about 35 per cent between 1871-73 and 1896, was a continuous damper upon enterprise. The relatively greater drop in the prices of manufactured goods than in those of raw materials such as lumber and agricultural products was a striking feature of the decline. Thus import prices fell more rapidly than export prices and the terms of trade became increasingly favourable. However, the stimulating effects of this factor upon the exporting groups was largely nullified by the tariff increases of 1879-87.

Domestic production in many lines could not take advantage of the new tariff overnight and thus the most immediate effect of the tariff increases was a substantial rise in Dominion customs revenue. The improvement in Dominion finances coincided with a short period of general economic revival throughout the world from 1879 to 1883. Encouraged by these favourable signs, Sir John A. Macdonald, on his return to power in 1879, took up again the project of a transcontinental railway. The half-hearted policy of building it piecemeal as a public work was discarded and in 1880 a group of capitalists agreed to undertake an all-Canadian railway to the Pacific as a private enterprise.

The Canadian Pacific Railway Company was promised substantial cash subsidies and grants of western lands. A monopoly clause in the agreement practically freed the Company from competition in the area between its line and the American border across Manitoba and the Northwest Territories. Surmounting stupendous difficulties, the railway to the Pacific was completed in 1885. During and after its construction, the Dominion tried to encourage the building of local lines in British Columbia and the Eastern Provinces by means of land grants and cash subsidies. The provinces and the municipalities also gave considerable assistance to railways in the same period. By 1896 this combined public assistance had secured the construction of some 3,300 miles of branch lines and about 1,700 miles of colonization railways.

Under these stimuli, the railway mileage of the country mounted rapidly, despite unfavourable economic conditions. By 1896, there were 16,270 miles of line (one mile per 312 persons, a proportion not much different from that of the present day). In the Maritimes, all the principal lines had been built and a fairly dense network of railways had been laid over the settled portions of Ontario and Quebec.
The changes in the composition of exports reveal some of the internal shifts in occupations that took place under the downward pressure. Lumber declined in relative importance while agriculture continued to expand. But here there was a shift from grains, which met the rising American tariffs and stiffer competition from the American West, to live stock and dairy products which, with cheaper transportation, found larger markets in Great Britain. Increasing exports of fish reflected the development of the salmon fishery in British Columbia and the lobster fishery in the Maritimes. Particularly after 1886, they also reflected the pressure of people crowding into the industry as a means of livelihood owing to the virtual disappearance of shipbuilding and shipping.

<table>
<thead>
<tr>
<th>Years ending June 30</th>
<th>Total Animals and Their Produce</th>
<th>Agricultural Products</th>
<th>Products of the Forest</th>
<th>Fish</th>
<th>Minerals</th>
<th>Manufactures and Miscellanea</th>
</tr>
</thead>
<tbody>
<tr>
<td>1863</td>
<td>48.5</td>
<td>6.9</td>
<td>12.9</td>
<td>19.8</td>
<td>18.7</td>
<td>3.4</td>
</tr>
<tr>
<td>1874</td>
<td>76.7</td>
<td>14.7</td>
<td>10.6</td>
<td>31.3</td>
<td>27.2</td>
<td>5.3</td>
</tr>
<tr>
<td>1879</td>
<td>56.4</td>
<td>14.1</td>
<td>19.6</td>
<td>33.7</td>
<td>13.3</td>
<td>7.1</td>
</tr>
<tr>
<td>1882</td>
<td>94.1</td>
<td>20.5</td>
<td>31.0</td>
<td>51.5</td>
<td>24.0</td>
<td>7.7</td>
</tr>
<tr>
<td>1886</td>
<td>77.7</td>
<td>22.1</td>
<td>17.7</td>
<td>39.8</td>
<td>21.0</td>
<td>6.0</td>
</tr>
<tr>
<td>1891</td>
<td>38.7</td>
<td>20.0</td>
<td>15.7</td>
<td>39.7</td>
<td>24.3</td>
<td>9.9</td>
</tr>
<tr>
<td>1896</td>
<td>109.7</td>
<td>30.5</td>
<td>14.1</td>
<td>50.6</td>
<td>27.2</td>
<td>11.2</td>
</tr>
</tbody>
</table>

The effect on Canada of the adverse economic conditions between 1874 and 1896 is most clearly revealed by the population figures. The principal policies and expenditures of the Federal Government were designed to fill the empty spaces with people. Yet for thirty years Canada was a land of emigration helping to people the frontier and cities of the United States.

<table>
<thead>
<tr>
<th>Year</th>
<th>Population at beginning of Decade</th>
<th>Actual Increase</th>
<th>Natural Increase (Est.)</th>
<th>Immigration (Est.)</th>
<th>Emigration (Est.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1871-81</td>
<td>3,680</td>
<td>636</td>
<td>799</td>
<td>342</td>
<td>305</td>
</tr>
<tr>
<td>1881-91</td>
<td>4,323</td>
<td>508</td>
<td>686</td>
<td>886</td>
<td>1,064</td>
</tr>
<tr>
<td>1891-1901</td>
<td>4,833</td>
<td>538</td>
<td>612</td>
<td>321</td>
<td>305</td>
</tr>
</tbody>
</table>
In each of the three decades, 1871 to 1901, as indicated by Table 10 the increase in Canadian population was less than the estimated natural increase. While slightly more than one-and-a-half million immigrants intending to settle entered Canada, almost two million people left the country. Between 1881 and 1901 over 600,000 native Canadians moved across the border and in 1891 about one-fifth of all the Canadian-born lived in the United States. So heavy was the emigration in the early nineties that the population was virtually stationary.

The disappointingly slow growth of population between 1871 and 1901 was accompanied by significant changes in its distribution. Owing to improvements in transportation and growing industrial development, Canada was losing its predominantly rural character. The urban population rose from 20 per cent of the total to 38 per cent. The towns and cities absorbed 77 per cent of the total increase in population. At the beginning of this period, Montreal and Toronto, serving the hinterland of the St. Lawrence Valley, had 5 per cent of the total population. In 1901, with a greatly extended hinterland, the proportion had risen to 10 per cent.

