CHAPTER V

NATIONAL ADJUSTMENT GRANTS

The Commission's recommendations for payment of National Adjustment Grants, and for provision of a body to advise on future adjustment grants and emergency grants, are of major importance for several reasons. They are a complete break from the traditional subsidy system and the principles ostensibly underlying it. They make provision for the Commission's recommendations (other than those for the relief of unemployed employables) on the major subjects of public welfare, education, and provincial developmental and conservation expenditures. They illustrate the Commission's conviction that provincial autonomy in these fields must be respected and strengthened, and that the only true independence is financial security. They meet a number of provincial grievances and claims, raised under other heads. They are designed to make it possible for every province to provide for its people services of average Canadian standards and they will thus alleviate distress and shameful conditions which now weaken national unity and handicap many Canadians. They are the concrete expression of the Commission's conception of a federal system which will both preserve a healthy local autonomy and build a stronger and more united nation.

The proposed method of operation has been outlined in the description of Plan I.1 Joint provincial-municipal expenditures on public welfare and education have been taken on a per capita base for every province, and, after adjustment in some cases for costs of living and other local circumstances, have been compared with the national average.2 In addition, the annual average of total current highway, agriculture, and public domain expenditures by each province for the years 1928 to 1931 was taken as the most satisfactory estimate available of "normal" developmental expenditures in that province. (An exception had to be made for the Prairie Provinces, since control of their resources was not transferred to them until 1930, and in their cases, only highway expenditures were taken.) The base period chosen is the most favourable one, from the point of view of the provinces, that could be selected, but the Commission does not consider it excessively generous in view of the expanding nature of highway expenditures, and the evident need for developmental and conservation expenditures in many instances. The proportion of total provincial and municipal taxation to the total income of each province (considering only those taxes which would remain with the provinces under the terms of the Commission's tax recommendations in Plan I) has been compared with the national average. In the subsequent calculations less weight has been given the taxation comparison, which could not be as satisfactorily determined as the education, welfare, and developmental expenditure comparisons, but the taxation comparison was introduced so that no province would be penalized for having provided superior services if it had done so by having taxed its residents with more than average severity, and so that no province would receive a payment to enable it to improve inferior services if it had chosen to have inferior services in order to tax its residents less severely than the average. The only exception to this general method was in the case of Quebec where the notable work of the Church in the fields of education and public welfare could neither be ignored nor measured in monetary terms. Consequently, in the case of Quebec it was necessary to make the arbitrary assumption that the contribution of the Church brought education and welfare service standards up to the national average.

The Commission has for this purpose developed a series of public finance and provincial income statistics in which every effort has been made to secure real comparability, but it is keenly aware of the crudeness of the techniques and the approximate nature of the statistics on which it has had to rely. However, in spite of the margin of error necessarily present, the Commission believes that its estimates furnish a satisfactory working base until more refined statistics are developed. It is the Commission's hope that the Finance Commission (or in the event of the Commission's recommendations not being implemented, some other

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1 See p. 83.
2 The national average excludes, for reasons to be noted, the Province of Quebec.
appropriate body) will develop and improve this material, which is basic to any serious consideration of public finance in general and Dominion-provincial relations in particular.

The purpose of the National Adjustment Grants to be paid by the Dominion to the provincial governments is then, in brief, to provide for balanced provincial budgets after provision for expansion of education and welfare services to the national average where these services are below it, and expansion of developmental expenditures to the 1928-31 averages of the individual provinces. This is, of course, a radical departure from the existing system of statutory subsidies, supplemented by special subsidies and conditional subsidies. The statutory subsidy system was not, however, so dissimilar in its origin. As we have discussed in Book I, and as noted in the studies made for the Commission the original subsidies were frankly adopted as expedients to make Confederation possible. After functions and taxation powers were allocated to the new Dominion and provincial governments it was clear that the remaining provincial and municipal revenues would be insufficient to support the remaining provincial and municipal expenditures. Reluctantly, for there was strong feeling against one government raising money to be transferred to and spent by another government, it was agreed to meet the difference by Dominion subsidies. Considering the undeveloped state of the taxation system and the nature of the economy of the time, there appeared to be no practical alternative. But although the subsidies were thus initially determined by the calculated fiscal need of the provincial governments, great efforts were made to freeze them in perpetuity at the 1867 amounts, and to this end elaborate formulae were devised to fit the amounts and to give the appearance of equality of treatment. Even at that time statistical equality of treatment did not produce real equality, but the more self-sufficient nature of the economy, and the much smaller scale of public finance as compared with today made the differences of little importance. Neither the growth in governmental responsibilities nor the great regional shifts in taxable incomes which occurred in the next seventy years could have then been foreseen.

