



Challenges to Federalism:


Policy-Making in Canada and the Federal Republic of Germany

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PREFACE

This volume had its origins in a conference held at McMaster University in 1986. At that time a small group consisting of both academic scholars and public servants from the Federal Republic of Germany and Canada came together to report on the complexities of politics and policy-making in two modern federal systems. The conference generated new ideas and comparative insights, which allowed the contributors to rethink their own analyses in the light of comparable policy contexts in the other federal order. This book is the final product of that exchange of ideas.

Both the initial conference and this volume were made possible by the generous support of several institutions and numerous individuals. A grant from the Social Sciences and Humanities Research Council of Canada allowed us to hold the initial conference and also aided in publication costs. The Thyssen Foundation and the State Chancellory of Schleswig-Holstein made possible the participation of the German delegation. The Ontario Ministry of Intergovernmental Affairs provided support, facilities and expertise, all of which were essential to the success of this project. In addition, McMaster University and the Christian Albrechts-University in Kiel were most generous and cooperative in their support. In the final stages, the Elfriede Dräger Memorial Foundation made a generous donation to cover the balance of the funds required to meet the publication costs.

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INTRODUCTION

Viewed historically, no constitutional order, regardless of type, has avoided the challenges presented by the social, economic and political consequences of modernization. For some, such challenges have generated regime threatening conflict and polarization and have culminated in institutional crisis and collapse. For others, new demands and strains arising from societal change have been eased, if not resolved, through institutional adjustments and accommodation. In these cases, constitutional regimes have shown themselves capable of adaptation and therefore endurance.

Among industrialized democratic orders, federal systems of government have tended to conform to the second category. Not only have they survived, but in many ways have exhibited remarkable health. However, if there is agreement on the survivability and adaptability of federal forms, there is greater uncertainty about their policy capacities and performance. Given the expansion of the modern interventionist, welfare state in the post-war era, and especially in light of the perplexing economic and social uncertainties associated with post-industrial trends, it appropriately can be asked whether and how federal regimes are able to respond to such new challenges. The contributions to this volume seek to address within specific policy contexts the central problem of the workability of federalism. They do so by bringing together analyses drawn from the politics and policy processes found in two dissimilar federal orders, Canada and the Federal Republic of Germany. The various essays also integrate the experiences of two types of observers, practitioners (public servants) and academics. In this way the task of evaluating the suitability of federal arrangements for confronting the dilemmas of modern politics may benefit from the sharing of knowledge across both international and professional boundaries.

FEDERAL ARRANGEMENTS

The first set of essays in this collection provides an institutional and comparative context in which to assess the capacity of governments to encompass workable cooperative arrangements. William Chandler's introductory chapter is designed to delineate those institutional features evident in Canadian and German federalism that provide an essential contextual background to the analysis and comparison of pervasive issues in the study of federalism. Anthony Care-

less and H.D. Marheineke analyze how intergovernmental cooperation has been practised given increasing interdependencies and new demands on the political agenda within their respective countries. While Careless criticizes Canadian federalism for failing to respond adequately to those economic and social issues that cross sub-national boundaries, Marheineke accentuates the cooperative dynamic in West Germany, which has minimized potential deadlock and confrontation between levels of government.

While in Canada cooperation has developed within a framework of de facto arrangements, cooperative federalism in Germany has accounted for a vast array of institutionalized bilateral and multilateral interstate agreements and procedures. While in Canada the increasing prominence of the First Ministers' Conference has been the object of great attention, it appears that in Germany a rather tight network of relationships including regular conferences of the Länder ministers has lessened tensions between various government levels by segmenting prevailing issues into manageable parts.

It has become clear that the extent of intergovernmental cooperation on the executive level may pose a threat to parliamentary control. While Careless refers to the connivance, collusion and even conspiracy of executive federalism, Marheineke concludes that the autonomy of the Länder parliaments may be endangered should interstate federal arrangements dominate. Both analyses furthermore strike a clear note of agreement on the fact that these two societies, which are simultaneously individualistic and community-minded, demand both adequate democratic and efficient procedures for consensus-building and cooperation.

ECONOMIC POLICY

In Canada and West Germany neither the federal government nor the provincial or Land government has exclusive jurisdiction on industrial policy matters. In both countries there exists seemingly broad consensus on the fact that the state should intervene in free market mechanisms only under very particular circumstances.

According to Michael Atkinson and William Coleman, economic and industrial policies fit squarely within Canada's statist tradition. Although provincial programs have had an important impact on the formation of industrial policy, federal interventionist powers have remained formidable. However, bureaucratic fragmentation and conflict along with lack of expertise, often regarded as *conditio sine qua non*, seem to impede successful industrial policy.

For West Germany, Hartmut Picht demonstrates that the magnitude of governmental intervention has been excessive and has increased substantially in recent years despite the fact that in official rhetoric this policy trend has often

been criticized, even rebuked. Picht is much more sceptical about the merits of an active industrial policy than his Canadian counterparts. Yet he shares their view that the competitive endeavours of the provinces and the Länder with their own programs of assistance may distract from rather than add to general welfare. He further shows that the multitude of programs and funding mechanisms on the federal level, designed to stimulate economic development and to distribute it on a regionally balanced basis, have encouraged the escalation of governmental intervention.

FISCAL FEDERALISM

Fiscal federalism in Canada and in West Germany centres around the following issues: the allocation of tax revenues, tax sharing, joint funding and horizontal and/or vertical equalization among the various governments. In Germany fiscal arrangements are codified in the constitution to such an extent that the term "financial constitution" describes the modes of distribution of public revenues among the different tiers of government. The Canadian counterpart is much more subject to ongoing political bargaining between the federal and the provincial governments. However, the challenges in both cases, are identical: severe restraint from 1970 onwards, sudden escalations in oil (and gas) prices, and the awareness that some co-financing arrangements can display quite reverse incentives.

Gerd Böckmann describes the fiscal system as it applies to West Germany against the background of the division of responsibilities and burden sharing among the various levels of government. He backs his interpretation up by data on most recent financial developments. Ronald McGinley discusses recent adaptations in various Canadian fiscal arrangements. In view of the scope and intensity of federal-provincial animosity that have developed over the issue of cash transfers to the provinces, he advocates that more attention be devoted to minimizing intergovernmental frictions.

A very interesting parallel can be drawn with respect to the response of both fiscal systems to the rise and fall of oil prices. In both countries fiscal equalization arrangements were put under severe pressure because the bulk of revenues from oil (gas) is derived from one province/Land.

HEALTH POLICY

In Canada, as in West Germany, the costs for medical and hospital services have risen to almost unbearable levels impairing federal-provincial relationships on matters of cost-sharing formulas. Christa Altenstetter and Carolyn Tuohy demonstrate that the institutional arrangements governing hospital and medi-

cal services in both countries are not only complex in themselves, but differ substantially from each other.

The German system represents a quite unique configuration of diverse regulations on governmental levels, of non-governmental self-help facilities and of professional associations resulting from exigencies originating in the nineteenth century. In Canada an encompassing national health system emerged only after World War II. It has found acceptance to such an extent that a trend towards shifting costs from the public to the private sector by way of user-charges to patients aroused great controversy. In the field of health care the German system displays a much higher degree of duplication and fragmentation than the Canadian one. Both analyses show that fragmented authority on health care between federal and provincial/Länder governments also includes a distinct potential for innovation and experimentation with respect to service-quality and cost-reduction. But in both cases, perhaps more obviously in Germany, and very significantly in terms of the intersection of influences found in the federal-provincial interface, health policy is subject to vested partisan interests at all levels of government. Since multiple access possibilities for lobbying are at hand, the question of whether these systems have sufficient capacity to check the cost explosion in health care has become even more pressing.

TELECOMMUNICATIONS POLICY

The field of telecommunications provides policy examples in which federal-institutional arrangements increasingly are being forced to adapt to rapid technological change and innovation. It is very informative to learn how the differing constitutional and institutional conditions prevailing in Canada and in West Germany cope with this development. While the Canadian response at the outset was characterized by sectoral corporatism and by divided jurisdiction concerning regulations, at the German federal level telecommunications were monopolized by the German Federal Post. The Länder governments derive their authority in the shaping of telecommunication matters only from their constitutionally embedded jurisdictional authority on broadcasting.

Kenneth Woodside and R.B. Woodrow discuss the reasons for initiatives in Canada supporting a stronger national policy and a more effective regulation of competition. C.A. Conrad shows that Germany is moving towards greater diversity on different levels. In both countries considerable pressure has also been exerted on the prevailing system by current and potential private competition, especially in the light of new media and information services. A variety of pressing questions has recently arisen concerning system inter-connection,

competition in terminal equipment, guarantees of minimal standards and cross-subsidization compatible with national as well as regional policy goals.

URBAN/LOCAL POLICY

Local government is constitutive of every federal system. It maintains its importance as a third tier even if it derives its authority basically from the province as in Canada or the Land as in West Germany. Effective local government is all the more important since at the local level—within both countries—essential challenges to society, such as high unemployment, growing demand for social welfare services and severe budgetary strains are felt most intensely. Herbert Uppendahl closely examines the constitutional basis of the West German system with its "core domain doctrine" assigning to local authorities certain rights that may not be shifted to any other level, especially the Land. In contradiction to this the ratio existing between self-governing and delegated functions of local governments has increasingly threatened the principle of local authority. Uppendahl concludes with a strong argument for the "joint policy approach" (in regional, provincial and federal affairs) as an alternative both to the more centralist and to the more decentralist patterns of interdependence in German federalism in recent years. For Canada Mark Sproule-Jones illustrates, against the background of intertwined social and economic activities in urban life, the interplay of the various governmental levels in a case study of conflicting values concerning the purpose of Hamilton Harbour. He points out the extent to which the structure of public and private property rights is a neglected aspect of Canadian federalism.

FOREIGN POLICY

It is not unusual to attribute to the national government sole authority in foreign policy. In federal systems the question therefore arises how regional governments deal with foreign governments and with matters of international concern. The options range from the habitual monopolization of foreign policy at the federal level to solitary actions by regional governments in line with substantial tasks allocated to them.

Christian Zöllner illustrates, by reference to the experience of the Schleswig-Holstein Land government, how complex the foreign policy of a Land government and the cooperation among the different government levels can be in a system where constitutionally exclusive legislative authority in foreign affairs is granted to the federal government.

K.R. Nossal for the Canadian side describes how and why a specific foreign policy issue—sanctions against South Africa—gained momentum within the

province of Ontario. Although the Canadian constitution is void of regulations on the rights and powers of the provinces in international affairs, various imperatives and opportunities impelled the provincial government to become involved: the election of a new premier, the developing situation in South Africa itself, the attitudes of the other governments towards it, and pressure from interest groups.

In West Germany there is a clear tendency towards close consultation among different levels of government alongside a strong impetus in favour of more independent participation in international affairs on the part of *Länder*. This is supported by an explicit understanding with the German Foreign Office, due in part to close economic interdependencies within a relatively small and densely populated area. By contrast with domestic policy issues, remarkably little conflict exists among the various Canadian governments concerning their role in the international arena. On the other hand, party politics have been quite important in shaping political attitudes on such foreign policy concerns.

ENVIRONMENTAL POLICY

In the Western world since 1960, environmental policy has emerged as a most sensitive policy area. The rise of new and important political tasks associated with environmental problems offers a unique opportunity to compare how various federal systems of governments have responded to this issue. O.P. Dwivedi and Brian Woodrow for Canada and J.D. Busch, for Germany, analyse how the two federal systems have dealt with this burgeoning sector.

In Canada, with its federal order based on clearly divided jurisdictions, multiple mechanisms of bilateral and multilateral modes of coordination and cooperation have been developed. According to the assessment of the authors, the federal system has proved itself to be reasonably effective. In particular, federal-provincial committees at the senior bureaucratic level have been able to overcome marked differences in setting policy priorities.