Regional and Provincial Discontent—the challenge to the dominance of the Dominion

A bald statement of the length of the depression gives little hint of its effect upon the lives of the people. Federal policies had burdened them with debt and failed to bring prosperity. The only large-scale remedy which the Dominion had been able to offer was the National Policy of 1879. In these circumstances, communities had to do what they could to help themselves, looking to the provinces for the help which the Dominion failed to give. The provincial governments attempted to promote expansion on their own frontiers by railway building and immigration policies. But most of them quickly discovered the strait jacket in which the financial settlement of Confederation had placed them. The agitation for better terms gathered strength and led to differences with the Dominion. The failure of the Dominion's economic policies, which formed such important elements in the new national interest, discouraged the growth of a strong, national sentiment; and local loyalties and interests began to reassert themselves.

Indeed, there had never been any large transfer of loyalty from the older communities to the new Dominion created for urgent common purposes. The achievement of Confederation and the spectacular activity of the Federal Government in the early years had merely overshadowed or, at most, temporarily subordinated the separate interests of the distinct regions and communities. From the very date of the union, there had been a widespread and burning conviction in Nova Scotia that it had been manoeuvred into a bargain prejudicial to its vital interests. In the provincial election held late in 1867 thirty-six out of thirty-eight members elected to the legislature were anti-Confederates. The new Government tried desperately to extricate the Province from the bonds of the union. Although these efforts were unavailing, the sentiment against Confederation remained strong in Nova Scotia and was significant in New Brunswick.

Confederation had not succeeded in eliminating the clash of racial and religious differences which had agitated the Province of Canada in the past. It had been hoped that the creation of two provinces, allowing free play to these cultural differences in separate spheres, would remove these antagonisms from deliberations on matters of common interest in the federal councils. When the western insurrections of 1870 and 1885 raised a racial and religious conflict in the valleys of the Red River and the Saskatchewan which disturbed the peace in the new federal territories, the opinions of the dominant groups in Ontario and Quebec clashed over the action taken by the Federal Government. Quebec's deepest feelings were outraged by the execution of Louis Riel and a wave of resentment against the Federal Government swept the Province. It became clear at once that there were federal issues in which conflicts of opinion might follow in the main provincial lines. In such circumstances, any solution was bound to create Dominion-provincial friction.

Such Dominion-provincial friction was not limited to cases of the resurgence of loyalties antedating Confederation. The problems of the Pacific railway embittered the relations of British Columbia and the Federal Government during the seventies; and in the eighties the requirements of federal railway policy brought Manitoba and the Dominion into sharp conflict. The appropriation of western lands "for the purposes of the Dominion" deprived Manitoba of its natural resources and the monopoly clause in the charter of the Canadian Pacific Railway Company prevented the Province from promoting a competitive transport system. Repeatedly the Provincial Legislature chartered railway companies to build lines to the international boundary and repeatedly the Dominion Govern-
ment disallowed them on the ground that the projected lines would divert traffic to the United States and thus conflict with the settled transport policy of the Dominion. Dominion policy was hard to reconcile with the interests of the settlers in Manitoba and the Provincial Government became the spearhead of local demands.

British Columbia was irritated by federal tariff policy and its long controversy with the Dominion over Oriental immigration began in this period. Large sections of opinion in the Maritimes were antagonized by the introduction of the National Policy in 1879. In 1886, a series of resolutions was introduced in the Legislature of Nova Scotia advocating secession on the ground that the commercial and financial interests of the Province had been vitally injured by Dominion policies. By 1887, agricultural and lumbering interests in Ontario were straining against federal tariff policy and urging commercial union with the United States. Ontario clashed with the Dominion over the location of the Ontario-Manitoba boundary and the ownership of its northern natural resources. Mowat, as Premier of Ontario, fortified the principle of "provincial rights" when he claimed and won the right of the provinces to regulate the sale of liquor within their boundaries and for years he conducted an unwearying attack on the federal power of disallowance.

These various grievances culminated in the provincial conference held at Quebec in 1887. The five provincial premiers who attended included all the leaders of provincial protest. The procedure of the provincial premiers seems to indicate that they claimed the right to examine and correct the operation of the federal system. Although their interests differed widely, they were able to agree that a considerable curtailment of federal power would be desirable. They proposed to increase the subsidies to the provinces, to abolish the federal power of disallowance, and to make the right of the Dominion to declare public works to be for the general advantage of Canada conditional on the approval of the province concerned. Lieutenant-Governors were to be acknowledged to be representatives of the Sovereign rather than of the Dominion, and each province was to nominate half of the Senators from the province in the Senate.

The conference challenged the view that Confederation was designed to set up a highly centralized and pervasively dominating government at Ottawa. In its swing to the other extreme, emphasizing the primacy of the provinces, it was no doubt employing a theory of federalism similar to the doctrine of "states' rights" in the United States. But the strength and diversity of provincial interests shown by the conference indicated that, under the conditions of the late nineteenth century, the working constitution of the Dominion must provide for a large sphere of provincial freedom.

The policies of the Federal Government were in discredit and the Government itself was embarrassed by its difficulties in the late eighties. Except for a short interval between 1874-78, the Federal Government throughout this period had been identified with Sir John A. Macdonald and his associates. Sir John's views of the nature of Confederation, so clearly stated both before and after the union, are well known. It is not known how many of the other framers of the British North America Act shared his views. But it is important that, for nearly thirty years, Macdonald and those who thought like him were the Federal Government of the new Dominion. The views which they took of the functions of the Lieutenant-Governor and the use to be made of the powers of reservation and disallowance have already been discussed. Their practice in revising the financial arrangements with the provinces and securing constitutional amendments has been noted. Their actions reveal clearly their conception of the primacy of the Dominion and the subordinate position of the provinces.