As we have recounted at length in Book I it proved impossible, almost from the very beginning, to keep the subsidies at the 1867 level. The fiscal need of some provincial governments made increases necessary, but the increase had always to be justified by some ingenious interpretation of the accepted formula. This led to political bargaining and devious legalistic argument, and failed to meet the necessities of the situation. The provinces were driven to uneconomic taxation methods, and increasing differentials developed in the services which they supplied. With the entrance of new provinces, and the establishment of arbitrary "lump sum" subsidies, and debt allowances and per capita subsidies based on fictitious population figures, the last shreds of logic of the old system vanished. Nevertheless the form was clung to, although the rapid development of the economy and growing disparities in the distribution of taxable income, and the increasing post-War demands on governments made it necessary to supplement the statutory subsidies with a growing number of special subsidies. These in fact departed completely from the theoretical principles of equal treatment, but introduced no new principles and objective scientific criteria in their place.

Experiments were made with the conditional subsidy technique. It first seemed to be a happy compromise, and an escape from the strait jacket of the obsolete statutory subsidy formulae. Assistance could be given where necessary, and administration left in provincial hands, but, as a safeguard against abuses and irresponsible expenditure, the Dominion could enforce compliance with specific conditions and uniform national standards. However, the flaws in the system became clearly apparent when, under the pressure of expanding social service demands and depression conditions in the thirties, the transfers involved grew to huge proportions. A system which might work well, even in a federation, on a limited scale and for certain specific and clearly defined objectives, broke down completely as a means of financing a large proportion of provincial functions. By 1937 the statutory subsidies, special subsidies, and conditional subsidies were nearly half the total of provincial revenues from their own sources. The Dominion in respect to conditional

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5 Provincial Subsidies, 1937

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<tr>
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<th>$ millions</th>
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<tbody>
<tr>
<td>Statutory subsidies</td>
<td>14</td>
</tr>
<tr>
<td>Special grants</td>
<td>7</td>
</tr>
<tr>
<td>Conditional grants</td>
<td>82</td>
</tr>
<tr>
<td>Total</td>
<td>103</td>
</tr>
<tr>
<td>Provincial revenues from own sources</td>
<td>220</td>
</tr>
<tr>
<td>Grand Total</td>
<td>329</td>
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8 Book I, Chap. I.

subsidies had to impose either such rigid and
detailed conditions (often unsuitable to local con-
ditions), involving such minute inspection and
regulation as to be a major infringement on
provincial autonomy and practical only in a unitary
state, or general conditions which were only nomi-
ually observed and no real check on any irresponsible
expenditure. The latter proved to be the general,
and almost inevitable practice. Even limited
efforts at effective regulation of the expenditure of
conditional subsidies led to bitter Dominion-
provincial fights. But acceptance by the Dominion
of the role of a rubber stamp opened the way to
waste of public funds, incapacity to deal with
national problems on a national scale, and lack of
enforcement of national standards where these were
appropriate. These weaknesses and abuses were
all the more vicious because the pretence was
preserved that the subsidies were "conditional",
and that violation of the conditions would lead to
their suspension of grants. That this was an empty
threat, everyone knew. Since such major expendi-
tures as old age pensions and unemployment relief,
affecting such a large proportion of the population,
have come to be financed by conditional grants, it
is neither humane nor politically possible to
suspend them. Constant bickering can, and does,
go on, and the more flagrant abuses may be
corrected as the result of persistent criticism, but
the provincial authorities know that in the final
analysis the subsidies will be paid.