In West Germany policy response consists primarily of nation-wide legislation as well as middle- and long-term planning on the basis of common guiding principles to promote public environmental protection. *Länder* and federal governments cooperate extensively, with the *Länder* participating directly in the federal legislative process. Furthermore, the *Länder* have acted as agents, through supplementary regulations, to complete and fulfill the requirements of federal laws. They also provide for the administration of various federal programs. The author further notes how fiscal instruments, either in setting incentives or in imposing additional taxes, have been refined. In both Canada and West Germany, federal and regional governments have cooperated closely in

the development of programs through their ministries, agencies and bureaucrats.



I

Federal Arrangements

Challenges to Federalism: Comparative Themes

William M. Chandler

FEDERALISM STILL IN QUESTION

As time-tested means of conflict resolution, federal states have shown themselves to be both resilient and durable. Nevertheless, questions persist about the strength of federal institutions and their capacity to operate effectively. Such questions have made the debate over the challenges of workability central to federal analysis.

Economic interventionism, the maturation of comprehensive welfare programs, and persisting public sector involvement in a wide range of policy concerns from environment to culture and communication have created new challenges for the performance of federal institutions. In contrast to the orthodoxy of an earlier generation of scholars who sensed a growing momentum towards centralization, it is now more reasonable to argue that the complexity and fragmentation that federal principles of authority foster may prove advantageous to the adaptation of political regimes and to the demands of industrial society. The centralized unitary state, while once thought to possess a higher capacity for long-term planning and coherent economic strategies, may often be bedevilled by bureaucratic or institutional rigidity. If so, decentralization and modernization need not be inevitably at odds. Instead of being archaic, federalism may find its relevance in adaptability through dispersion. The central question is no longer, "Does federalism make a difference?" It is rather how, why and under what conditions federalism makes a difference. The problem for policy-makers and academic observers alike is then one of the workability of federal power-sharing. The object in this introductory overview is to sketch out the issues that make up the challenges to federal arrangements today. A working agenda of problem areas based on Canadian and German federal experience may be developed, not to borrow institutions but rather to understand how they work.

To analyze variations in the performance or workability of federal arrangements, we need to examine the extent and quality of institutional change given the expanding scope and complexity of governing within industrial democratic systems. We must also consider the changing shape of policy agendas, emergent patterns of public policy, and transformations in conflict patterns; for the policy process itself can provide essential clues for evaluating the workings of complex federal orders. In the sections which follow, the underlying theme will be how federal systems are structured and how this may influence their ability to meet modern political challenges.

Finally, it is worth observing that while there is a natural tendency to limit attention on federal problems to those regimes having a constitutionally enshrined division of powers, it is certainly valuable to recognize that federalizing trends may occur within formally unitary states and that the issues of power-sharing explicit in federal debates are applicable to all modern political systems.

FEDERALISM AND THE GROWTH OF THE STATE

The emergence of complex interventionist governance within industrialized societies has made federal arrangements increasingly relevant to understanding patterns of conflict resolution. As states have expanded in size they have multiplied not only the number of problems on the public agenda but also the scope and impact of policy outcomes. Inevitably, this has imposed a division of labour within the political process. Policy networks and influence systems have spread across formal administrative divisions, as bureaucratic empires have flourished with government growth. Such transformations have inevitably spawned policy interdependence and have given new significance to the style and practice of political power-sharing inherent in federal institutions (Bird 1970:1-32).

Within the two federal regimes compared in this volume, we certainly find distinctive patterns of state expansion. For Germany, pioneering welfare programs in the Bismarckian era coupled with a long tradition of state-industry collaboration provided a solid foundation for public sector involvement in social and economic affairs. The early post-war success of Erhard's social market economy cemented a modern consensus in support of comprehensive social services alongside a free market economic order.

In Canada patterns of state expansion, especially those concerned with the establishment of a modern welfare state, developed only recently (Banting 1982:9-44). Given the jurisdictional provisions within the Canadian constitution, this change was to have dramatic effects on the federal order. The centralization of fiscal relations during World War Two gave the false impression that regional interests might be in decline, and at the end of the war, relations between Ottawa and the provinces were rather quiet. However, as

war-related policy priorities declined and as social welfare and economic issues took centre stage, the expansion of government activity in Canada became increasingly identified with the maturation of decision making processes at the provincial level.

This trend was reflected in two ways, first by a marked quantitative growth in provincial activity and second by growing pressures for decentralization. The interaction of these two forces is captured in the concept of province-building. Undoubtedly, the spark behind provincial activism was found first in Quebec's Quiet Revolution, but certainly over the course of the 1960s and 70s, most provinces began to assert their authority and began to challenge central preeminence in areas like natural resources, energy and economic management. Despite the hesitation of some recent observers about the meaning of the term "province-building", there can be little doubt that by the end of three decades of public sector expansion, the provinces were displaying a willingness to intervene and a competence to make policy that spelled the end of Ottawa's quasi-colonial supremacy in federal-provincial relations (Black and Cairns 1966: 27-44; Stevenson 1977; Chandler and Chandler 1982; Jenkin 1983: 43-5; and Young, Faucher and Blais, 1984). The process of provincial political maturation is a by-product of the growth of the state. More importantly, it has served to alter irreversibly the nature of Canadian federalism and is at the root of the modern dilemmas of workability in intergovernmental relations.

Comparable developments are not to be found in the German post-war experience for several reasons. First, the re-establishment of the *Länder* within zones of military occupation prior to the establishment of the Federal Republic in 1949 entrenched regional units and their institutional status. Second, the German stress on functional divisions of authority, rather than jurisdictional ones as in Canada, invested the *Länder* with bureaucratic machinery and expertise that did not have to be built up. Thus in German federal relations we can identify no institutional maturation comparable to province-building. This does not mean, however, that federal relationships in the German case are insignificant or unchanging. To the contrary we find a pattern of political and bureaucratic interdependence between the two principal levels of government that is characterized by strong interlocking linkages and that has fostered an integrative rather than confrontational style of conflict resolution. Indeed, variations in styles of intergovernmental relations along a dimension of collaboration-confrontation is one of the most striking differences that distinguishes these two federal systems.

By the late 1970s, the growth of the Canadian state witnessed overlapping crisis of separatism, constitutional inadequacy and economic stagnation. All culminated, and then defused, in the first half of the 1980s, whether through referendum, constitutional accord, electoral defeat, or by external factors. The

middle of the 1980s marks an interlude in which many of the old battle lines of intergovernmental struggle seemed strangely quiet. New political majorities in Ottawa, Quebec and Toronto opened the door to a new phase of intergovernmental relations in which economic problem areas, such as free trade and industrial strategy, took priority.

However great the sea change in political debate, it is now clear that the dramatic era of governmental growth is at an end. Today we observe in Canada, as in West Germany, strong impulses in favour of containing and reducing the scope of government through instruments like privatization, deregulation or fiscal restraint. However, where federal-provincial relations are concerned, there can be no return to an earlier and simpler era.

COMPARATIVE DIMENSIONS FOR THE ANALYSIS OF FEDERAL INSTITUTIONS

Degrees of centralization/decentralization have traditionally been assumed to be the primordial distinguishing feature of federal systems. Wheare's classic formulation of the federal principle stresses,

"the method of dividing powers so that the general and regional governments are each, within a sphere, co-ordinate and independent." (1946:11)

A necessary consequence of this arrangement is that both levels of government "operate *directly* upon the people; each citizen is subject to two governments" (Wheare 1946:2). The core of Wheare's definition concerns the division of sovereignty along territorial lines (the so-called water-tight compartments of the federal arrangement) and has remained a base point for comparative studies. However, students of modern federalism, in trying to account for the origins and evolution of federal systems have also seen the need to stress the flexibility and dynamics of federal arrangements (Deutsch et al. 1957; Riker 1964; Friedrich 1964). Today, the distinction between centralization and decentralization can only be a starting point for comparison.

Power-sharing between central and regional authorities takes multiple forms. Especially significant for understanding the problems of workability are the practices and problems of interdependence, the modes of representation, and the underlying rationales for divisions of authority. These three categories provide inclusive conceptual frameworks for interpreting the effects of institutions. They also encourage us to formulate problems comparatively and to abandon the common tendency to measure differences in federal arrangements by only one yardstick. Of course, all three dimensions proposed here are related to differences in centralization of political authority. But the broader point is, if we wish to gain from comparative inquiry of complex institutional arrange-

ments, that we must recognize that no one institutional dimension is likely to adequately stand alone. The significance of each will be discovered both by its interaction with other institutional qualities and by its impact in policy-making.

As long as the scope of governance remained limited, the likelihood of policy interference across levels was of little consequence and the opportunity for relatively autonomous decision-making correspondingly high. The growth of the public sector and the expanding complexity of policy problems have made variations in interdependence essential to any analysis of federal systems. Modern dilemmas of state involvement in the industrial order—from economic steering to energy issues, to industrial strategies, or managing welfare programs—cannot be resolved without the cooperation of both major levels of government. Moreover, where effective interaction is lacking, the need for it becomes readily apparent. Richard Simeon has identified a key feature of the Canadian federal system in the coexistence of a high level of political autonomy of federal and provincial governments with a high level of functional interdependence between them (Simeon 1972: chapters 1, 2). In this respect the contrast with the German experience is striking.

In Canada, the proliferation of intergovernmental relations has challenged the role of both parties and parliamentary institutions by creating parallel mechanisms of "executive federalism," which by-pass the established routes of democratic accountability (Smiley 1980: chapter 5). The extent of this displacement through executive federalism, which is common in Canada but not in West Germany, depends on the degree to which intergovernmental relations are integrated within the constitutionally defined policy process at the national level and on whether the underlying rationale for the federal division of authority is rooted in a division of jurisdictions or in a division of labour. The first of these conditions will be considered in detail below under the problem of representation in federal systems. The second addresses the question of the bases of federal divisions, also discussed below.

Pervasive interdependence does not necessarily spell collaboration, and in Canada federal-provincial confrontation rather than collaboration has surfaced in a wide range of policy areas (Simeon 1979). Effective collaboration takes place only when the integrity of each level of government and mutual trust between levels are preserved. There are, of course, both optimistic and pessimistic assessments of the workings of intergovernmental relations in Canada (Careless 1977; Simeon 1980; Stevenson 1980; Veilleux 1980; Savoie 1981). At the same time there is throughout much of this debate a loose consensus that the institutional framework has provided one of the most powerful dynamics in structuring the relations between Ottawa and the provinces. This consensus is best crystallized in Alan Cairns' state-centred view of federalism (Cairns 1977; Cairns 1979a).

REPRESENTATION

Federal constitutions generally include provisions for the direct representation of territorial units within parliamentary institutions at the national level. In Canada, however, regional opinions have been ineffectively transmitted via the legislative process or by the party system. The Westminster model, it is often said, concentrates power in the hands of the prime minister/premier and cabinet and assigns a minimal role to legislatures or parties in the policy process. In addition, majorities inside parliament often exhibit strong regional bias, fostered both by the electoral system and by the regionalized character of party organizations, while aside from a feeble Senate, the constitution does not prescribe any formal representation of regional or provincial interests in central policy-making. Furthermore, the distribution of powers in Canada tends to foster separation rather than sharing of responsibilities. The combination of these institutional and political realities creates a pronounced inclination to favour intergovernmental "executive federalism" as an arena for dealing with regional conflicts (Smiley 1980: chapter 4).

German federalism stands in sharp contrast. Regional opinions are guaranteed a direct and effective voice in the policy process at the centre via the constitutionally enshrined representation of the *Länder* in the Bundesrat. This formal and visible aspect of regional voice does not normally generate confrontation between the two legislative chambers or between the federal and Land governments. Regional concerns are effective because of the wide scope of policy requiring second chamber consent and because of the elaborate network of intergovernmental consultation involved in all stages of policy development. Furthermore, and again in clear contrast to Canada, the German stress on functional federalism means that in all major domestic policy sectors federal authorities and Land authorities are of necessity partners sharing tasks within a complex and on-going policy process.

