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CANADIAN FEDERALISM AND ITS IMPACT ON CROSS-BORDER TRADE

*Patrick Monahan**

I want to do two things similar to what Professor Farber did. I want to give a rough sketch of the constitutional division of powers in Canada in relation to trade. Then I want to talk a little bit about the implementation of trade agreements and ways in which the divisions of powers impact trade issues specifically. Then I will offer some prediction as to the future.

Canada has the Constitution Act of 1867, formerly known as the British North America Act, but renamed in 1982, which seemed, in the wording of the 1867 Act, to allocate an omnibus trade power to the Federal Parliament because the Parliament of Canada is given the power to regulate "trade and commerce."

In 1867, the drafters looked at the U.S. and saw the U.S. limiting Congress' power to regulate interstate trade and interstate commerce. The Canadian drafters said, "We do not want any of that." The Canadian Parliament was given an all encompassing power over trade and commerce, whether it is interstate or intrastate, local trade. However, the Judicial Committee of the Privy Council, which was until 1949 the highest judicial tribunal in Canada, significantly narrowed the scope of the federal trade power.

That began in a case called *Parsons* in 1881, in which, essentially, the Privy Council said that this omnibus trade power was in reality limited to two specific kinds of categories.¹ The first category was international and inter-provincial trade, that is what Americans would term interstate trade or foreign trade, and the second being a potential category, something the Privy Council described as being the general regulation of trade affecting the whole dominion. The Law Lords said it may be that there is some general trade power in addition to this power to regulate inter provincial and international trade. However, that second category was largely ignored for the next century.

The result of this early case and subsequent cases was that through interpretation, the federal trade power could not embrace purely local or intra-

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¹ *Citizen's Insurance Co. v. Parsons* (1880) 4 S.C.R. 215.

provincial transactions, transactions occurring entirely within a single province. For example, let us look at marketing board schemes, which until the 1970's generated a huge amount of litigation in the Privy Council and the Supreme Court of Canada. The courts basically said that in relation to these agriculture-marketing schemes, where you are trying to regulate the production and price of commodities, federal power could not embrace purely local transactions. The courts gave the example that Professor Farber talked about, the wheat farmer.

Canada had a case in which the argument was made that it was, in fact, the Federal Parliament who should regulate the production of wheat and the dealing in wheat at a local level where the wheat was eventually going to be exported. The facts were quite different than the U.S. case described by Professor Farber, where wheat was being used locally. The Canadian case concerned a farmer who was going to bring the wheat to a grain elevator and it was going to be exported. The Privy Council said the Federal Parliament could not regulate that local trade, because that is a local transaction. All that Canada can deal with is the export, or the crossing of provincial borders of that wheat. Fortunately for Canada, there was a provision in the Constitution Act that allowed Parliament to declare certain works to be federal works and subject to federal jurisdiction. The Federal Parliament used that power to overcome that specific decision and the Canada Wheat Board was created. But the court decision reflected this focus of the courts on inter provincial trade and international trade as being a limit of federal power.

Similarly, labor relations have been generally held to be a matter under provincial jurisdiction and federal regulations of industries (even those that operate on a national basis) is limited to inter-provincial or international transactions.

In 1949, appeals to the Judicial Committee were abolished, and the expectation was that the Supreme Court of Canada would significantly expand the federal role in relation to trade. I think that the Supreme Court of Canada has largely failed to meet expectations in the sense there has been no significant or material expansion of the federal trade power.

The only significant change has been in this so-called second branch of the federal trade power, this concept of there being a federal power to regulate trade in general. There was a new Competition Act enacted by Parliament in the 1980's that was upheld in 1989. Formerly, anti-trust laws in Canada had been upheld as criminal laws that established a relatively narrow basis for those laws. The new Competition Act went significantly beyond traditional criminal law, and was upheld as trade regulation using the general trade power. Since that time, however, there has been no significant trade case decided by the Supreme Court in Canada. There has been no material

change in the last decade on the trade power of the Supreme Court of Canada.

What about provincial power? The provincial power over property and Civil Rights has become the default trade power in Canada. Any trade matter that does not fall within a specific federal power allocated to Parliament goes by default to the provinces. Some people may take exception to that and say it is not accurate, but in my view that is what happens. The regulation of all local business and trade transactions is provincial. It may be that the Federal Parliament can assert some specific power but it will fall by default to the provinces if Parliament cannot find some specific footing in relation to that matter.

The main constraint on provincial authority is it must be directed to matters that are "in the province." The courts have imposed or maintained a limit on provincial powers where the power seemed to be directed at something outside of the province. That is the main legal constraint that we have seen. Yet, even the "in the province" requirement has been interpreted flexibly by the courts so that as long as a law has a plausible connection with a matter in the province, as long as it can be said that it seemed to be directed as a matter in the province, it may have effects outside of the province without thereby being rendered invalid. The courts say those effects are merely incidental as long as the law is directed at something in the province.