There are many fields in which the conditional
subsidy may be highly useful. Where the amounts
involved are not large; where technical criteria
for objective and scientific measurement exist;
where administration is in the hands of a profes-
sional personnel; and where it is in the national
interest to stimulate some otherwise lagging local
activity, the conditional subsidy may be an appro-
priate and efficient instrument. In a unitary state,
of course, its scope of usefulness would be much
greater, since the question of infringing local
autonomy (if the conditions are to be enforced)
does not arise, or at least does not arise to the
same extent. But as a method of financing major
functions of government and of providing for
necessary inter-governmental transfers in a federal
state, it fails to meet the test of efficiency, and
dissipates seriously responsibility for public expen-
ditures.

It is for these reasons that the Commission
recommends National Adjustment Grants, as out-
lined above, to balance provincial budgets and to
provide for maintenance of average standards. The
principle is basically the same as that underlying
the Confederation settlement, but the major changes
which have occurred since Confederation in the
relative taxable capacity and governmental respon-
sibilities of the different provinces make it necessary
to discard the assumption that equal per capita
payments would provide for real equality of fiscal
positions. This assumption has, in fact, long been
discarded, and it has been the Commission’s effort
to replace the obsolete formula, and the ad hoc
makeshifts which have grown up about it, with a
system based as far as possible on ascertainable
facts and real equality of treatment.

As explained in the outline of Plan I, no con-
ditions are attached to the National Adjustment
Grants. They are given when a province cannot
supply average standards of certain specified
services without greater than average taxation, but
the province is free to determine on what services
the grants will be spent, or whether they will be
used not to improve services but to reduce pro-
vincial (and municipal) taxation. It may be
assumed that there will be strong public pressure
to improve those services which are below the Cana-
dian average once the necessary funds are available,
but it is the Commission’s view that the extent to
which this is done and the methods by which it is
done (i.e., either by direct provincial expenditures
or by subsidies to municipalities) can best be deter-
mined by the provincial electors and their repre-
sentatives. The Commission’s recommendation for
Dominion assumption of relief for unemployed
employables will abolish the conditional subsidy in
connection with which there have been the most
serious abuses and inefficiency. It is recommended,
however, that the old age pension system be left
undisturbed; the Commission recognizes that the
contribution to which the Dominion Government
has already committed itself for a primarily
provincial responsibility is justified by various
national, fiscal, and practical considerations. And
the Commission would not consider the future
introduction of conditional subsidies for certain
limited and clearly specified purposes in other
fields objectionable, although it is believed that
the provision of National Adjustment Grants will
remove much of the pressure for these arising from
fiscal need. But in its recommendation for
National Adjustment Grants the Commission has
deliberately abstained from suggesting that the

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6 Appendix 7—J. A. Corry, Difficulties of Divided Jurisdiction, pp. 28ff; Cf. Book I, Chap. IX.
grants should be made on conditions which would either violate provincial autonomy in these important services, or simply be a sham.

"YARDSTICKS"

It is necessary to say something of the services which have been selected as a yardstick for determining the adjustment grants. These services represent (1937 basis) three-quarters of the total provincial expenditures which will remain if Plan I is implemented, and slightly more than half the combined provincial-municipal expenditures.

_Education and Welfare Services on the Canadian average._—The quality of education and welfare services is no longer a matter of purely provincial and local concern. In Canada today, freedom of movement and equality of opportunity are more important than ever before, and these depend in part on the maintenance of at least minimum national standards for education, public health and care of the indigent. The most economically-distressed areas are the ones least capable of supporting these services, and yet are also the ones in which the needs are likely to be greatest. Whether the remedy lies in emigration from these areas or in the development of alternative means of livelihood, they must not be allowed to become backwaters of illiteracy and disease. Not only national duty and decency, if Canada is to be a nation at all, but equity and national self-interest demand that the residents of these areas be given average services and equal opportunities,—equity because these areas may have been impoverished by the national economic policies which enriched other areas, and which were adopted in the general interest. Those whose interests were sacrificed have some claim that the partnership should work both ways. National self-interest demands it because the existence of areas of inferior educational and public health standards affects the whole population, and creates many grave and dangerous problems. In the modern age these areas be given average services and equal wished, and constant contact and intermingling of the population between favoured and unfavoured regions is bound to occur. The more fortunate areas cannot escape the pressure on their standards and the effect on their people; in this case prevention, in both fiscal and human terms, is much cheaper than the cure.