Virtually unanimous agreement exists over the failure of the Canadian federal system to guarantee a stable pattern of effective regional representation. This has quite naturally prompted various reform proposals involving changes in the Senate, the electoral system, and organization of the Cabinet (Irvine 1979; Task Force on Canadian Unity 1979; McCormick, Manning and Gibson 1980; Special Joint Committee of the Senate and the House of Commons on Senate Reform 1984). We will not here seek to evaluate the array of possible changes but rather to clarify their meaning in the context of the workability of institutions. This can best be done by examining the distinction between two representational modes, intrastate and interstate, because these encapsulate the major issues of representation and as general concepts are applicable comparatively across federal settings.

The distinction between intrastate and interstate federalism,¹ dormant for some time, was resurrected by Donald Smiley in 1971 and has since become a popular framework in which to interpret proposals for the reform of federal arrangements in Canada (Smiley 1977). Intrastate federalism refers to those systems in which regional interests are primarily represented *within* central policy-making institutions. Interstate, on the other hand, refers to those in which the constituent units themselves (states, provinces, Länder) formally articulate conflicting preferences through relations *between* levels of government. This distinction is particularly compelling for Canadian politics, where both regionalized economies and cultural diversity have generated persisting pressure for regional representation.

A dilemma of Canadian federalism, as Smiley noted some years ago, is that despite the need for regional representation, Canada has only developed a very weak form of intrastate federalism (1977: 2-18), due in part to the constitution itself, which makes no allowance for the formal representation of provincial or regional interests in central policy-making. Even informally Ottawa has been regularly accused of being insensitive to regional concerns. Correspondingly, interstate modes of representation have also remained underdeveloped in character and, importantly, have never been integrated into the constitutional order, a situation that has limited the legitimacy and effectiveness of inter-governmental relations as an alternative to intrastate representation.

Before going further, it is useful to make clear what real institutional options are suggested by these two terms. Particularly with regard to interstate federalism there is room for confusion, because the term may be used in two ways. Alan Cairns, for example, has found the essential meaning of interstate federalism in the constitutional division of powers between the central government and the provincial/state governments (Cairns 1979b). This formulation stresses the passive or conditional facet of interstate federalism. The concept has, however, a second more activist side. Interaction and interdependence tend to dominate the relations among governing levels within modern interventionist federal orders. Jurisdictional issues are always a starting point, but the status and style of intergovernmental relations provide daily meaning to the term interstate federalism in a policy-making context. This activist side of such relations is furthermore the crucial one when it comes to the question of the effective representation of regional diversity within the federal system. Representation occurs through state to state relations and sometimes through the direct representation of regional state units at the centre—as is true for the

1 The terminology originates with Karl Loewenstein, *Political Power and the Governmental Process*, University of Chicago Press, 1965, 405.

German Bundesrat, a rare combination of inter- and intrastate modes of representation within one institution.

The Canadian variant of interstate federalism describes the quality of executive federalism, that is, interactions between governments, primarily at the level of senior civil servants and political leaders. The style and form of executive federalism have frequently been blamed for many of the major rifts that have occurred between federal and provincial governments over the past two decades and for transforming differences of opinion between centre and periphery into intense conflicts where powerful governments are pitted one against another.

A key point to stress for purposes of this analysis is that when interstate federalism is portrayed only in jurisdictional terms, we may neglect its activist, representational importance. Viewed in this second way, interstate representation may provide both a complement *and* an alternative to intrastate forms of representation. This has significance, particularly in Canada, where intrastate representation of regional interests has been judged inadequate.

It is, not surprisingly, within the confines of intrastate federalism that most of the Canadian debate over representation has taken place. As Smiley and Watts have noted in their definitive analysis for the Macdonald Royal Commission (1986), there was an explosion of interest in institutional reform subsequent to the 1976 victory of the Parti Québécois and partially in reaction to the growing political assertiveness of the provinces. The ensuing constitutional debate of the next six years examined most of these. In the end the constitutional accords themselves, while granting more room for provincial control, notably over natural resources/energy and while opening the door to future change through the judicializing of political decisions via the Charter of Rights, did nothing to alter the basic structure of power. Thus if more effective representation of regional interests within the federal decision-making structure provides the route to defusing federal-provincial confrontation or to reducing regional discontent, we have so far seen little to indicate that either goal is any closer. Part of this dilemma derives from the constitutional tradition alluded to above that allows little room for bases of governing other than the principle of parliamentary majorities. As Smiley and Watts have observed, "attempting to reconcile intrastate federalism with the Westminster model is akin to trying to square the constitutional circle" (1986:32; Verney 1983).

Throughout the discussions over constitutional change in Canada the problem of regional representation through reform of second chambers has dominated much of the contemporary debate (Smiley and Watts 1986:117-44). Various remedies have been proposed through numerous studies, task forces and commissions, but broadly they may be collapsed into two general options. One is for some type of Bundesrat-like chamber composed of provincial delegates; the other is for a popularly elected senate (Watts 1970; Burns 1975;

Task Force on Canadian Unity 1979; McCormick et al. 1981; Gibbins 1983). As the Meech Lake Accord of 1987 demonstrated, no acceptable solutions have yet been found, leaving open the question of whether effective regional representation within the central legislative process is compatible with the Westminster style of responsible government (Smiley and Watts 1986:130-1).

It is noteworthy that the proposal for Senate reform emerging from The Macdonald Royal Commission advocates an elected second chamber. But according to Smiley it is a "recipe for a weak Senate which is unlikely to attract able or aggressive people who will represent regional or any other interests effectively" (Smiley 1986:114). Albert Breton's Supplementary Statement to the *Report*, based on his concept of "competitive federalism" (1985:486-526) has argued for a stronger version of reform that would permit the Senate to play a monitoring role in "the inter-provincial competition of resources at the disposal of the federal government" (Smiley 1986:120).

BASES OF DIVISION WITHIN FEDERAL SYSTEMS

The German-Canadian comparison is particularly useful in identifying often unnoticed variations in the purpose and effect of federal authority, that is, divisions of jurisdictions versus divisions of labour. In those federal regimes organized primarily in terms of jurisdictional principles, the object is to create two levels of authority, each with its own well-defined policy sectors, operating semi-autonomously. The entire machinery of governments tends to be duplicated at each level, and there is a presumption that each level can and should manage its own affairs.

Jurisdictional federalism encourages a stable tension between the reality of policy interdependence and the ideal of disentanglement. The fact that political actors at each level possess a complete policy-making apparatus means that in the face of intractable conflicts, unilateral action remains a political option. Furthermore, provincial/state electoral politics under jurisdictional federalism rarely mirror national divisions. As a general rule, one can expect that jurisdictional divisions will expand the incentives for political elites to exploit regional conflicts and to politicize federal-provincial relations. There can be little doubt from Canadian history that fighting Ottawa provides political advantages for provincial premiers who then present their own provincial party as the sole defender of regional interests.

The alternative involves a concept of federalism based on a division of labour and the sharing of power as the essence of federation. This arrangement does not produce replicas of the machinery of government at both levels. Instead, within a given policy sector, subsets of the decision-making process are accorded to one level or the other. Thus, as in the Federal Republic of Germany,

the central government may be predominantly concerned with policy initiation, formulation and legislation, while regional units may be heavily weighted in favour of policy implementation and administration (Mathews 1980; Johnson 1983:118-25).

Functional federalism assumes a high degree of interdependence and cooperation, both politically and administratively. It tends to spawn elaborate patterns of consultation and bargaining, for neither level will succeed in resolving conflicts without the help of the other. There is, then, a strong institutional impetus towards a complex meshing of political and bureaucratic interests. To the extent that functional federalism does not allocate policy fields to a single level of government, the regional distinctiveness of policy packages will be less than under jurisdictional federalism. However, even a functionally oriented division will allocate some policy sectors primarily to one level, for example, education, police, and municipal affairs in the Federal Republic of Germany. As a result one cannot assume under functional federalism that regional elections are all alike in terms of issues, policy options and partisanship, even though they will tend to involve national issues and national parties on a regular basis (Chandler 1987:156-7).

The recurrent Canadian phenomenon of one-party dominance reflects the politicization of provincial governments in the intergovernmental policy process. That is, provinces act as if they constitute the partisan opposition to the federal government. From this, follows the proposition that jurisdictional federalism tends to displace parties in intergovernmental relations, while functional federalism integrates parties into the process. Under this type of federalism, parties tend not to distinguish themselves by claiming provincial rights or in terms of resisting the centre but by alternative sets of policy options for governing nationally.

Of course, intergovernmental relations also may occur in decisional arenas where the traditional functions of parties have little place. In Canadian federalism intergovernmental relations based primarily on executive-bureaucratic bargaining have often operated on an ad hoc basis, outside the par-

tisan arenas of elections and parliament. Thus parties may be peripheral to much of the policy process despite strong political traditions of parliamentary supremacy and party government. By contrast, in functional federalism the displacement of parties is less likely because regional-provincial elites have little incentive to structure federal-provincial conflict in government versus opposition terms, while the centrality of parties in the federal bargaining process may be guaranteed by the integrative effects of functional federalism on party organization.²

German federal arrangements suggest that a functional division of labour fosters cooperative bargaining within a stable process of coordination/consultation and provides a strong incentive for coordinated party alliances between levels of government. For example, from the early years of the Bonn Republic as the modern post-war party system was evolving, there was an early effort associated with Adenauer's majority-building to pressure Land politicians into coalitions parallel to that at the federal level (Lehmbruch 1976:158-77). Crucial to this process was the need of the federal government to assure the political compatibility of the Bundesrat. Thus there has developed a strong incentive on the part of federal politicians to intervene in Land elections, often involving the parachuting of national leaders into Land politics. It has also meant that Land elections are fought, to some degree, over national rather than provincial issues, making them tests of national party support. In terms of elite recruitment, the Länder have been an important source of future national leaders (whereas in twentieth century Canada no provincial premier has ever succeeded in becoming prime minister).

Generally, it can be said that regional party elites are tightly integrated and have an active voice within the federal party organization, a fact which complements and reinforces the formal role of Land governments in the Bundesrat. Germany has integrated parties in organizational terms. By comparison jurisdictional federalism in Canada encourages the bifurcation of party organization, while territorial politics have generated centrifugal effects and accentuated strains within national parties (Black 1979:89-99). Politicians at

- 2 Although functional federalism, by its stress on interdependence, may reinforce the bureaucratization of intergovernmental relations and may minimize overt politicization of these relations, it does not necessarily reduce the role of parties in the process. The German federal example suggests that partisan influence within executive-bureaucratic frameworks may be maintained in part through a partisan penetration of the higher levels of the public service. There may also be a reverse flow of bureaucratic influence on parties through the recruitment of elected officials from bureaucratic ranks. For a detailed treatment of this phenomenon, see Kenneth Dyson, *Party, State and Bureaucracy in Western Germany*, Sage, 1977.

either level have found it costly to be directly associated with the political stances of their counterparts at the other level. Typically, federal and provincial parties remain organizationally autonomous, for there are fewer incentives to create parallel majorities than in the German Federal Republic. Provincial elections are never interpreted as votes of confidence in the federal governing party. Federal politicians do not normally intervene in provincial contests, while provincial premiers do so to only a limited degree federally.

The issues of workability and governability arise directly from the interaction inherent in the multi-dimensionality of federal arrangements. That is, the displacement effects of regional conflict common in Canadian politics depend, for example, on the interaction between jurisdictional divisions with weak intrastate representation and pervasive policy interdependence. From this has emerged a confrontational rather than collaborative style of governance that has too often deadlocked the intergovernmental process. By contrast in Germany, institutional factors and policy styles have interacted with party organizations to reinforce the centrality of partisan ties within intergovernmental relationships.

We have stressed to this point the structural conditions of workability found in federal arrangements, but this clearly is only part of the explanation. J. Stefan Dupré's recent analysis of the nexus between federal-provincial interaction and intragovernmental organization goes one step further in identifying the trend from "departmentalized" to "institutionalized" cabinet operation as an important factor in both the waning of functional relations and the prominence of summitry in federal-provincial affairs (1986). Dupré points to the importance of trust-ties for maximizing workability, ties which are only partially determined by the institutional frameworks of the federal state.