Let us take the taxation example. Provinces can tax a resident in the province with reference to transactions that occur outside of the province. The province would say, "Well, we are taxing the resident because the resident is here. It is true that the tax is referencing a transaction outside the province, but the resident is here, so we have the right to tax here." That is a possible basis. Or, alternatively, if you are not a resident, but you are carrying on business or engaging in transactions in the province, then the province can say, "Well, I know this person is not a resident here, but they are carrying on business here. We are going to tax them based on what they are doing here." So in either event, we have satisfied our in the province requirement. Now, I did say that the Constitution gives jurisdiction over certain matters to the Federal Parliament, and I will just mention them briefly here. Banks, the airline industry, inter provincial transportation undertakings, telecommunications and broadcasting, and nuclear power are all matters that either expressly or by interpretation have been held to be within federal jurisdiction. If you fall within one of these industries, then the Federal Parliament does have authority to regulate purely local transactions. This limitation to inter-provincial transactions does not apply in these specific industries.

One of the most significant developments in the last ten years has been the growth of the federal criminal law power as a method to regulate local

matters. For example, in the last few years, we have had a national firearms registration system, the national regulation of potentially toxic substances, and the national regulation of cigarette advertising, all upheld based on the criminal law power.

What, then, are the practical implications for the federal government flowing from this constitutional framework? In my view, these constitutional constraints have sometimes limited the federal power to regulate trade effectively. The federal government is often forced to focus on inter provincial and international trade because they cannot regulate purely local trade. One thing the federal government has done, which is quite useful, is they have sometimes said, "We will impose mandatory standards on inter provincial dealings and a local trader can opt in voluntarily." The courts have said this is possible. For example, if you are going to produce automobiles for export. Parliament can require the manufacturer to meet federal standards. That then becomes *de facto* a standard in Canada. The Federal Parliament can use this targeted approach as a means of regulating transactions within a province.

On the other hand, that limited form of regulation can sometimes have unintended, adverse consequences. I will give you a brief example that was, in fact, relevant under the North American Free Trade Agreement (NAFTA). A federal statute enacted a few years ago called the Manganese Based Fuel Additives Act regulated a fuel additive called methylcyclopentadienyl manganese tricarbonyl (MMT). I should disclose I was involved in this as an advisor to the Motor Vehicle Manufacturer's Association, which was lobbying the federal government for this legislation, so you can take everything I say here with a grain of salt. The Motor Vehicle Manufacturer's Association took the position that gasoline with this fuel additive MMT would have a negative impact on catalytic converters and on onboard diagnostic systems in automobiles. The manufacturers said this equipment would malfunction as a result of MMT. There were also arguments made that there were potential health consequences arising from having MMT in the gasoline.

The manufacturers want the federal Parliament to completely ban the use of MMT in gasoline. However, the federal government said, "We cannot ban the local use of MMT. All we can do is ban the importation or the inter-provincial movement of gasoline with this additive in it. We cannot reach down to regulate these local transactions. But if we regulate the inter-provincial movement or importation, we effectively regulate the entire Canadian market. If you cannot get the additive into Canada, no one can sell it locally." That is the same kind of regulation that is used to set emission control standards for automobiles.

Well, the Ethyl Corporation, the main producer of MMT, brought a Chapter 11 complaint under NAFTA. One of the arguments that they made

was that this legislation was targeting foreign investors. They said, "Look, they are only regulating importation and inter-provincial movement. If you were a local producer and trader, you could add this MMT to your gasoline and sell it. This is a law that is discriminatory." A complaint was also launched by Alberta based on the Agreement on International Trade.

In response, Canada said, "Well, this is a law of general application. No one can import gasoline with MMT. It applies to all importers, whether Canadian or foreign. The reason we are targeting importers is because the Constitution prevents us from regulating local trade."

The case was settled. The result was that Canada abandoned the attempt to regulate MMT and paid a large sum as compensation to Ethyl. So there was an example where this constitutional limitation on federal powers, I think, had a practical impact.

What about firms operating in Canada? Unless you operate within a specific federal industry indicated to you earlier: transportation, airline, telecommunications, etc., you can expect to be subject to significant provincial regulations. In fact, I would argue that the concept of provinces as sovereigns is growing in Canada, particularly in the four largest provinces of Ontario, Quebec, British Columbia and Alberta.

For example, the Agreement on Internal Trade in 1994 (an agreement signed between Canada and the provinces and Territories) adopted the international trade model for regulating trade disputes in Canada. It is a model in which provinces are treated as sovereigns. The concept in this model is that dispute resolution panels would be set up to resolve disputes as though provinces were sovereign entities. The federal government has very limited scope for unilateral actions or decision-making. Virtually anything the federal government wants to do, they have to secure provincial agreement before they can do it.