It will be clear from the discussion in the Social Service Chapter7 why the Commission has dealt with the problem of relief for unemployed employables in quite a different way. The allocation of jurisdiction to the Dominion in that case, and the affirmation of provincial jurisdiction and the financial strengthening of provincial autonomy through the National Adjustment Grant mechanism in all the remaining fields of social services is a logical division of responsibility based on reasoned principles. At the risk of some repetition of the argument in the foregoing section on Social Services it is desirable to recapitulate the reasons for the Commission's recommendation on the responsibility for unemployment relief. By contrasting the proposed methods the fundamental difference in the nature of the problems concerned can best be illustrated. It will then be clear why the Commission does not believe that the first method—transfer of jurisdiction to the Dominion—would be desirable in the case of most social services, nor that the second method—provision of adequate funds for provincial administration by National Adjustment Grants—would be a desirable way of handling relief for unemployed employables.

The principles guiding the Commission's recommendations are that the recognized needs of those who are incapable of supporting themselves should be a local (i.e., municipal and provincial) responsibility, and that the needs of those who are able to support themselves but lack the opportunity should be a federal responsibility.

The indigent has traditionally been pictured as an unfortunate, of local origin, who is physically or mentally incapable of earning his livelihood. His care has traditionally been a local responsibility, and there are strong arguments to support this allocation of responsibility wherever it is practicable. The community (and the regional area) presumably develop a greater sense of kindred responsibility and neighbourhood spirit than is possible in the national unit; local knowledge and local administration can determine real needs more accurately, establish appropriate standards more fairly, and supervise more economically than can a centralized and distant bureaucracy, and at the same time, be more humane and helpful to the recipient.

But the growth of agricultural and industrial specialization, and of a highly geared and powerful, but highly sensitive and vulnerable economic mechanism introduced new factors. Large numbers of able-bodied workers and farmers were, under the new order of things, periodically threatened with complete destitution. In Canada, the preliminary ripples of 1913 and 1921 gave no warning of the tidal wave of 1930-36. When this struck it hit an economy which, because of a series of fortuitous coincidences, had never suffered a major depression or been faced with the need for a major economic

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7 See Sect. A, Chap. I.
adjustment since it became of age. And it is not surprising that the public finance structure was equally unprepared for the deluge.

The areas in which destitution and the need for relief grew most alarmingly were also the areas in which local revenues and credit fell most abruptly; the traditional local responsibility for relief of destitution broke down almost overnight. Nevertheless, an attempt was made to preserve the façade of the old structure, and huge inter-governmental loans and grants were made for this purpose in a manner which quickly undermined the financial independence of the provinces (which is fundamental to the federal system) and which made a mockery of responsibility in public finance. In one form or another this method of financing relief has been continued on a shifting, ad hoc, and always temporary basis.

The traditional technique of poor relief is quite inadequate for coping with the modern problems of mass unemployment and mass agricultural destitution in Canada.

The causes of these problems are in no sense local; they lie in national and international trade cycles, and, to some extent, in climatic cycles. The burdens resulting from these problems never fall with equal incidence on the different provinces; and they are subject to extreme and erratic fluctuations. Both problems call for constructive remedial policies rather than for provision of a mere subsistence for their victims, and remedial policies involve the use and co-ordination of all the weapons in the national armoury—monetary and exchange policy, national taxation and deficit financing, trade and tariff policy. It is for these reasons, in addition to the proven incapacity of municipal and provincial units to bear the financial burden, that the Commission recommends the assumption by the Federal Government of relief for unemployed employables, and relief to a primary industry in general when this burden exceeds the financial capacity of the province concerned.