FEDERALISM AND POLICY IMPACT

To this point the performance of federal arrangements has been viewed in terms of institutional processes. An alternative strategy for examining workability is, of course, within specific policy contexts and is pursued in the chapters that follow. From this perspective, the question of how federalism makes a difference is considerably more difficult to answer. Uncertainty about the policy impacts of federalism result in part from the vast array of policy sectors. It is also a function of the tendency in the past for students of federalism, by concentrating on formal constitutional features, to neglect the often subtle policy consequences of federal structures.

The full exploration of the connection between institutional dynamics and policy outcomes in federal systems requires both case studies and systematic comparison in order to analyse how conflict situations are resolved given

federal dispersions of power. From a policy perspective the challenges to federalism can be crystallized within the issues of capacity and adaptability.

Capacity refers to the potential of policy-makers to go beyond ad hoc crisis management and to engage in effective strategies for dealing with those persisting issues that comprise the working agenda of modern states. In other words, governments must be more than merely reactive agents, or prisoners of dominant social and economic interests; for capacity assumes some substantial degree of state autonomy (Nordlinger 1981).

Institutions may themselves be powerful determinants of political forces affecting the probability of policy outcomes. This is obviously more true for so-called "strong states," which as Zysman observes are able to, "mobilize and direct the resources of society toward the ends chosen by the executive." Thus the governing elite is able "to get its own way when implementing policy" (Zysman 1983:296). Similarly Krasner contends, "the weakest kind of state is one which is completely permeated by pressure groups.... At the other extreme [is a state] which is able to remake the society and culture in which it exists...." (Krasner 1978:57-60).

Where issues of federalism are concerned, the most general proposition emerging from the strong state—weak state dichotomy is that unitary institutions are more likely to facilitate the capacities associated with the strong state model. Federal systems, by virtue of the dispersion of power combined with complex interdependence, are less able to command the same degree of control. The Macdonald Commission *Report* provides a recent and succinct formulation of the "federalism as a weak state" thesis:

Some say that federalism unduly complicates the process of policy making. Decision-making costs increase as 11 sets of political authorities must co-ordinate their activities. The result in shared fields often seems to be immobility and indecisiveness.... Federalism seems to be the enemy of policy that is planned, comprehensive, coherent, uniform and consistent (1945:147).

The weak state thesis has also been developed by Michael Jenkin, who sees provincial aggressiveness and a lack of federal leadership combining to produce policy paralysis (Jenkin 1983:170). Canada's fragmented economic structure is at the root of this problem, for regional conflict and the regionalization of economic interests have afforded little basis for effective national consensus on economic strategies. One consequence of this is that Canada has remained a relative novice in the field of industrial policy with benefits for one region, usually in the form of industrial incentives, being perceived as deprivations for another.

The crucial comparative question that follows directly from the link between policy capacity and federalism is whether some federal arrangements are

weaker/stronger than others. In the context of industrial strategies, Michael Atkinson has asked if Canadian federalism in particular provides "a set of political institutions through which state officials can exercise the leadership that industrial policy demands?" (1984:454). If we assume that federal structures need not be an impediment to the capacity to govern, that is, that they are ultimately correctable, then the challenge to federalism is essentially one of devising an apparatus whereby the federal state is compatible with the strong state.

The latter assumes planning to be both essential and positive. Yet, as governments increasingly turn towards planning, certain strains, especially in federal systems, are likely to be exacerbated because the delicate balance in the dispersion and sharing of power may be destroyed by infringements of one level on the other. Thus the challenge of workability is to be found not merely in the ability to implement long-range objectives but in the development and adaptation of adequate mechanisms of coordination.

In addition, the impacts of federalism on public policy and vice versa are observable not just within particular policy sectors. As Schultz and Alexandroff have demonstrated with regard to the politics of regulation, variations in governing capacity and adaptability may also be associated with changing arenas and instruments of public policy. They contend that regulatory activity must be viewed as multifunctional, ranging from relatively restrictive forms of policing to promotional efforts and regulatory involvement with planning/policy-making functions. The tendency for regulation to widen its scope given sustained public sector intervention in economic affairs creates shifts towards the planning function and away from policing. With this trend, regulation is increasingly likely to involve effects exogenous to the regulated industry itself and to gradually lead to "the integration of the regulatory agency into the wider political process" (Schultz and Alexandroff 1985:31). This, they argue, has two political consequences. First, it directly affects the role and structure of organized interests by broadening participation in regulatory politics. Where corrective policing functions predominate, there is likely to be "a coincidence of interests for both management and labour resulting from the ability, in the case of the former, to pass on labour costs automatically or, in the latter case, to attain job security via anti-competitive entry restrictions" (1985:17). Consensus based on protecting the common interests of a regulated industry may break down as regulatory planning takes over, for the broadened policy focus of regulation will attract previously unrepresented interests into the process and is likely to encourage other agencies of government to protect their own policy domains when these are thought to be threatened by expansive regulatory action.

The second effect, having particular significance in the Canadian system, involves the impact on intergovernmental relations. Schultz and Alexandroff as-

sert that this effect must be understood in terms of the impact of changing federal regulatory practice on three roles played by provincial governments—regional interest representatives, owners of regulated sectors, and policy-makers. The shift in the direction of regulatory planning/policy-making magnifies the importance of policy interdependence and accentuates the potential for intergovernmental conflict. It forces provinces as defenders of regional interests to strengthen their adversarial role against Ottawa. It makes provincial Crown corporations increasingly dependent on federal regulatory decisions, and it infringes on the autonomy of the provinces as policy-makers.

The widening scope of regulation and regulatory policy-makers represents a challenge to provincial authority which, in an era of activist provinces, is likely to produce resistance and confrontation rather than compromise and cooperation. Provinces have in many policy contexts shown clear distrust and misgivings about the legitimacy of federal initiatives. This has damaged the "trust-ties" that Dupré has argued are essential to workability. The consequence is to immobilize governmental action and "create barriers to adaptation and effective policy response in areas of economic policy where change is perceived as necessary" (Schultz and Alexandroff 1985:144). An added consequence is that the politics of government against government produces battles over who should do what rather than what should be done (Simeon 1977).

Given the inevitable character of complex interdependence and given the conflict patterns that occur within regulatory arenas—as they do within specific sectors like natural resource/energy, culture/communication, economic management or regional policy fields—the real challenge to federalism is found in the questions of whether and how cooperative styles of conflict resolution through consensus-seeking and bargaining can replace, or at least displace, strongly rooted traditions of confrontation, deadlock and unilateral action. Certainly part of the Canadian problem takes us back to the lack of regional voice epitomized by the weak forms of intrastate and interstate representation. Some of the confrontational style is also undoubtedly tied to the jurisdictional conception of the division of powers, which sees government against government as a natural condition of federalism.

Another clue to maximizing adaptability through cooperation may be found in the link between organized interests and public policy noted earlier. The most general effect of federal structures on organized interests is that dispersion of powers induces groups to develop fragmented, decentralized organizations in order to gain access at multiple decision points. As William Coleman's comparison of interest group structures demonstrates, there is a great deal of variation both within policy sectors and across nation states. Nevertheless, there is a tendency, especially within jurisdictional federalism for decentralized constitutional arrangements to foster autonomous, regional group involvement

(Coleman 1987). Such encompassing organizations will have "an incentive to make sacrifices up to a point for policies and activities that are sufficiently rewarding for society as a whole" (Olson 1984:47). This implies that where groups can be made more encompassing or where institutional incentives induce them to behave in an encompassing manner, the capacity of the political order will be enhanced. Conversely, where fragmented, specialized organizations pursue narrow self-interest and where political elites are primarily responsive to such interests, governments may find themselves handcuffed by a multiplicity of parochial demands. This results in a politics dominated by clientistic favours, by short time frames and by a reactive style or crisis management. Certainly, by comparison with Canada, West German economic and social interests appear to approximate this "encompassing" quality, which is reflected in the strength and policy involvement of peak organizations.

This formulation of the governing capacity problem treats economic actors, that is, organized interests, as determinants, but it is no doubt equally important that policy-makers themselves also have adequate incentives to develop an encompassing mentality (Trebilcock et al. 1982:33). It is primarily through institutional frameworks—particularly those involving alternative modes of representation and functionally-based policy cooperation—that these incentives for elite behaviour may be hindered or advanced. An additional crucial point with regard to Canadian federalism is that as policy interdependence has expanded, intergovernmental relations have institutionalized a confrontational style of conflict in which elites at both levels have too often had incentives to defend their own turf and to pursue parochial interests rather than to promote encompassing goals. The challenge to workability of federal arrangements must therefore be seen in the linkage between structural contexts and policy-making roles.

CONCLUSION: CHALLENGES TO MODERN FEDERALISM

From this brief investigation of the workings of federal institutions and policy impacts, two themes emerge, both of which pose basic challenges to the future of federalism. The first involves governing capacity. Must a federal system always be weak due to its own internal dispersion of authority? In this context the challenge is to understand how the federal mechanisms can function and adapt so as to approximate a strong state. The second theme is one of integration and involves the influence of both institutions and organized interests within the federal state. Here the issue is whether political decision-makers are primarily responsive to narrowly defined interests or whether they have adequate opportunity to take an encompassing perspective toward policy issues and strategies. This should not imply that the maximization of national wealth

is the only criterion for an encompassing policy priority. Indeed, the essence of a federal order is precisely to allow for alternative public goals to be pursued simultaneously. In Canada, as Thomas Courchene points out, federalism has been designed to guarantee the pursuit of multiple goals (1983:98-103). Responsiveness to parochial interests is typically reflected in the prevalence of special pleading to spare some group or firm from being a loser. Where this is the case, it suggests a situation in which the institutions of the state have failed to foster encompassing group relations. In an era when imperatives of economic adjustment to fast-moving conditions of international competition are at the core of policy success or failure, the luxury of what Goldthorpe refers to as "unregulated representation of interests" may be a "recipe for disorder and unrest" which fosters policy immobilism and crises of ungovernability (1984:324). In this context styles of representation based on *concertation*, as found in West Germany, suggest a means of enhancing governmental capacity, for the direct involvement of business and labour encourages a broadening of their bases of representation. Concertation also implies a trade-off between power-sharing and restraint in group demands that facilitates bargaining and consultation in place of adversarial confrontation.

The significance of group representation for governing capacity has a direct analog to certain of the institutional issues posed above. Gerhard Lehmbruch has argued that federal relationships are inherently ones of a complex bargaining process in which conflicts are resolved not by imposing the principle of majority rule but by consensus-building and accommodation (1976:11-17). However, where federal and parliamentary traditions are combined within one regime, two distinct sets of "rules of the game" may intersect.

It is squarely on this point that the dilemma of Canadian political institutions becomes most apparent; for as Smiley and Watts have argued, the strict majoritarianism inherent in the Westminster tradition has left no room—at least within constitutional structures—for corporatist-style conflict resolution (1986:40-7). Thus despite the centrality of power-sharing to the concept of federalism, Canadian federal structures have themselves absorbed adversarial, "government versus opposition" policy styles within intergovernmental arenas. For want of structural incentives, concertation and consensus-seeking have been relegated to the informal and extra-constitutional component of the inter-governmental policy process.

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The Workability of Federal Arrangements: The Case of Germany

Horst Dieter Marheineke

INTRODUCTION

A significant problem in the working of federal arrangements resides in the fact that ministerial bureaucracies have penetrated into the area of political planning. It is true that all agreements are formally concluded by cabinet members, however, in practice they can only devote a limited part of their time to personal participation in preparatory tasks. The work is carried out by civil servants, and the results often take the form of compromise solutions. Final decisions at the cabinet level are, thus, largely based on the camaraderie of bureaucrats. This in turn may well be one of the main reasons why so little criticism has been voiced against joint decision-making by the participating ministries.

The Basic Law (Constitution) specifies in detail the fields where the Länder (States) have exclusive jurisdiction. The autonomy of the Länder manifests itself primarily in the fields of cultural policy and law and order, e.g., in police matters. In these areas the Länder may choose varying arrangements. And yet, perhaps surprisingly, whether you switch on television in Kiel, in Munich, or in Berlin, what you will see on TV Channel 2 is nation-wide the same program of a TV corporation operating under public law. And no matter in which Land you reside, police officers everywhere wear the same green-and-tan uniforms. At least in this respect we have obtained a striking degree of uniformity of living conditions throughout the Federation as postulated in the Basic Law.