It is highly significant that the realities of the later years of the period forced a modification of this conception on the very men who held it most strongly. Their interpretation of the general interest failed to command widespread assent in the different provinces. The ineradicable, particularist interests, always associated with different regions and ways of life, demanded free expression. In face of the formidable provincial protest, the Government was forced to retreat. In 1884, the Ontario Rivers and Streams Act, already thrice disallowed by the Dominion, was re-enacted by the Provincial Legislature and the Dominion acquiesced. Later, the Dominion abandoned its policy of protecting the Canadian Pacific Railway Company from competition through the power of disallowance and finally repealed the monopoly clause itself. During the early nineties, it began the downward revision of the tariff.

Provincial Rights and the Constitution—the interpretations of the Privy Council widen the powers of the provinces.

It is a matter for speculation what would have been the ultimate issue between the Dominion
and the provinces if the conditions of the eighties had continued. The equilibrium was becoming very unstable. On the one hand, there was the conception of federal dominance which the Dominion Government tried to enforce and which was strongly supported by powers of reservation and disallowance. There were the sweeping words of the opening paragraph of section 91 which, it might be argued, gave to the Dominion those “high functions and almost sovereign powers” which at least some of the framers intended it to have. The power to tap all the really productive sources of revenue was in the hands of the Federal Government.

On the other hand, there was the patent failure of the great general projects of the Dominion to meet what the provinces deemed to be their particular interests. There was the provincial revolt, focused by the provincial conference of 1887, which significantly demanded a drastic reduction of federal powers. There were straitened provincial governments representing large bodies of opinion and demanding greater revenues.

The preamble of the British North America Act announced the formation of a federal union, but it was not clear how far this was consistent with the wide general powers conferred on the Dominion by the opening words of section 91. Dominion-provincial friction was not lessened by these seeming obscurities in the constitution. It was becoming vital to know what the constitution meant and whether it could be harmonized with the realities which had appeared. In this crucial decade, the Privy Council began to give its first important decisions on the British North America Act. By the end of the period under review, the main lines of the working constitution had emerged through these decisions. It is therefore necessary to turn to them to see how the constitution was moulded by their influence.

It would be difficult to say how far these decisions influenced the concessions made by the Federal Government. At any rate, some of the earliest of these cases bore on the nature of the provincial governments and their relation to the Dominion and to the Crown. In particular, decisions in 1883 and 1892 denied some of the main tenets of the Macdonald school. In *Hodge v. The Queen*, in 1883, their Lordships, by implication, denied that the provincial legislatures were inferior bodies. They held that, within the limits of subjects and areas as prescribed by section 92, “the local legislature is supreme and has the same authority as the Imperial Parliament or the Parliament of the Dominion, would have had under like circumstances” to confide powers to bodies of its own creation.

In *Liquidators of the Maritime Bank v. Receiver-General of New Brunswick* in 1892, it was necessary to decide how far the provincial Executive was entitled to exercise the ancient prerogatives of the Crown. In answer to the argument that the British North America Act had severed all connection between the Crown and the provinces and reduced the latter to the rank of Liverpool or Manchester, the Privy Council replied that the provinces were not subordinated to the Federal Government or depreciated to the level of municipal institutions. The supremacy of the province in its field of jurisdiction was reiterated. Their Lordships were pressed to say that, as the Lieutenant-Governor was appointed by the Dominion, he was purely a creature of the Dominion. Lord Watson denied this conclusion saying that the Governor General, in appointing, was acting for the Queen and that a “Lieutenant-Governor, when appointed, is as much the representative of Her Majesty for all purposes of provincial government as the Governor-General himself is for all purposes of Dominion government”. These decisions magnified the provinces and struck at the theory that they were merely a superior kind of municipal institution. They also raised acutely the question of how far the enactments of a legislature endowed with the same kind of supremacy as the Imperial Parliament should be subject to an unrestricted power of disallowance. These decisions, at least, made it harder for the Federal Government to maintain its positions and foreshadowed the steep decline in the use of the powers of reservation and disallowance which came in succeeding years.

A detailed review of the Privy Council decisions of this period would be out of place here. But there were several cases of historic importance in determining the lines of constitutional development which must be considered. In 1882, the Privy Council had to decide whether the Canada Temperance Act was within the powers of the Dominion. This Act forbade the sale of intoxicating liquor under penalty of fine and imprisonment in those municipalities which exercised the “local option” of applying its provisions.

Naturally, it was argued that this prohibition would interfere with property and civil rights in

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20 (1883) 9 A.C. 117, at p. 132.
the local areas where it was adopted. However, the Act recited the desirability of uniform legislation promoting temperance throughout the Dominion and the Privy Council concluded that the traffic in liquor was being dealt with as a matter of public order and safety and not in relation to the aspects of property and civil rights which were admittedly involved. They decided that general liquor legislation so conceived was exclusively within the general power of the Federal Parliament "to make laws for the peace, order and good government of Canada". General legislation, genuinely "deemed to be necessary or expedient for national safety or for political reasons" or "designed for the promotion of public order, safety or morals", was held to fall within the general power of section 91. Of course, in almost every case, such legislation would "in some incidental way, affect property and civil rights". Thus, "the true nature and character of the legislation in the particular instance under discussion must always be determined in order to ascertain the class of subjects to which it really belongs".

This decision asserted the clear primacy of the "peace, order and good government" clause over section 92 and argued the validity of all federal laws dealing with general and national aspects of any subject matter even though that subject matter, in its local aspects, might be within the enumerations of section 92. However, it left the criterion of what might be "necessary or expedient for national safety or for political reasons" and of what might be "designed for the promotion of public order, safety and morals", vague and unsettled. Such questions as these could only be determined by reference to the political, economic and social conditions of the time and to certain broad considerations bearing on the problem as to what it is proper for governments to try to do.