Developmental and Conservation Services.—The provision for including development and conservation expenditures (provincial highway maintenance, agriculture and public domain) as part of the needs of the provinces has already been described. In a general way the revenue sources remaining to the provinces (together with the National Adjustment Grants in those provinces which receive them) should enable every province to finance a normal developmental program (on the 1928-31 average) including maintenance of the productivity of its natural resources. Separate provision has been made to cover the case of depletion of resources the productivity of which cannot possibly be maintained. As has already been explained it is recommended that the Dominion should pay over to the provincial government concerned mining and oil company taxes equal to 10 per cent of the profits made from exploitation of provincial resources. This would give the provinces a substantially larger revenue than they now receive from corporation taxes of these companies and should enable them (if they so choose) to create new assets, perhaps in the nature of development works, which would offset the depletion and so maintain the general productivity of the provincial economy.

Every province is naturally interested in securing the highest standard of living and the greatest possible measure of economic security for its residents. While the main economic policies of the nation are determined by the Dominion Government, much remains to be done to see that the most advantageous use is made of the province’s resources within this framework. There are many cases where community action is more effective than individual action to this end, and it has become a recognized function of provincial governments on occasion to provide facilities such as highways and railways, public utility services, dams and reservoirs to regulate rivers, soil, mineral and forest surveys, which will open up frontier territories and facilitate the development of resources; to protect and conserve resources by forest fire services, cutting restrictions, reforestation protecting game; to develop improved methods applicable to local industries and furnish them with scientific and technical assistance; to battle insect pests and animal and plant diseases; to nurse infant industries and depressed areas; to assist desirable transfers of population and industry—all with a view to strengthening the provincial economy. Some of these services can best be carried out in co-operation with other provinces and by uniform methods, but most of them must be adapted to the special local circumstances and be locally administered. Frequently the objectives are more than economic, and the developmental policies followed will reflect the prevailing political and social philosophy of the particular province. One may favour public ownership, and another development by private capital; one may put
security and stability first, and another the goal of maximizing the income; one may adopt a laissez-faire attitude in relation to its industries and another a large measure of government planning, assistance and regulation. These are additional reasons why the Commission has adopted a yardstick based on immediate past policy, under generally favourable conditions, rather than any theoretical formula, as an appropriate measure of "normal" developmental expenditures. Resources, needs, and philosophies change, and this measure can only be a temporary one. It is proposed as such, but as one that affords a practical working basis for the present.

The possible benefits from well-administered (and adequately-financed) provincial developmental services are many and large, and affect every resident in the province. It is encouraging to note the recent trend9 to establish competent professional boards to study provincial economies and consider developmental policies as a whole, rather than to proceed with a number of completely independent projects of widely varying value which may be in direct conflict. An important portion of provincial (and Dominion) deadweight debt is the result of unco-ordinated and ill-considered projects of the latter type.

The Commission has adopted a generous basis for calculation of the adjustment grants, and a generous formula, in its mining tax apportionment proposal partly to make possible more adequate conservation measures. It was brought home clearly in both the evidence submitted in the Commission's hearings,10 and by the work of the Commission's research staff, that conservation work in general has been seriously neglected, and that far too little attention has been paid to developing the most economic methods of exploiting Canadian resources. Investment in this work is one of the most profitable which Canadian governments can make. There are resources, of course, which cannot be restored or maintained, and there are others which could only be maintained at excessive cost. But the great proportion of our forest resources, our soil resources, our fish and game, can be maintained and improved to the great advantage of the country for generations to come with the use of foresight and a very modest investment.

The problem of exhaustible resources is no less important. Their exploitation should be as efficiently carried out as modern science permits; the rate of exhaustion should be determined by the broadest economic and social considerations, and not solely by the immediate profits of the private producer concerned; in preparation for the day when the last ore-truck trundles out and the last pump stops working, every alternative means of livelihood for the dependent population should be surveyed and developed; and provision must be made in the days of high profits for the amortization of public expenditures on roads, schools, utilities, and other works which will no longer be needed, and for the welfare costs which inevitably accompany such serious adjustments.

9 The following provinces have recently established temporary or permanent economic advisory councils: Nova Scotia; New Brunswick; Quebec, Manitoba; British Columbia.

10 E.g., Brief of B.C., p. 30ff; Ex. 236, Edmonton Chamber of Commerce, p. 21; Ex. 387, Federation of Ontario Naturalists.