The federal government does have the ability to regulate cross-border trade. There is a danger of overlapping and conflicting regulation. Conflicts may involve not only conflicts between federal and provincial laws, but different provincial laws that may be conflicting and competing and enacting different standards. Therefore, the challenge in Canada has been to achieve coordination between policy and administration.

For example, let us look at securities regulation. Canada has no national securities regulator. Provinces regulate securities. Provincial securities regulators have made significant steps in terms of coordinating their regulations in establishing common standards. There are a variety of federal, provincial, and territorial agreements or accords that try to achieve policy co-ordination between federal and provincial jurisdictions.

Just to say a brief word about the implementation of international trade agreements. In Canada, treaties must be incorporated into law by the enactment of legislation. The British North America Act (BNA) provided that Canada could implement British Empire Treaties. However, the BNA Act did not anticipate Canada signing treaties on its own behalf. The Judicial Committee of the Privy Council, in a 1937 case called *Labour Conventions*, said that the authority to implement treaties must follow the Constitutional divisions of power, which meant if it was a matter of provincial jurisdiction the treaty question had to be implemented by the provinces.²

That outcome has been severely criticized, but remains the law in Canada today. For example, if a treaty requires a change to domestic law that is a matter of provincial jurisdiction, then the provinces must enact that law. In the Canada- U.S. Free Trade Agreement and the NAFTA, the Extent of Obligations Clause in those agreements required the Canadian Government to insure provinces would observe the agreements. The provinces ultimately agreed to comply voluntarily, that is to say to amend any of their laws that were inconsistent with the obligation under the Canada/U.S. Trade Agreement and the NAFTA.

However, there was a provision in the implementing federal legislation that said that the Canadian cabinet could enact a regulation that would override a provincial law that was inconsistent with certain obligations in the NAFTA. This provision focused on liquor regulations and the marketing and trade in alcoholic beverages. Ontario threatened to challenge that provision but never did. Therefore, the scope of federal authority was never authoritatively confirmed by a court. I think it was widely believed that if the Courts had been asked to deal with that, they would have upheld that federal legislation.

What are the general conclusions we can draw? The obvious conclusion is that the federal system in Canada is significantly more decentralized than the federal system in the U.S. The provinces are major economic regulators in Canada and the federal government has a limited power to effectively regulate local trade. Regulation of inter-provincial or international trade is

² The opinion of Duff C.J.C. in *Reference re Weekly Rest in Industrial Undertakings Act, etc.* (1936) S.C.R. 461, (1936) 3 D.L.R. 637, affirmed in part in *A.G. Can v. A.G. Ont.* (1937) A.C. 326, (1937) 1 W.W.R. 229, (1937), 1 D.L.R. 673, better known as "the *Labour Conventions case*," when appealed to the Privy Council, which took a different view on the Constitutional merits than did the equally divided Supreme Court of Canada. This issue, as far as it touched the matter under discussion here, concerned the alleged want of power of the Governor-General in Council, the federal executive, to enter into a treaty or accept an international obligation toward and with a foreign state, especially where the substance of the treaty or obligation related to matters which legislatively within Canada were within exclusive provincial competence.

sometimes limited in Canada. Alternatively, the federal government must rely on other constitutional sources of authority, such as the criminal law or the residual power called the Peace Order and Government Power, to enact regulatory schemes.

What about future trends? My own view is that the overall trend in Canada, although this has slowed in recent years, is towards continuing decentralization. That is to say, power is moving slowly to the provinces, especially the four largest provinces. The political ideology in Canada of provinces as sovereign is growing in influence and acceptance. For example, the ability of the federal government to spend money in an area of provincial jurisdiction, the spending power which Professor Farber talked about, is increasingly now becoming regarded as something that should not be permitted without provincial consent. I think we can expect to see continued growth and influence of the four largest provinces, which have the fiscal capacity to act unilaterally without the federal government. For example, for the past few years Ontario has been collecting its own corporate income tax with a system independent of the federal government.

In terms of implementation of trade agreements, at the moment, this is not a controversial matter because four of the five federal political parties, all the provincial governments, and Canadians themselves are generally pro-trade. So these debates about the power to implement trade agreements have not been a significant issue in Canada recently.

However, public sentiment may change. Thousands of demonstrators are expected at the meeting in Quebec City this weekend. For the last seven or eight years, there were no public polls taken on the popularity of trade agreements, which indicated that Canadians, in general, were in favor of NAFTA and free. Significantly, that has changed very recently and public opinion polls are now being taken on trade issues. The constitutional issue about power to implement trade agreements could re-emerge if public sentiment were to change and a political party could take the position that these trade agreements should not be implemented in Canada.

That, in general terms, is the situation in Canada. It is very difficult to predict future directions, but I think the trend is one in which there will be continuity in the same direction we have seen over the last twenty-five years. Thank you very much.