The decision did not explain how "the true nature and character of the legislation in the particular instance" was to be determined. There were only two alternatives. Either the existence of that urgent general or national aspect which was to justify untrammelled federal legislation under the "peace, order and good government" clause should be decided by the court before which the validity of the legislation was raised, or it would have to depend on the simple assertion of national urgency by the Federal Parliament.

In the first event, the court would be required to say whether the federal legislation in question had such a general or national aspect—in short, whether, in view of all the circumstances, the legislation might conceivably be desirable in the national interest. But this is a question which the courts always dislike to answer on the sound ground that it is not a question of law at all. The answer, if given, would inevitably depend upon the temper-ament of the judge and his personal views on public policy. Judges, like other people, differ profoundly in their views on public policy and their decisions would become essentially unpredictable. The hope of drawing a clear line between the legislative sphere of the Dominion on the one hand, and that of the provinces, on the other, would disappear. Moreover, because the principal test of the validity of provincial and Dominion legislation would be the judgment of the court on large issues of expediency and public policy, the final court of appeal would become the arbiter of public policy rather than the guardian of the constitution and, therefore, the storm-centre of Dominion-provincial disputes.

The court might escape from this invidious task by limiting itself to the question of whether the Federal Parliament had decided, in good faith, that general and national aspects were involved. Careful reading of Russell v. The Queen gives some reason for thinking that the personnel of the Privy Council in that case conceived its duty to be discharged by this limited scrutiny. In the nature of things, it would be a rare case where bad faith on the part of the Federal Parliament could be established and therefore the first alternative might, in practice, come to little more than the second, which is now to be considered.

The second alternative would be that the bare assertion by the Federal Parliament of a general or national aspect in the subject matter of the legislation would, of itself, justify the legislation under the "peace, order and good government" clause. That clause would then confer tremendous power on the Federal Parliament, giving it, as Macdonald had proposed, "the general mass of sovereign legislation". The exclusive sphere ensured to the provinces by section 92 might, if the Dominion so desired, become very small indeed. The power of the Dominion Parliament under the "peace, order and good government" clause would become so overwhelming that the federal character of the constitution would be open to grave doubt. Indeed, under these conditions, the constitution in its working, would approach the legislative union which

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24 Russell v. The Queen (1892) 7 A.C. 929, at pp. 938-40.
25 Although Russell v. The Queen is frequently cited in the courts, the general principle which it lays down has not been followed and it must be regarded as virtually over-ruled by later decisions.
26 Confederation Debates, p. 41.
some of the Fathers desired but which, as they recognized, they could not secure by agreement.

These implications of *Russell v. The Queen* must be kept in mind and related to the growing revolt of the provinces against the paternalism of the Dominion when considering the case now to be discussed. "The Local Prohibition Case," as it has come to be called, which was decided in 1896, is the most important case in the period, and one of the most significant of all interpretations of the British North America Act by the Privy Council. In it, the Privy Council upheld the validity of the Ontario Temperance Act which provided for Ontario a structure of regulation of the liquor traffic similar to that which the Canada Temperance Act provided for the Dominion as a whole.

The technique of interpretation used to reach this result need not be discussed here. It is sufficient to say that while Lord Watson held that the Dominion, relying on the enumerated heads of section 91, could validly enact legislation which affected subjects enumerated in section 92, he also declared that the Dominion, when legislating under the general "peace, order and good government" clause, "has no authority to encroach upon any class of subjects which is exclusively assigned to the provincial legislatures by s. 92". He stated that the exercise of legislative power under the general clause of section 91 must be "strictly confined to such matters as are of unquestionably Canadian interest and importance", admitting that "some matters, in their origin local and provincial, might attain such dimensions as to affect the body politic of the Dominion and to justify the Canadian Parliament in passing laws for their regulation or abolition in the interest of the Dominion". Under the authority of this decision, the general clause of section 91 has come to be regarded as justifying little more than emergency legislation in the stress of great national crises.

While not challenging the correctness of *Russell v. The Queen*, this decision struck directly at the reasoning on which it was based. It denied the primacy of the "peace, order and good government" clause of section 91 over the enumerations of section 92 and as a result Dominion jurisdiction became, for most purposes, restricted to the specific heads enumerated in section 91. In the main, interpretation of the legislative powers of the Dominion and the provinces settled down to a competition between the specific enumerated heads of sections 91 and 92. In this competition, the provinces enjoyed an advantage because section 92 contained two heads capable of a general and inclusive signification, viz., "Property and Civil Rights in the Province" and "generally all Matters of a merely local or private Nature in the Province", while section 91 contained only one such head, "the Regulation of Trade and Commerce" and, as will be pointed out below, it received a restricted interpretation. Thus the stage was set for the subsequent course of interpretation which has provoked the comment, in recent times, that the residuary powers under the constitution are now to be found in section 92.

There are some who believe that the Local Prohibition Case involved a textual violation of section 91 of the British North America Act. Logical exposition, limited to sections 91 and 92, might lead to that conclusion. But it must be remembered that, according to the preamble of that Act, what was desired by the provinces was a federal union. It has been pointed out that the decision in *Russell v. The Queen*, which, in practical effect, was over-ruled by the Local Prohibition Case, would have imperilled the federal character of the union if it had become the ruling decision. There seems to be no doubt that this consideration weighed heavily with Lord Watson. In an earlier case, he had pointed out that "the object of the Act was neither to weld the provinces into one, nor to subordinate provincial governments to a central authority, but to create a federal government... each province retaining its independence and autonomy". In justifying his construction of sections 91 and 92 in the Local Prohibition Case, he made the following significant statement:

"To attach any other construction to the general power which, in supplement of its enumerated powers, is conferred upon the Parliament of Canada by s. 91, would, in their Lordships' opinion, not only be contrary to the intendment of the Act, but would practically destroy the autonomy of the provinces. If it were once conceded that the Parliament of Canada has authority to make laws applicable to the whole Dominion, in relation to matters which in each province are substantially of local or private interest, upon the assumption that these matters also concern the peace, order, and good government of...