Bilateral and multilateral federal agreements have in fact assumed a great importance as means of coordination and cooperation in the Federal Republic of Germany. The Basic Law starts from the principle of a clear-cut separation of responsibilities between the Federation and the Länder. In practice, the structure of the federal-state relationship as originally defined in the Basic Law has

changed decisively. An ever-tightening network of relationships between various governmental levels has developed. These relations are based on written agreements whereby federal institutions have played an ever-increasing part. From 1947 on, more than two hundred formal interstate and federal-state agreements have been registered in Schleswig-Holstein. There is no comprehensive, nation-wide synopsis, but the total number is probably in the magnitude of several thousands—not counting the enormous number of resolutions and joint recommendations.

INTERSTATE AGREEMENTS

Interstate agreements are used in various fields in the public sector. They apply to judicial administration, social affairs, traffic, and economic affairs, but the major focus is on cultural and educational matters and on media politics.

The legitimacy of these arrangements is not seriously questioned in terms of legality (Herzog 1967: 198; Roellenbleg 1968: 225; Maunz 1981: 232; Vogel 1983: 854; Maunz and Zippelius 1985: Paragraph 31 (I, II)). The Basic Law also authorizes the Länder to conclude agreements with foreign governments in cases in which they have legislative powers. In such cases a *de maiore a minus* conclusion is perfectly admissible. Further, the Financial Reform Legislation of 1969 resulting in a constitutional amendment formally opened the possibility of concluding federal-state agreements (Barschel, 1982: 156).

According to their legal structure federal arrangements can be classified as formal treaties (Staatsverträge), administrative agreements (Verwaltungsvereinbarungen), resolutions of the Conferences of the First Ministers (Konferenz der Ministerpräsidenten der Länder), and Conferences of Land Ministers (Konferenz der Fachminister der Länder) (Schneider, 1961: 8):

- Formal treaties aim at direct legal consequences which may also pertain directly to individuals. They relate to situations where legislation or formal law is required for their execution. They also require consent of the state parliament. Thus, the agreements obtain the quality of state law.
- Administrative arrangements refer to matters which are within the jurisdiction of the Federation and the Länder (Bundesverfassungsgericht (Federal Constitutional Court) 1976).
- The resolutions passed by the Conferences of First Ministers and Land Ministers are merely recommendations. Nevertheless they are of substantial importance, for the realization of recommendations always involves Länder.

The most important institutions for on-going interstate cooperation are probably the Conferences of the First Ministers and the Conferences of Land Ministers, of which there are fourteen. The best-known of the latter is the so-called Standing Conference of Ministers of Cultural Affairs which is an essential factor in the field of public education (state jurisdiction). It has a permanently staffed headquarters in Bonn and a full-time secretary-general (Sekretariat der Ständigen Konferenz der Kultusminister 1985). The Standing Conference has held more than two hundred meetings of ministers and has passed more than one thousand resolutions on various issues. All conferences on the ministerial level have some sort of administrative infrastructure (e.g. committees and sub-committees). In parliamentary circles this infrastructure has been referred to as a 'gray area' because subject matters which cannot be controlled by the state legislatures often are addressed at the interstate level instead. The purpose of such conferences generally is to harmonize state legislation. In many cases so-called 'model laws' have been drafted. Due to this fact the Länder often have to implement federal legislation under their own responsibility. They have frequently agreed on coordinated statutory regulations, administrative directives and guidance. They have also tried to harmonize administrative procedures.

In addition to nation-wide conferences of this type, there are also regional standing conferences of neighboring states, such as the North German Conference of the First Ministers (Norddeutsche Konferenz der Ministerpräsidenten). One item which is permanently on the agenda in this particular group is, for example, the concern about the viability of the German shipyard industry which is located in the coastal area of northern Germany (see Picht in this volume).

Among the procedural rules applicable to all types of agreements, a particularly important one is the principle of unanimity. All Länder have equal standing. As a consequence often protracted and complex decision-making processes are necessary, mainly as a result of diverging interests between rich and poor Länder, and also according to the party-alignments of the respective Land governments. In practice, compliance with the unanimity rule can often be ensured only by recording divergent minority positions in the minutes.

From the multitude of existing federal agreements the question arises whether the original distribution of functions to various levels of governments as envisaged by the Basic Law still meets present needs. Although there is no doubt about their legal admissibility, certain limits with respect to such agreements exist. It is still essential to examine the arguments in favour and against federal arrangements in each particular case. In general, interstate agreements aim at the following goals (Schneider, 1961: 16):

1. One type of arrangement serves the purpose of regional demarcation, i.e., to define territorial and administrative jurisdictions.
2. A large group of agreements serves to establish joint administrative or public institutions in order to reduce and/or share financial burdens. Further, the institution in question may only come into full operation with the cooperation of two or more Länder. Examples are joint courts, examination offices, and public broadcasting corporations.¹
3. Another justification for interstate agreements is found in the increasing demand for equal status in law and for equivalent living conditions throughout the Federation. This in turn may imply greater uniformity in governmental activities, e.g., in education.

A few illustrations show that cooperation can take on forms that differ markedly depending on the range and importance of the tasks addressed. There is, for example, a film rating board of the Länder. If a movie is highly recommended, it will be tax-privileged. Although it is an agency run by Hesse, the tax-privilege holds for the entire Federation. A further example is an institution called *Gemeinsames Oberverwaltungsgericht Lüneburg*—the jointly run Higher Administrative Court of Schleswig-Holstein and Lower Saxony. A final example is TV Channel 2 already referred to above. It is run by the Länder and is an independent institution which operates autonomously.

One of the most important current controversies at the interstate level undoubtedly involves the field of new media where the Länder claim exclusive jurisdiction. The issue at stake concerns primarily the TV satellite programs of public law corporations and the licensing of private radio and TV operators. The Länder hold fundamentally divergent views on the issue due both to their general positions on economic and social policies and to their particular party-alignment. Numerous questions arise in this context: Do the Länder have the right to license media operations within their own territory when the programs are broadcast nation-wide? Is an interstate agreement ratified by all Länder indispensable? Is it admissible that one Land enter into special agreements with another which is politically compatible, perhaps for the sole purpose of putting pressure upon others?

The question is whether federalism is being overtaxed in this case. The federal level has already made suggestions in this direction. Meanwhile, the First Ministers of the Länder have reaffirmed their regulatory authority. In other words, they reject the idea of coordination by the Federal Government.

1 The interstate agreement on TV Channel 2 has in particular been of considerable importance to the development of cooperative federalism.

However, if the Länder wish to enforce their claim to determine the evolution of electronic media under their own responsibility, it appears that they are condemned to reaching a consensus. (See also Conrad, Chapter 10 in this volume.)

FEDERAL-STATE AGREEMENTS

Agreements between the Federation and the Länder are often referred to as the most specific form of cooperative federalism. The Financial Reform Legislation of 1969 created genuine joint tasks for the Federation and the Länder. It provided, for example, a common basis for increased cooperation in educational planning and in research. The same applies to federal financial aid under specified conditions. In regions which have a major impact on future economic development, expenditure patterns and financing requirements may not coincide. Their importance requires a concentration of efforts on the part of all governments including the Federal Government. A major provision in this respect has been established through Article 104a Section 4 Basic Law which expands federal powers. The Federal Government may provide financial support for investments to the Länder.

An important area of application has been the field of public housing. The example given here stems from my own departmental experience in public housing and town renewal. The responsibility for the promotion of housing is allocated as follows: the overall competence rests with the Federal Government which is responsible for nation-wide legislation. The Länder are responsible for promoting housing within their respective territories. Considerable amounts of their budgets are devoted to this task. In the past four years the housing promotion budget, for example, of Schleswig-Holstein amounted to 1.2 Billion Deutsche Mark. A significant proportion of the money came from the federal level.²

Federal aid for social housing projects is subject to annually negotiated administrative agreements which have the same legal standing as comparable federal law which requires approval by the Bundesrat (Federal Council). The Federal Constitutional Court (*Bundesverfassungsgericht*) has laid down the following rules: The Federation can only conclude such agreements simultaneously with all other Länder involved in the matter, i.e., all Länder must give their consent. Only in those cases where a Land refuses to agree for reasons unrelated to the subject matter does the requirement of unanimous consent not hold.

2 For an empirical account of housing subsidies in the Federal Republic of Germany, see Picht in this volume.

Such behaviour would be considered as an act of disloyalty vis-à-vis the Federation.

Administrative agreements are prepared annually by the competent departments and are signed by the respective ministers on behalf of the First Minister. In the case of administrative agreements on housing project funding, federal resources are divided among the Länder on a *pro rata* basis according to population figures, although variations in the availability of housing and demand for rental homes may well call for a regionally differentiated formula.

The agreements reached can generally be characterized as compromise solutions. One of the reasons is probably the pressure to reach a decision at all. The Federal Government is dependent on negotiations; but consent can be achieved only if equal treatment and protection of acquired rights is granted. Conflict postponement and renunciation of federal intervention are used as yardsticks in joint decision-making.

The Länder have for several years made efforts to conclude a basic agreement with the Federal Government aiming at a restriction of federal powers concerning Article 104a Section 4 of the Basic Law. The First Ministers are currently trying to achieve a disentanglement of co-funding schemes. The objective is to constrain the growing influence of the Federation on state spending which results from co-funding. Earmarked federal aid is to be replaced by non-specified lump-sum allocations as part of the annual financial interstate compensation scheme (see Böckmann in this volume). This has so far been possible only with regard to hospital funding. A similar agreement for housing and urban development is currently being negotiated. Generally, the goal is to restrict the scope of federal arrangements.

CONCLUDING REMARKS

The instrument of federal arrangements has been criticized from the point of view of parliamentary control. The agreements are said to deprive the Länder parliaments of their powers. The case of Schleswig-Holstein is typical. Formal interstate treaties require approval by the Land legislature. However, the scope of parliamentary control is limited because the legislature can only approve or reject a treaty once the executive has initiated it and all clauses have been specified. The members of the legislature cannot propose any amendments, and the legislative branch therefore has no legally founded influence over the contents or genesis of the agreement. In turn, the initiative with respect to interstate agreements rests exclusively with the executive which determines the negotiation strategy, conducts the negotiations, and finally decides which solution is acceptable. Once an agreement has come into effect with the consent of the parliament it has the same legal standing as a law. Further, the fate of a treaty

is in the hands of the executive which may avail itself of a cancellation clause (if there is one) without the consent of the state parliament. The inherently weak position of the legislative branch with regard to state treaties has often been justified by referring to the so-called constructive vote of no-confidence in the Basic Law (Konstruktives Misstrauen), which favours greater independence on the part of the executive.

In Schleswig-Holstein the government reached an agreement with the parliament which takes into account the interest of the legislature in being informed as early as possible of essential aspects of an impending interstate treaty (Schleswig-Holsteinischer Landtag 1987). In the case of an administrative agreement the executive will inform the respective committee of the legislature on essential parts of the agreement once the latter has been concluded. On the other hand, prior decisions by parliament are definitely relevant. The parliament may complicate or even block joint decisions. However, as joint decision-making presupposes a certain margin for choosing options on either side, the executive may well be assumed to have a *de facto* monopoly position, which is tantamount to depriving the parliament of its powers. There seems to be no golden mean between safeguarding the power of the parliament on the one side and facilitating effective cooperation on the other.

The debate over whether the network of interstate agreements may jeopardize the autonomy of the Länder has never really ceased. There is some concern that interstate agreements might pave the way for nation-wide uniformity in all spheres of life. Objections are raised on the ground that the Länder were given legislative competence in order to enable them to solve their specific problems independently and in the light of particular circumstances. The specificity of states should not be limited to the task of watching over local folklore. However, in the controversy over the legitimacy of the nation-wide TV Channel 2 program, the Federal Constitutional Court has ruled that there was no constitutional requirement for states to disagree amongst themselves, i.e., there exists no mandatory parochialism for the sake of differentiation *per se*.