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34 Ibid., pp. 360-61.
36 The most cogent and complete statement of this view is to be found in the Report pursuant to Resolution of the Senate to the Honourable the Speaker, by the Parliamentary Counsel relating to the Enactment of the British North America Act, Ottawa, 1939. For criticism see V. Evan Gray, Canadian Bar Review, 17, p. 309.
38 Liquidators of the Maritime Bank v. Receiver-General of New Brunswick, [1892], A.C. 437 at pp. 441-2.
the Dominion, there is hardly a subject enumerated in s. 92 upon which it might not legislate, to the exclusion of the provincial legislatures.\textsuperscript{97} It may be that the insight which guided his decision was solely derived from a theoretical analysis of the requisites of a federal state. It may be that he was also aware of the growing provincialism, then assailing the pretensions of the Federal Government. At any rate, he perceived and stated the lines of what he regarded as a tolerable compromise between Dominion power and provincial claims in the Canada of his day. And compromise is always the essence of the federal state.

It is necessary to notice briefly a foreshadowing in this period of the limited interpretation later given to the Dominion power under head 2 of section 91, “the Regulation of Trade and Commerce”. In a case before the Privy Council in 1881, the question of the meaning to be attached to this phrase was considered. Their Lordships pointed out that the words “regulation of trade and commerce”, in their unlimited sense are sufficiently wide, if uncontrolled by the context and other parts of the Act, to include every regulation of trade . . . down to minute rules for regulating particular trades.\textsuperscript{98} By a process of textual criticism for which the enumerated heads of section 91, taken as a whole, give some warrant, they reached the conclusion that the words were not used in their unlimited sense,\textsuperscript{99} and suggested limitations which were later adopted and pushed still further by the courts. The case also made a significant contribution to the interpretation of head 13 of section 92, holding that, in the phrase “Property and Civil Rights in the Province”, the expression “civil rights” includes rights arising from contract as well as rights directly maintained by the law itself such as the status of persons.

One other case, relating to the taxing power of the provinces, requires to be considered. Section 92 gave the provinces a power of “Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes”. In 1882, the Quebec Legislature passed a statute imposing on certain commercial corporations, a tax the amount of which varied with the paid-up capital and the number of places of business. A number of corporations resisted collection of the tax and an appeal was finally taken to the Privy Council.\textsuperscript{40} Their Lordships were obliged to decide whether or not it was a direct tax.

“Direct taxation” is a phrase which lacks precise signification. From an economic point of view, it is impossible to say that any particular tax is direct in its final incidence because of the opportunities which may exist for shifting its burden. Economists would agree that a corporation tax generally is an indirect tax because of the ease of shifting it. However, the Privy Council felt bound to find a criterion for the validity of provincial taxation which would not involve the impossible task of trying to find out, in each case, whether the burden had, in fact, been shifted.

Adopting from John Stuart Mill a statement that “a direct tax is one which is demanded from the very persons who it is intended or desired should pay it”, they inferred from the legislation itself that the legislature must have intended it to be finally borne by the very corporations from whom it was demanded and held it to be “direct taxation” within the meaning of section 92. The decision was one of great significance. From the point of view of the provincial governments it made available an important and increasing source of revenue since corporate enterprise was expanding rapidly. From the point of view of the economy as a whole it was the legal basis of the growth of much of the duplication, confusion and uneconomic types of taxation which today weigh oppressively on the national income.

2. Public Finance, 1867-96

The Financial Settlement on Trial—an extremely tight fit for the Maritimes and revisions of the formula

Confederation began auspiciously for the public finance operations of the Dominion. World prosperity spurred on a large program of development. Imports rose rapidly and the taxation system, geared so sensitively to import trade,
responded in an impressive manner. Customs receipts rose from $9 million to $14 million, and excise revenues, from luxury consumption, from $3 million to $5½ million between 1867 and 1874. This increase of more than 60 per cent in taxation revenues in a short period of seven years made possible the “rounding-out” of the Confederation scheme already discussed. The Dominion Government was proving to be a magnificent financial instrument for creating the new British North America of which the Fathers had dreamed.

On the other hand, there was a wide variation in the financial condition of the provincial governments in the early years after Confederation. At first, Quebec was in a relatively easy, and Ontario in an even more comfortable position, while New Brunswick, and particularly Nova Scotia, were, from the beginning, in very strained circumstances. The allocation of functions and revenues discussed at Quebec in 1864 meant roughly that the provinces would be left with $16 million of local revenues to meet an estimated $4 million of local outlay while the Dominion was to be given $12 million in revenue to meet less than $9 million in outlay. It was proposed to balance the provincial budgets by transferring $21 million to the provinces in the form of federal subsidies. The total amount of the agreed subsidies was sufficient to bridge the estimated gaps but the current conception of equity which required calculation of subsidies on a per capita basis glossed over real differences in need arising from disparate circumstances, unconnected with differences in population. The result of the settlement was that Ontario and Quebec got subsidies greater than their needs at the time. For several years, Ontario had considerable surpluses while the position of Nova Scotia became intolerable as early as 1868.

As already mentioned, Tupper had promised at Quebec that Nova Scotia would make ends meet somehow on a subsidy of 80 cents per capita, yielding $264,000. Even when supplemented by the grant of $60,000, in support of legislature and government, agreed on at London, Nova Scotia was still unable to honour Tupper’s promise. The “better terms” agreement of 1869 gave the Province an additional $140,000 of which $83,000 was for a ten year period only.

In 1873, the Dominion assumed the “excess debt” of Ontario and Quebec. The consequent proportionate increase in the debt allowances of the other provinces afforded some further relief to Nova Scotia. However, with the expiry of the temporary grant in 1877 and the withdrawal by the Province of capital sums on debt allowance account, Nova Scotia’s subsidy, in spite of other minor additions, had fallen to $433,000 by 1884, at which figure it remained until 1906. The revenues from public domain did not expand as expected, municipal organization lagged and political considerations discouraged the introduction of direct taxation. Appeals to Ottawa for further subsidy increases were fruitless and throughout the period under review, Nova Scotia was seriously cramped by its inelastic revenue system.

New Brunswick had made a rather better bargain at Confederation and also improved its position slightly when it commuted its export duty on lumber for a subsidy of $150,000 a year. But apart from these minor reliefs and particularly after its special temporary grant expired in 1877, its position was on all fours with that of Nova Scotia. Indeed, it was more heavily dependent on the Dominion subsidy for its revenues than was Nova Scotia.

The impossibility of dealing fairly with dissimilar areas and conditions by use of a common formula was revealed again in the financial settlements with the new provinces which entered the union early in this period. The Red River Settlement which had chafed under the rule of the Hudson’s Bay Company but lacked experience in managing its own affairs suddenly blossomed into the Province of Manitoba in 1870. In substance, it was a creature of the Dominion Government without a will of its own and consequently the formula used in calculating the amount of subsidies for the four original provinces was strictly applied to it. As a result of the arrangement with Nova Scotia in 1869, the debt allowance had been raised from $25 to $27.77 per capita. Manitoba’s population of 12,000, of whom less than 2,000 were whites, was generously assumed to be 17,000. Thus the Province was given the subsidy of $67,000 to which it was entitled according to the formula.

Other provinces were expected to supplement their revenues from the public domain but Manitoba’s lands were reserved by the Dominion to aid the federal policy of development. Yet the Province was not compensated for their retention. Lacking taxable capacity and having virtually no other revenue, the province was unable to support its governmental structure and it is not surprising that the annual subsidy was increased on four separate occasions during the next fifteen years.

Actual need and political expediency brought a considerable modification in the application of the formula to British Columbia and Prince Edward
Island. Strict application of the formula to British Columbia in 1871 would have given a subsidy wholly inadequate either to replace the customs revenue which was being surrendered to the Dominion or to meet the financial needs of the Province. British Columbia contended that its customs collections were equal to the amount of customs revenue derived from 120,000 people in the Eastern Provinces and suggested that the 9,000 whites and the 25,000 Indians and Chinese in the Province be regarded, for the purpose of subsidy, as a population of 120,000 and that the subsidy be calculated accordingly. This was not acceptable to the Dominion but another device was invented which served much the same purpose and British Columbia was brought into the union with a subsidy of $216,000 a year instead of the $75,000 which a rigid application of the formula to the original formula would have yielded.41

In 1873, Prince Edward Island secured a settlement involving a more radical revision of the formula. The public debt of the Province had rushed upward between 1867 and 1873. In order to lift the burden of debt charges from the Province, it was necessary to calculate the debt allowance at $50 per capita. In addition, the fact that the Province had no public lands induced the Dominion to give a further subsidy in lieu of lands. The original formula would have yielded a subsidy of only $45,000 but with these modifications, the Province secured an annual grant of four times as much.

Within a short period of time, these settlements in turn proved inadequate. In the eighties, Quebec also got into financial difficulties and, by 1887, all the provinces except Ontario were clamouring for an increase in subsidies. No further alterations were made during this period. The reasons why these adjustments and concessions, which had seemed adequate at the time, failed to meet the fiscal needs of the provinces will be considered later when the provincial revenues and expenditures are reviewed.

The Finances of the Dominion—concentration on economic development

The Federal Government had taken over the pre-Confederation debts of the provinces and was expected to finance the new program of development, to provide for defence and to assume the major burden of general government and legislation. The budgets of this period show that these expectations were being substantially realized. Virtually all the Dominion debt accumulated between 1867 and 1896 was incurred for development. By paring expenditures on general government and taking advantage of its freedom from large expenditures for defence which weighed so heavily on European governments, the Dominion was able to concentrate its efforts on this single activity. In 1874, at the end of the first spurt of development, debt charges and current outlay on transportation, agriculture and public domain accounted for half the current expenditures. The building of the Canadian Pacific in the early eighties added considerably to the total liabilities. In the general depression which descended again after completion of the road, the Dominion found its debt charges embarrassing and did not undertake any further large developmental program in this period. Nevertheless, in 1896, these same items still absorbed almost half the current outlay, while defence and general government accounted for only 6 and 28 per cent respectively. The traditional role of government in British North America as an agency for creating conditions in which private enterprise might thrive had been assumed by the Dominion. In this respect at least, the Dominion was living up to the original conception of its purpose.

But the ability of the Dominion to carry through the developmental program fluctuated greatly because of its heavy dependence on customs revenue. Until the Great War (1914-18), the financial fortunes of the Federal Government were directly and completely linked to the ups and downs of international trade and investment. As revenues rose with rising imports, the Dominion embarked on large developmental expenditures. This involved the investment of foreign capital, which entered the country in the form of goods. The increase in imports at once swelled the customs revenue. Meanwhile, investment stimulated internal activity, increasing employment, raising wages and consequently improving domestic trade. This increase in domestic trade boosted excise revenues.

Therefore, one of the first effects of a program of development was to fill the Dominion treasury and the government tended to forget that it increased the debt as well. In an optimistic mood, it raised its commitments for development still further. As long as investment funds were forthcoming, this procedure could continue almost indefinitely. However, because the flow of investment was certain to be checked at some time, a thoroughly false position was being built up.

41 For extended discussion of subsidy arrangements with British Columbia see Book II, Section F, Ch. II.
The moment the inflow of capital ceased, imports fell sharply, customs revenue slumped, employment declined, the consumption of liquor, tobacco and other luxuries fell away, excise revenues collapsed and the Dominion suddenly found itself with a heavy deficit. Meanwhile, the outlays on development had substantially increased debt charges, thus adding to the rigid and uncontrollable expenditures. In the sequel, it became more difficult to balance the budget by the familiar methods of retrenchment and higher taxation.