Another aspect deserves consideration in this respect. In fields which are within federal responsibility, uniform action of the legislature is ensured by virtue of majority vote in the parliament. It can be ensured within the executive branch by a single minister or by a competent senior civil servant. Interstate matters, in turn, require consent among the Länder involved. The idea behind federalism may, in this view, not be so much to account for the heterogeneity of the Länder, as it is to allow for a pluralism of initiatives. At the same time the problems associated with simple majority vote prevailing at the federal level are reduced.

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Limits to Cooperation

Anthony G. Careless

CHALLENGES TO FEDERALISM

The post-war welfare state has promoted principles of mutual responsibility and equity, resulting in social and economic schemes that have been costly, complex and comprehensive. Now, the post-industrial society must cope with the phenomenon of interdependence: the openness of domestic economic choices to international economic developments and the spillover of regional economic fortunes into national politics, thereby promoting similar comprehensive solutions. For federal systems, these developments of equity and interdependence pose a common dilemma: can territorially based politics adapt?

Whether by design or coincidence, the German federal structure has been well-suited for a response; despite the formal division of powers, provisions in the Basic Law also recognized need for concurrent powers and "joint tasks" (Article 91a). Creating less a division of powers and more a division of labour, the Republic has formally provided for integration of roles in its political system to respond to economic and social issues that cross subnational political boundaries.

Canada has been less well-equipped. Its 1867 constitution, based upon the concept of watertight division of powers, (reinforced by subsequent Court decisions) renders difficult a joint, concurrent and integrated action on specific issues and relegates them to the shadowy realm of non-constitutional adaptation. Philosophical contests of sovereignty and autonomy (even separatism) have been removed only recently from active intergovernmental debate in Canada and this, in part, explains the continuing conceptual discomfort in many quarters with the functional adaptations of cooperative and "executive" federalism. Cooperative federalism for some economic theorists is not enough integration; for populists it represents an undemocratic form of elite collusion.

This deficiency of structure and ad hocery in process over common, interdependent federal and provincial issues in Canada have explained the lag in

Canadian public policy development—notably in social policy. At times the federal government has resorted to unilateralism in economic and social initiatives, exasperated with the many formal veto points of federalism. The result has been a continuing unease with both the purposes and results of inter-governmental cooperation—from both traditionalists and reformists.

Now two new challenges face federalism. First, the post-industrial society exhibits in its political, economic and social life the needs and problems of scarcity, interdependence, vulnerability, confusion, ambiguity, anomie and fragmentation. Second, both a rights-oriented society and welfarism have required government to be particularly sensitive to equity, entitlement and sacred trusts. The pressure of deficits, and loss of international competitiveness are testing the Canadian system of governance once again for its capacity to respond with allocational efficiency, redistributive justice, openness and timeliness.

This chapter surveys the Canadian choices for adapting—or eliminating—intergovernmental relations as appropriate modern responses to advanced industrial society. It suggests that broad consensus-building in a society simultaneously individualistic and community-based is the most critical response needed, and it concludes that the continued but altered practices of federalism would facilitate this.

THE SHORTFALL OF COOPERATION

Cooperative federalism denotes a form of intergovernmental relations in which two formally separate orders of government accomplish common functional objectives. Most frequently these are *de facto* arrangements, with federal cost sharing of provincial expenditures to meet an agreed-upon set of uniform national standards. The process proceeds by way of "executive federalism", with joint tasks identified and negotiated by political and bureaucratic elites, outside the purview of legislatures or courts. In a country of enduring cleavages the successes are noteworthy, resulting in landmark commitments to inter-regional equalization and uniformity of entitlements while retaining genuine provincial autonomy. Although the formal division of powers remains cast in 1867 terms, cooperative federalism has kept this country comparable in performance to its more homogeneous, unitary or quasi-federal OECD equivalents.

Still, the practices of cooperative and executive federalism have their detractors from both the federal and provincial perspective. Whether the issue is social equity, economic interdependence or self-determination, cooperative federalism is regarded as unsuited for a modern, democratic or effective form of government, for several reasons:

- a) It is inertia prone, forcing bilateral issues into a multilateral forum with multiple vetoes.

- b) It substitutes process for purpose or means for the ends, reducing public policy to the lowest common denominator and depriving governments at both levels of the legitimacy of unilateral actions.
- c) It is formless, substituting the outcome of executive negotiations for the formal roles of government as enshrined in constitutions and debated in parliaments.
- d) It homogenizes regionally-held differences into a multilateral consensus-bound process aimed at uniformity, thereby co-opting different provincial preferences to the "national interest".
- e) It coerces provinces into a form of joint effort whereby conditional federal funding is offered in lieu of greater tax room, which perpetuates a relationship of dependence.

RESPONSES TO THE LIMITS OF COOPERATION

Proposals to address the limitations of cooperation abound. The range includes the creation of super planning bodies of economic experts standing over the partisan process, the abolition of federalism, the return to watertight compartments and tinkering with the existing process. This paper surveys a limited range of options, notably the counsel to recentralize and the counsel to renew.

a) The Counsel to Recentralize

The case for reinvigorating the national government with new purpose and new process is derived from both radical Marxist analysis and more conventional neo-conservative proposals. From the former perspective divided power, whether between governments or private-public, will become an expendable luxury in face of a "fiscal crisis" (Hueglin 1985; Wolfe 1985: 132-3). In the latter perspective "toughing-out" the no-growth scenario will require better management and more discipline: provinces will be relegated to administrative arms of central decision making.

The most radical argument for political reform is made from the realm of economic reforms needed to respond to the phenomenon of the "fiscal crisis of the state". The case made by Marxist analysts is that the capitalist state is faced with a contradiction: under conditions of economic scarcity it must spend simultaneously on a sustained high level of welfare and a massive program of economic restructuring. While the affluent state could once generate the means for lavish welfare programs from the surpluses of economic growth, it must now choose winners and losers and uncouple the latter from state support. This is deemed a crisis, not only because of the insufficient revenues to meet both

welfare and restructuring demands but because of the political realignment that will occur, to the jeopardy of the existing elite.

This school of thought questions the capacity of Canada's political system to respond to a new set of identities that supercede the salience of territory. Probing an area largely ignored by the otherwise exhaustive Macdonald Commission, Marxists suggest that there is a sociological as well as economic transformation under way which will have a profound political consequence. "Sectoral deindustrialization" will subject capitalist political institutions to an erosion of faith. In a nutshell, the argument is that dependence on different and varying economic prospects compel Canadians to be individualistic in their identities and pluralistic in their associations, a condition of fragmentation and regrouping that is replacing older collectivist and community identities. The failure of Quebec's appeal to a distinct community in its sovereignty-association referendum is identified as but one aspect of this re-orientation of allegiances. It is further noted that the new Charter will add new identities based on equality, mobility and language so that the Charter could release or focus pan-Canadian identities based on function or gender rather than region (Whyte 1984: 24, 28).

Taking up the challenge of the radical political economists are the neo-conservatives. A.H. Birch writing for the Macdonald Commission documents why Canada has not reached fiscal (or sociological) crisis, and he rejects the prospects for a new political alignment (Birch 1986). Yet there is a recognition that the "demand overload" for personal and corporate welfare must be restrained by exhortations to claimants to be "leaner, harder and tougher".

This will call forth a new form of determination in Canadian politics. For example, Birch goes on to urge pre-emptive strikes by the state against racism, and unemployment. His arguments are mirrored by those who urge that Canada centralize to "get its act together" and this drive takes many forms, including the following:

Tradition. With an appeal to the golden post war decades of nation-building in resource and social policy, advocates attempt to relive the days of Keynesian economics with its singular, purposeful and growth-buoyed national government. Provinces would be retained as inferior orders of government, serving more as administrative arms of federal policy initiatives.

Equity. The strong advocacy of rights-oriented groups (women, environmental, welfare) for interpersonal and interregional equity elevates the primacy of uniform and common services, which allegedly only national governments can provide.

Crisis. Unlike the deep sociological changes identified by the radical school, neo-conservatives foresee an era of economic stagnation. The loss of jobs and

the vulnerability to changing trade arrangements encourage citizens to look to that level of government with the scope, power and resources to respond appropriately. This response favours a strong national government reinforced by the search for leadership and vision in a period of transition. Accordingly, decentralization is regarded as a luxury, resulting in a fragmented scale of politics unsuited to the large, sweeping scale of economic issues, such as bilateral or GATT free trade initiatives.

Democracy. Dismissing the closer-to-the-people argument for decentralized government because of its potential for parochialism, advocates of centralization propose that a strong central government, without the intermediation of provinces to confuse citizen loyalties to the nation-state, would reduce the need to rely on intergovernmental bargaining for a sense of common purpose. A focus on Parliament as the crucible of public interest better suited to emerging individualism (pluralism) and with allegedly declining communitarianism would eliminate the elitism, delay and self-serving nature of executive federalism at the conception stage of public policy-making.

To centralize Canadian federalism on the basis of radical or neo-conservative prescriptions alone risks a simple-mindedness or exercise of bravado in the face of problems more complex than ones caused by the mere existence of provincial governments. Whether the issue is uniformity sought by rights-oriented society or decisiveness in the face of economic inter-dependence collapsing the Confederation into a unitary policy-making system—even with more sensitive intrastate federalism—and reducing interstate federalism to an administrative relationship (Ottawa sets policy, the provinces deliver programs) could gloss over a more complex reality of the following nature:

First, a too-narrow reading of the policy agenda could leave the faulty impression that Canadians are increasingly of one mind and that territory or community is outdated. This is more likely to be the conclusion from social policy rather than economic policy issues. Indeed, the last two decades have been ones of claims and policies primarily and successfully directed to social issues. Yet regional economic diversity with its conflict of claim rather than taste may still prove too divisive for a unitary Canadian political practice. Moreover, there is a danger, as Richard Simeon points out, (Simeon 1988: 271) that federal politics could become overwhelmed by the politics of regionalism, deflecting it from a focus based on market and international competitiveness. That is, federal policy-making could be clogged by and succumb to truly confederal identities.

Second, the sociology behind a "rights-oriented society" is more complex in its demands than simply promoting centralized decision making. Michael Sandel has noted that contemporary liberalism has in fact rejected all-embracing utilitarianism as a suitable principle for moral law because the "greatest good"

annihilates the minority and because it regards society as if it were a single person. In its place a "rights-based" ethic defends the sacrifice of individual rights to the general good. For our purpose, what is of interest is the justification of such rights because they enable "individuals *and groups* [my emphasis] to choose their own value and ends." (Sandel 1984: 4) Evidently our "choosing self" is not simply unencumbered and independent; rather communitarians say we make choices based on the roles we perform in association. "We are partly defined by the community we inhabit." (Sandel 1984: 6) Thus the reality is more complex; we are both "unencumbered selves" and "situated" selves. Communitarians thus worry about the "erosion of those immediate forms of community that have at times shaped a more vital public life." The conclusion is that, "insofar as our public life has withered and our sense of common involvement diminished, we become vulnerable to the mass politics of totalitarian society." (Sandel 1984: 7)

The nation has proved too vast to cultivate a shared, extensive community, and it has had to come to terms with the intensive communitarian reality of many territorially-based communities. It has adapted by becoming a procedural nation rather than a substantive one, moving from a common purpose to one of fair procedures, due process and balance among situated-self rights. The postulated unencumbered self of the liberal state has in reality become the entangled self in a number of mutual obligations among communities. At the very least, this ambiguity as to identity gives grounds to use the several identities of the federal system as an appropriate fitting device—enabling political architects to keep their options open, as it were.

Third, the capacity of the federal government to respond in politics to the economics of the advanced industrial state may be inadequate. The end of economic growth denies to the central government the resources to meet all demands. The concentration of political power at the centre may be incongruent with the preponderance of economic power in the provincial-municipal sector. Furthermore, it may be that both the smaller scale of provinces and their number permit different market manipulations, experimentations, innovation and competitive dynamism. Small scale avoids the spectacular errors of bigness, such as the National Energy Program and mega projects.