The embarrassing stages of the first of these cycles coincided roughly with Alexander Mackenzie’s tenure of office. The Ministry of Sir John A. Macdonald experienced a similar cycle in the eighties, which was initiated by the expansion attending the construction of the Canadian Pacific railway. In the years 1881, 1882 and 1883, the Dominion enjoyed remarkable surpluses on ordinary account. Relying on these temporary surpluses, the Government devoted a larger sum than ever before to public works (including buildings and harbours) in 1883-84 and embarked on a scheme of cash subsidies for railway construction. Then the flow of investment slackened, the peak surplus of over $8 million reported in 1884 was wiped out by rising expenditure a year later and by 1886 was converted into a substantial deficit.

The public finance system was still sufficiently flexible to enable Ministers of Finance, by increased taxation and economy, to balance their budgets in a short period. Deficits reappeared in the early nineties which were more difficult to wipe out. The persistent fall in prices due to economic stagnation affected seriously the yield of ad valorem customs duties. In 1895, customs receipts were $5.1 million below what they had been in 1883, while debt charges and other governmental expenditures were slowly but stubbornly rising. Under such circumstances the enthusiasm for an aggressive program of development disappeared. The results of past efforts were disappointing in the extreme and now the Dominion could do little more than carry the commitments it had already undertaken.

The Straitened Circumstances of the Provinces—
the growth of expenditures and the slowness of municipal development

The financial settlement at Confederation had left the provincial governments almost entirely dependent upon federal subsidies and the revenues from licences, fees and the public domain. It was expected that the receipts from the public domain would expand sufficiently to enable the provinces to extend their existing services to a growing population. Direct taxation was held to be impracticable and thus the expansion of activities would be restricted. Municipal organizations, it was expected, would assume an increasing share of the governmental burdens.

Municipal development lagged, however, except in Ontario. The Maritimes were slow to introduce a system to which they were not accustomed.

Some progress was made in Quebec and Manitoba but very little in British Columbia. Failure to make rapid progress in this direction increased the financial difficulties of these provinces. In Central Canada, where urbanization was rapid, the number of cities of over 10,000 in population doubled and the population of Montreal and Toronto doubled and trebled respectively in this period, municipal activities and expenditures expanded greatly. The provincial government of Ontario, and to a certain extent that of Quebec, derived considerable financial relief from the growth of local governments which provided a large share of the necessary services out of levies on real estate.

Although in most provinces municipal development was slow, provincial governments confined by their narrow revenue systems did not increase their expenditures greatly. Between 1874 and 1896, the total per capita outlay of all the provinces rose only from $1.69 to $2.20. This restraint on provincial outlay during a long period of depression was made tolerable by the nature of the economy of the time. The relative self-sufficiency of the family and local communities enabled individuals to weather the depression somehow without reliance on governments. Those who were unable to make adjustments in this way were forced into the stream of migration to the south where they were absorbed by the rapid industrial development and the expanding frontier of the United States. In the 1930's, when self-sufficiency had sharply declined and emigration was stopped, it proved to be no longer possible to hold down governmental expenditures in face of a prolonged major depression.
While the provinces were not greatly burdened during this period by their responsibilities for public welfare, there were other significant developments which began to place a strain on their revenue structures. The most important of these was the growth of debt charges. When the debts of the provinces were taken over by the Dominion in 1867, it had been thought that the provinces would not again incur any considerable public debt. But all the provincial governments except that of Ontario had got into debt before 1896 mainly as a result of developmental expenditures of their own. The topography of Nova Scotia, New Brunswick and British Columbia led to capital expenditures on railways, roads and bridges which could not be met out of restricted current revenues, and the slow development of municipal institutions in these provinces prevented any large shifting of burdens to municipalities. The Dominion curtailed its developmental program after the building of the Canadian Pacific railway but the depression did not prevent Quebec and Manitoba from assisting railway construction. Quebec, in particular, attempted a vigorous railway and colonization policy. By 1896, its debt charges amounted to two-thirds of the debt charges of all the provinces at that date. As the weight of debt charges increased, it pressed against the confines of the revenue system.

On the other hand, Ontario took advantage of its freedom from debt charges to expand other services. With an adequate network of railways and a mature municipal system which carried much of the cost of local roads and public works, the provincial government was able to increase considerably its assistance to education and public welfare. In the early nineties when the increased outlay on these services threatened to raise total expenditures above the yield of the existing revenue sources, the Province moved into the field of direct taxation. However, for all the provinces taken together the amounts spent on education and public welfare during this period did little more than keep pace with the rise in population.

Total current expenditures of the provincial governments on transportation fell slightly between 1874 and 1896 and the only marked increase, aside from debt charges, was in the cost of the administration of justice and general government. This was due, in part, to the extension of government services to a wider area as well as to an increased population. The general government overhead varied widely as between provinces. It rose more steeply in Quebec than in Ontario and expenditures of Manitoba and British Columbia on this item more than trebled in this period. British Columbia with one-fifteenth of the population of Ontario was spending two-thirds as much as Ontario on general government and administration of justice. To a considerable extent, this disparity was due to the obstacles of topography and the lack of a developed municipal system in British Columbia.

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**Table 11.—Government Expenditures on Current Account (a), 1874 and 1896**

<table>
<thead>
<tr>
<th></th>
<th>Provinces</th>
<th>Dominion</th>
<th>Total Provinces and Dominion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1874</td>
<td>1896</td>
<td>1874</td>
</tr>
<tr>
<td><strong>Net Debt Charges</strong></td>
<td>—</td>
<td>1,526</td>
<td>5,373</td>
</tr>
<tr>
<td><strong>Justice, Legislation and General Government</strong></td>
<td>2,564</td>
<td>4,274</td>
<td>4,651</td>
</tr>
<tr>
<td><strong>Defence</strong></td>
<td>1,331</td>
<td>1,627</td>
<td>213</td>
</tr>
<tr>
<td><strong>Public Welfare</strong></td>
<td>657</td>
<td>1,472</td>
<td>213</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td>1,421</td>
<td>2,003</td>
<td>213</td>
</tr>
<tr>
<td><strong>Agriculture and Public Domain</strong></td>
<td>726</td>
<td>951</td>
<td>250</td>
</tr>
<tr>
<td><strong>Transportation</strong></td>
<td>1,222</td>
<td>924</td>
<td>3,753</td>
</tr>
<tr>
<td><strong>Subsidies to Provinces</strong></td>
<td>1,369(a)</td>
<td>2</td>
<td>529(a)</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>1,369(a)</td>
<td>2</td>
<td>529(a)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>7,969</td>
<td>11,152</td>
<td>20,170</td>
</tr>
<tr>
<td><strong>Total Per Capita (Dollars)</strong></td>
<td>1.09(a)</td>
<td>2.20</td>
<td>5.18</td>
</tr>
</tbody>
</table>