Fourth, the uncertain policy directions of the advanced industrial state may be ill-served by the centralizing policy options in Parliament, itself highly centralized. It should be recognized, first, that most of Canada's significant public policies have come as a result of intergovernmental, not parliamentary, political debate with the provinces serving as a *de facto* opposition to the Liberal's long hold on power of Ottawa. Reform of national institutions is proposed to capture this sensitivity to regional needs through a capital division of powers rather than an areal division of powers. Still, such a move ignores

the reality of the politics of scarcity causing an inward-looking, fortress mentality in each region so that the concurrent majorities of federalism may be more attractive than the majoritarian basis of the national parliament.

b) The Counsel to Reinvest

The foregoing should, at the least, render the critic of cooperative federalism hesitant as to the remedy necessary to overcome those aspects of cooperation unsuited for advanced industrial society. A more tentative judgement on federalism is needed. Perhaps we are reminded that life today is more ambiguous than complex: that new attitudes rather than new structures will equip us to fashion new identities. Although economists or civil libertarians may find Canadian politics unsuited to their preferred allocative processes and objectives, the political preferences of Canadians do not seem to have abandoned the twin territorial identities nor deserted the political arena for the winner-take-all setting of the courts.

Rather than rail against provincial governments in "diabolical and apocalyptic" language that is "exaggerated and coloured with emotion" (Young, Faucher and Blais 1984: 817) and places the blame on intergovernmental relations *per se*, there is need to recognize that many of our problems of will are those of the modern state, rather than those of federalism itself.

One of the attractive features of federalism is that it keeps a number of governing options open; a less attractive feature is that it can become mired in the immobilism of vested interests. Any reform must deal with both aspects.

Structural solutions abound. A recurring theme in the Macdonald Commission Report is the creation of checks and balances in the federal-provincial relationship, what some have called a move to republican, representative government, away from our parliamentary, responsible government traditions. Any reform of institutions, depending on magnitude, is susceptible to the criticism of structural determinism as we struggle to understand the relationship between form and process. There are more modest adjustments to existing procedures, first, that could contribute to a more open, conscious and consensual approach to issues that spill over jurisdictional boundaries and across different communities. Admittedly these are more mundane process steps and they may be a last slide into Hueglin's "policy immobilism". (Hueglin 1985: 35ff) Or they may reflect Balmer's maxim that "cooperation involves working together within the framework of mutually agreed procedures for the resolution of conflicts" (Balmer 1981: 220). What follows are three sets of proposals: the affirmation of both orders of government, the injecting of formalism into relationships and the reform of structure.

1. *The language and tone* of federal-provincial exchanges contribute much to constructive intergovernmental relations. This distinction is very clear when the approach of Prime Minister Mulroney is contrasted with that of Pierre Trudeau. For the former, provinces need to be treated as "trusted partners" (Federal Provincial Relations Office 1985: 7) in managing federalism while Trudeau regarded provinces as inferior—protecting parochial, non-modern communities—and deserving of only the most token of consultations rather than meaningful negotiations. Even the Macdonald Commission in its substantive proposals, whatever its rhetoric, seems to regard provincial governments as worth by-passing through intrastate reforms—such as elected Senators—to represent "regional" interests in the making of national policy. (Oddly, using 24 or so Senators to represent the interests of a provincial community in Parliament in place of more numerous members of the provincial legislatures acting through provincial governments seems more elitist than the system it was designed to upstage). As long as the status of provinces lives under the stigma of being viewed as dated, artificial or unqualified for the exercise of fashioning national policies with the federal government, acrimony and accusations will deflect constructive actions.
2. Conversely, provinces must respect the distinctiveness of the national community and the integrity of the federal government. *Cooperation may not be appropriate* for all public issues in Canada. Breton notes that the indiscriminate call to consult or cooperate could condemn independent action by any one government and is "a disguised ploy to shackle the federal government" (Breton 1985: 493). This could particularly apply to trade policy and economic development issues where a multilateral setting is inappropriate for zero-sum decisions at this time. Provinces vary in their understanding of the national interest: they concede Ottawa's unilateral right to pursue bilateral trade initiatives with the U.S., or to strike a settlement on trade irritants, yet they come close to rejecting this authority when challenging the appropriateness of the recent Canada-France fishing agreement. The distinction between consultative and executive obligations is frequently blurred, for partisan reasons.
3. The idea of the national interest, perhaps because it is so all-embracing and uncritical, has undergone much greater expansion and advocacy than that of the "provincial interest" which is often treated as a residual category. At times it has seemed that national uniformity has been confused for national unity.

"Where the federal government does not possess the constitutional authority and where provinces are unable or unwilling to respond effectively to new needs, there is in the future ... a case to be made for wide federal freedom to put forward proposals for shared cost programs." (Royal Commission 1985: III 243)

If both orders of government are to be reaffirmed—if changed attitudes must accompany changed institutions (leaving aside causality)—*greater effort must be invested in identifying "the provincial interest"*.

In this regard Breton talks of more healthy "vertical" competition which could be secured by clear provisions to prevent the centre from pre-empting regional interests in Canada (Royal Commission 1985: III 243). Geoffrey Sawer distinguishes between aggregate and integrated national issues: the former consisting of issues that are found nationwide but might be quite discrete and self-contained within provinces, like urban sprawl (Sawer 1976: 107). Integrated national issues occur nationwide too, but are causally related from one occurrence to the next. Thus immunization and airline safety would suffer from a non-conforming province. If aggregate "national" issues and integrated ones cannot be distinguished from one another—and thereby provincial and federal responsibilities respectively—then, Sawer says, the cause of the federal state is doomed.

The provincial interest consists of those activities that primarily and predominantly achieve the following (while acknowledging that no federal or provincial actions can ever be free of consequences in the local or national realm respectively) (Grewell 1981: 234; Dupré 1985: 29-30).

- the social and cultural well-being of the residents in the province
- cohesion of a region as community when it is desired this be recognized
- responsiveness and adaptability in services
- resource-based programs, major developmental programs associated with land use
- policies having few externalities beyond provincial boundaries
- efficiency in the provision of high cost services.

4. An identification of provincial interest as explicit rather than residual need not mean the recreation of watertight compartments, but rather recreation of the notion that Canada is composed of many communities, not just one. Accordingly, *a more vigorous negotiation between communities must occur*. Prime Minister Mulroney has captured this in the concept of "partnership", a modern expression of the conventional no-

tion of "community of communities" or Althusius' *consociatio symbiotica*. Others have gone beyond promises of mutual good intentions, into institutional checks and balances, and this will be examined later. Partnership could be promoted by regular and routine meetings of ministers and staffs of both orders of government. This might be furthered by joint staff task forces, which breed their own form of inter-governmentalism or by "mobile diplomacy" of federal ministers meeting bilaterally and informally with provinces. Spectacular achievements may not result, but such actions will promote mutual understanding, early warning systems and "trust" ties that can contribute stability in stressful times.

5. The increasing prominence of First Ministers' Conferences can give a productive focus and *shape to the intergovernmental year*. Functional ministers should expect to provide "best efforts drafts" for such meetings rather than shunt up lower level deadlocks. FMCs, when public, should be devoted to issues identification, ratifying and mandating ministerial actions. Private meetings of First Ministers should occur quarterly and be the forum for exerting political will on deadlocks between governments. With a more routine intergovernmental year, FMCs would be less a "high noon" matter, where everything is expected to be resolved in a three day confrontation. Dupré has suggested that chance of agreement is rendered more remote "when everything is forever." A disposition to negotiate could be further encouraged by segmenting large undertakings into manageable parts and could minimize tensions. Avoiding attempts at broad statements of principle and focussing on specific measures could further help.
6. Finally, *checks and balances could be formalized* within the Canadian federal structure. The aim would be to promote negotiation and bargaining where unilateralism is inappropriate and to secure the status of both federal and provincial governments by requiring bargaining. Here, too, is the point at which the public-private relationship should be addressed. Canadians have been thankful that, by comparison, their parliamentary system does not flounder in the "group grope" of the American congressional system. Yet the point is frequently missed that the federal-provincial arena of interstate politics may have merely replaced the American intrastate spectacle—and with correspondingly more elitism!

Consensus might be promoted by several modest constitutional changes. The amending formula consensus threshold could be applied to the intergovernmental agenda. The principle would be to establish checks and balances that force

parties to negotiate in order to exercise their powers, perhaps on the use of spending power, treaty power and tax reform. Additionally, the identification of concurrent powers but with paramountcy attached might inspire the need to reach agreement. Peter Leslie suggests we should understand the powers allocated in sections 91 and 92 as responsibilities that are "shared even though most of the powers are assigned ... exclusively to the one or the other" (Leslie 1985: 5).

The provision for opting-out in past shared cost programs and now in the Constitution not only recognizes provincial diversity but serves also as a means of requiring parties to negotiate. Such a practice should be incorporated into ongoing intergovernmental relations as found in the *Constitutional Amendment*, 1987.

At the same time, similar incentives to negotiate could be achieved through intrastate rather than interstate reforms. Provided that the integrity of both federal and provincial governments remains the objective of the federal system, this would dictate a form of provincial intrastate federalism (Smiley and Watts 1985: 17). It is here that hidden agendas are revealed. For all the talk of the Macdonald Commission about the wisdom of federalism, their intrastate reforms would set up regionally elected Senators as competing voices for the provincial interest. The result would be neither federal nor parliamentary government. Nonetheless intrastate reforms could be acceptable to some provinces and promote bargaining. A reform package could include new proportional representation elements in the Commons (to enhance its regional legitimacy) and a House of Provinces whose veto would require a Commons override (to respect the intrastate character of Canadian federalism). Intrastate and interstate federalism would be in a check and balance relationship. Merely introducing more regionalism into Parliament might trump the provincial governments, but it could likely paralyze Parliament over competing regional claims rather than permit its agenda to be occupied by national and international concerns.

A further set of structural reforms could address the need for greater democracy in cooperative federalism. Breton talks of "connivance, collusion and conspiracy" emerging from executive federalism—a moderate critic might at least seek greater accountability. Introducing parallelism rather than cost sharing in areas of common interest or federal basic funding with provincial "top ups" or a division of powers by constituency rather than process all could avoid the loss of federal or provincial identity. Lest this practice be considered an invitation to competitive escalation of the public sector, Cameron concludes, to the contrary, that "federalism may have some dampening effect on the rate of escalation in spending." (Cameron 1985: 30)

The creation of Parliamentary task forces or private sector advisory groups can put more direct pressure on bureaucrats to get their act together. Court decisions or countervailing trade moves have shown that focussed opposition serves to concentrate the mind. Frequently, an atmosphere of dissensus is promoted by the absence of catalysts and governments might consider setting conditions, such as FOI and privacy legislation, where they put themselves under an obligation to act more responsibly.

The prevailing message about cooperative federalism appears to be its necessary but limited contribution to Canadian politics. While it may be improved, it nonetheless imparts a shape to political debate that may be insufficiently flexible or decisive, given contemporary group realignments. While subnational units are vital for the "many republics" of self-identification or participatory democracy, international developments put a premium upon Canada acting as a single personality in trade matters. Thus the creative tension of the post-industrial age has superceded that of Confederation: the former communities of territorial interests are now replaced by clusters of technological interests. Earlier, Canada's horizons were expanding and thus was also our concept of federalism; now, our visions are fragmenting. Will federalism be suitably adaptable?

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II

State and Economy in Federal Systems

Structural Policy in the Federal Republic of Germany

Hartmut Picht

CHALLENGES TO THE GERMAN ECONOMY

The success of the West German economy in the 1950s and 1960s in terms of GNP growth rates, employment, and inflation was so remarkable that it has widely been recognized as the German economic miracle. It was principally based on an open market approach. The approach was developed by Walter Eucken in the late 1930s (Eucken 1950).¹ The performance of the economy has remained high in comparison to most of its trading partners during the 1970s and the first half of the 1980s, but it has been disappointing in absolute terms. There have been high inflation rates and absolute decreases in real incomes. In addition, Germany has not been able to cope successfully with high rates of unemployment (Table 4.1). By and large, 1973 might be considered the benchmark year of transition from full employment to unemployment.