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(a) Compiled from the Public Accounts of the Dominion and the Provinces.
(b) Includes a distribution of surplus to the municipalities in the Province of Ontario of $1,361,000.
(c) The post office revenues were netted against the post office expenditures and only the net operating deficit is included.
(d) Excludes Ontario surplus distribution to municipalities.
The Provinces embark on Direct Taxation—corporation taxes and succession duties

In each of the seven provinces, despite the smallness of the increases in expenditure, the total requirements exceeded the yield of the revenue sources on which they had relied at the time of entering the union. Total provincial revenues from public domain doubled and those from licences and fees almost trebled between 1874 and 1896 but, in absolute terms, these additions were small. Even when supplemented by the modest increases in subsidies to some provinces, they did not suffice to meet the demands for expenditure. Before the end of the period all of the provinces had resorted to direct taxation of some kind. In 1896, corporation taxes, succession duties, property and income taxes were already providing about 10 per cent of total provincial revenues. Beginning in 1873, British Columbia pioneered the field of direct taxation, trying real and personal property taxes, poll tax and income tax as well as succession duties before the end of the period. Quebec, in 1882, was the first province to attempt to levy a corporation tax, and New Brunswick followed shortly afterwards. All seven provinces were levying succession duties in 1896. British Columbia and Prince Edward Island attempted to supplement their revenues by an income tax and, lacking a developed municipal system, both imposed provincial taxes on real property. Most of these ventures into new fields of taxation date from the early nineties, after unsuccessful demands for subsidy revision.

Behind the search for revenues lay the fact that the provincial governments had turned out to be more important agencies for collective action than the framers of the financial settlement had anticipated. Their per capita expenditures increased and their revenues from public domain did not expand sufficiently to bridge the gap. In efforts to combat the depression, they tried to push development on their own frontiers, thus incurring debts and debt charges. Failure to

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Table 12.—Government Revenues on current Account(a), 1874 and 1896
(Thousands of Dollars)

<table>
<thead>
<tr>
<th></th>
<th>Provinces</th>
<th>Dominion</th>
<th>Total Provinces and Dominion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1874</td>
<td>1896</td>
<td>1874</td>
</tr>
<tr>
<td>Federal Subsidies</td>
<td>3,842</td>
<td>4,301</td>
<td></td>
</tr>
<tr>
<td>Taxes:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs</td>
<td>1</td>
<td>1</td>
<td>14,443</td>
</tr>
<tr>
<td>Excise</td>
<td></td>
<td></td>
<td>5,617</td>
</tr>
<tr>
<td>Corporation Taxes</td>
<td></td>
<td>156</td>
<td></td>
</tr>
<tr>
<td>Succession Duties</td>
<td></td>
<td>428</td>
<td></td>
</tr>
<tr>
<td>Income Taxes on Persons</td>
<td></td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>Taxes on Real Property</td>
<td></td>
<td>42</td>
<td>180</td>
</tr>
<tr>
<td>Taxes on Personal Property</td>
<td>108</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poll Taxes</td>
<td></td>
<td>65</td>
<td></td>
</tr>
<tr>
<td>Other Taxes</td>
<td></td>
<td>4</td>
<td>213</td>
</tr>
<tr>
<td>Sub-total</td>
<td>43</td>
<td>954</td>
<td>20,273</td>
</tr>
<tr>
<td>Licences, Permits, Fees, Fines and Penalties (b)</td>
<td>651</td>
<td>1,756</td>
<td>14</td>
</tr>
<tr>
<td>Public Domain</td>
<td>1,413</td>
<td>2,601</td>
<td>351</td>
</tr>
<tr>
<td>Sales of Commodities and Services</td>
<td>97</td>
<td>63</td>
<td>738</td>
</tr>
<tr>
<td>Other</td>
<td>619</td>
<td>97</td>
<td>225</td>
</tr>
<tr>
<td>Total</td>
<td>6,665</td>
<td>9,972</td>
<td>21,601</td>
</tr>
</tbody>
</table>

(a) Compiled from the Public Accounts of the Dominion and the Provinces.
(b) Including Liquor Licences.
Summary, 1867-96

In the first thirty years of Confederation, the physical framework of the Dominion had been completed and the basic national economic policies for the future had been adopted. Despite these achievements, the period was one of trial, discouragement and even failure. The national economic expansion failed to materialize. The long depression naturally weakened the newer and more tenuous loyalties and the Federal Government which, at first, undertook its appointed task of national leadership with vigour and assurance floundered and seemed to have lost its way. Its hesitations helped to undermine its claim to dominate the provinces. Provincial loyalties, on the other hand, showed an unsuspected strength and Privy Council decisions confirmed the provinces in possession of a large sphere of action beyond the reach of the Dominion. But the provinces were caught in a financial strait jacket from which they laboured, as yet unsuccessfully, to free themselves. The provincial governments lacked financial resources, while the Dominion failed to evoke a spirit of national loyalty. In these circumstances, it was by no means clear, at the end of the period, that the equilibrium necessary to a working federalism could be reached. It was not clear whether room could be found for the free play of provincial aspirations without denying to the Dominion the confidence and loyalty it needed for the advancement of common national purposes.