Three major developments have posed a serious challenge to the German Economy:

- the drastic changes in the relative prices of labour and energy;
- the rapid diffusion of new technologies, in particular in micro-electronics; and
- the success of Japan and some newly industrialized countries, particularly in Asia, in the World Market.

1 This strand of research has been popularized as so-called *Ordnungspolitik*.

Table 4.1
Income, Employment, and Inflation

All figures are in percentages

	<i>GNP Growth Rates</i>	<i>Unemployment Rate</i>	<i>Inflation Rate (GNP)*</i>
1970	5.0	0.7	7.6
1971	3.0	0.8	8.1
1972	4.2	1.1	5.3
1973	4.7	1.2	6.3
1974	0.2	2.5	7.1
1975	-1.4	4.7	6.0
1976	5.6	4.6	3.7
1977	2.7	4.5	3.8
1978	3.3	4.3	4.2
1979	4.0	3.7	4.0
1980	1.5	3.7	4.8
1981	0.0	5.3	4.0
1982	-1.0	7.6	4.4
1983	1.8	9.3	3.3
1984	3.0	9.3	1.9
1985	2.5*	9.3*	2.2

Source: Author's calculation; Sachverständigenrat 1985; *Deutsche Bundesbank 1986.

While substantial adjustments to the relative increase in energy costs have already taken place, notwithstanding the recent trend reversal in energy markets, real wages still do not reflect actual scarcities. At the same time there is no evidence that the adoption of new technologies has in the aggregate added to the unemployment problem. Quite to the contrary, aggregate investment has increased substantially in comparison to the late 1970s. Over the last four years about 150,000 additional jobs have been created. However, this has certainly not been enough to keep pace with a growing labour force (Schmidt et al. 1986: 1f.).

The export performance of the German economy has also improved impressively over the last four years, but to a considerable extent this may have been, at least until recently, the consequence of a drastic over-evaluation of the US-Dollar in terms of the German Mark. Thus, one will still have to see to what extent the export industry has really adjusted to the new challenges in international markets.

Beyond this aggregate picture of the economy as a whole, major structural changes within the German economy have occurred. The most important change has been popularized as the German North-South problem. This issue

has pushed aside two major post-war heritages: the depressed areas along the West German border with the German Democratic Republic that were cut off from their traditional pre-war trade patterns and the insular situation of West Berlin. Table 4.2 indicates in absolute and relative figures that the job losses from 1970 to 1985 in the northern states are much higher than in the southern states. As measured by percentage changes of employed labour force, the big losers in the North are Hamburg, Bremen, and Lower Saxony, while Baden Württemberg and Bavaria in the South have lost only modestly. In the aggregate the northern regions have lost 6.6 per cent of the labour force employed, whereas the southern states have lost only 1.5 per cent.

Table 4.2
Changes in the Number of Persons Employed in States

	<i>in 1000s</i>	<i>in Percentages</i>
Schleswig-Holstein	+4	+0.4
Hamburg	-128	-13.3
Lower Saxony	-245	-8.2
Bremen	-42	-11.5
Northrhine-Westphalia	-403	-5.8
Northern States together	-814	-6.6
Hesse	-64	-2.6
Palatinate	-71	-4.8
Baden-Württemberg	-26	-0.6
Bavaria	-18	-0.4
Saarland	-11	-2.5
Southern States together	-190	-1.5
Berlin	-85	-9.0

Source: Schmidt et al. 1986.

To some extent these observations reflect the fact that the sectoral patterns of the regional economies differ between northern and southern states. Very crudely, the North hosts relatively more Ricardo type industries while a relatively higher proportion of Heckscher-Ohlin and Schumpeter type industries is located in the South. The Ricardo type industries depend largely on natural resource endowments such as coal and waterways, the Heckscher-Ohlin and Schumpeter industries depend primarily on the relative factor endowments, i.e., human resources and capital.² As with new industries and investments in other

2. See Krieger, Chr., et al. (1985) for an elaboration on the industry types mentioned.

countries, there has been a general trend away from "smokestack" to "sun" regions.

The purpose of this study is to analyze how structural policy is conceived in the Federal Republic of Germany and how governments have actually coped with the international challenge to the German economy. The empirical part is confined to an analysis of recent data on direct and indirect subsidies.

HOW STRUCTURAL POLICY MAY BE CONCEPTUALIZED

The magnitudes involved in the process of adjustment to new international patterns of division of labour are certainly so great that policy makers cannot ignore them. In order to operationalize structural policy as distinct from other economic policies that also affect structural patterns of the economy, one may focus on the primary intent of the policy in question. If the ultimate purpose of a policy is to affect the structure or structural changes of an economy, for example, sectoral or regional patterns of employment and production rather than aggregate outcomes—it is referred to as structural policy, in all other cases where structural effects are not targeted, it is not.

Any change in the structure of an economy involves costs. Personal qualifications as well as physical production capabilities may simply become economically obsolete. In this sense any policy that aims generally at the reduction of adjustment costs is a structural policy option. In other words, a policy promoting competition in a market economy is a structural policy option (Giersch 1964). This type of policy option has been called general structural policy. It addresses the question of the cost side of structural changes. The implicit assumption, of course, is that in most cases the market is the proper social institution to alleviate scarcity.

An alternative option would, consequently, be directly concerned with structures or structural changes. It has been referred to as direct or specific structural policy (Oppenländer 1985: 10). Within this category one may wish to distinguish between policies which are directed towards targeted changes, and those which aim basically at the preservation of an existing structural relation, or at least at a significant slowdown in the adjustment process to changing conditions of a competitive environment.

One argument put forward for the targeting option is that some sectors need to be supported for some time (the infant industry argument), before free market forces should decide whether or not an industry stays in the market. Another argument here is that there are social benefits to be gained by stimulating certain kinds of private activities, which otherwise, i.e., in the absence of an intervention, would not have taken place (the externality argument). In favour of the preservation option of structural policies, it is sometimes claimed that the supp-

ly of goods and services is too important to be left to the market. Occasionally distributional considerations such as guaranteeing certain levels of income, or jobs, regardless of competitive pressures, are advocated explicitly (Oppenländer 1985: 10f.).

The fundamental difference between general structural policy and the various types of direct structural policies is obvious. The former focuses on the degree of competitiveness of the environment for an industry as the principal clue to the reduction of adjustment costs, because in a competitive market changes occur continuously and may be absorbed gradually, i.e., less painfully, in small steps, while the latter rely upon various sets of pecuniary or equivalent incentives as well as regulatory frameworks to reduce costs.

The focus of our analysis below will be on sectoral and regional structural policies only. Those policies which aim at promoting small- and medium-sized firms known as *Mittelstandspolitik* are not referred to.³

A COMMITMENT TO MARKET-ORIENTATED STRUCTURAL POLICY?

The federal government has explicitly defined what it considers to be the proper scope of structural policy in the Federal Republic of Germany. It should be directed primarily towards adjustment in a competitive international environment (Deutsche Bundesregierung 1984: 94f.). This general commitment means that any direct structural policy actually pursued should be only temporary in nature and that generally the conditions for private entrepreneurs should be improved.

Bernhard Molitor, a senior official in the Federal Ministry of Economics, states that the Bonn government aims at a soft landing as far as direct structural policy is concerned: the scope of direct interventions should ultimately be reduced (Molitor 1985: 292f.). What he has in mind are mainly pecuniary or equivalent incentives in the form of direct or indirect subsidies. At the same time the federal government explicitly acknowledges the importance of investments in productive infrastructure, in particular, when sectoral problems involve regional disparities. While the bulk of infrastructural investments is carried out at the state and local level rather than the federal level, co-financing arrangements bring the federal government almost everywhere directly into play.

3 See Deutsche Bundesregierung for an account of *Mittelstandspolitik* in the realm of financial support for technological development (1986: 73ff.) Further, structural policy aspects of labour market policies have not been taken into account.

On the other hand, the federal government has committed itself to supporting research and development when private agents are expected to fail, i.e., to do what is considered best for the economy as a whole (externality argument). This commitment is expressed in financial support for basic research as well as directly product- and market-related development. The primary focus is on nuclear energy, aerospace, and information technologies (Deutsche Bundesregierung 1984: 10). This position is, by the way, hardly different from the view formulated by the federal government in its Report on Structural Policy almost two decades ago at the beginning of the Social Democratic era (Deutsche Bundesregierung 1969).

The implicit assumption behind this commitment towards an active governmental involvement in the promotion of research and development is, of course, that governments know better than private agents where profits can be reaped, which does not really square with the general position put forward in the first place, i.e., the principal commitment in favour of the market mechanism. One is, thus, left with some ambiguities as far as the federal government's notion of structural policy is concerned.

The picture gets even more complex, for in a federal system state and local governments pursue structural policy goals on their own. In the case of the Federal Republic of Germany, one finds a relatively high degree of centralization in this regard. General structural policy, as defined above, is mainly a matter of national (and in part the EEC's) domain. The promotion of technological advances and sectoral policies is highly concentrated at the federal level. In charge are the Federal Department of Research and Technology and the Department of Economics.⁴ Policies with primary focus on regional impacts fall largely into the category of joint tasks as codified in the Article 91a of the Basic Law. This means that the states and the federal government share responsibilities jointly (cooperative federalism). The basic goal is to guarantee a sufficient de-

4 The promotion of technological development in Germany is not directly related to regional goals, but certainly we may expect that regions with a relative high concentration of "new" prospering industries will get more support from those sources than other regions (Deutsche Bundesregierung 1986: 71ff.).

gree of uniformity of living conditions throughout the whole country.⁵ At the same time all state governments have implemented regional development programs on their own. Table 4.3 displays the relative importance of the federal government and the states as measured by subsidies narrowly defined. The category of tax relief has not been broken down since, in a financial system where revenue sharing is predominant, direct attribution is difficult to make.⁶ It can be seen that the weight of the federal government is about as large as that of the states taken together.

Table 4.3

Structure of Subsidies According to Types of Sources in Percentages

	1973-1974	1979-1981
Tax Reliefs	31.0	29.9
Subsidies	69.0	70.1
Federal Budgets	30.3	27.8
State Budgets	26.3	26.0
Local Governments	2.5	1.8
Other Entities	8.9	14.9

Source: Jüttemeier 1984; Gerken 1985.

It should be mentioned that state governments as well as local governments within their boundaries possess a considerable degree of discretion as far as the

- 5 Article 91a of the Basic Law specifies that the federal government contributes 50 per cent and more—depending on the particular type of joint task—of the total costs involved. In addition, the federal government may use the provisions of Article 104a to couple aggregate stabilization policies—in the presence of a macroeconomic disequilibrium—with the goal of uniform living conditions by the granting support on regional grounds. Still another aspect of cooperative federalism is the presence of an elaborated horizontal fiscal equalization scheme among the states, and a vertical equalization scheme between the federal level and the states.
- 6 The income and corporate tax on one hand, and the value added tax on the other hand, are the major taxes. The income and corporate tax is shared equally between the federal government and the states. Within the states share the distribution follows the regional generation of the tax. The shares of the value added tax are negotiable between the federal and the state level. For 1986 and 1987 the federal government gets 65 per cent, and the states get 35 per cent. The distribution of the states' share among the states follows the population pattern. The details of the tax legislation, the tax revenues, and the tax sharing arrangements are codified in Section X of the Basic Law. For a presentation and discussion of German Fiscal Federalism see Gerd Böckmann in this volume.

supply of infrastructural facilities, zoning policies, and the allocation of publicly owned property to private uses are concerned, which is not properly reflected in our figures either. At that level of government there is not much interest in what has been called the general structural policy option. Indeed, all state (and local) governments are more or less inclined to attract new business and cultivate old ones actively. Some of them, such as the Baden-Württemberg government and the Bavarian government, are quite open in this respect: Bavaria is involved in the aerospace industry, and Baden-Württemberg facilitates a producer of luxury cars. In these cases, it has been argued that it is the state government's responsibility to help to create, or at least maintain, jobs for its constituency (Westphal 1986).

Taking federal and state levels of government together, one may conclude that at the conceptual level structural policy connotes elements of both the general and the direct structural policy options discussed above. The market-oriented policy tradition that has characterized the German economic miracle in the 1950s and 1960s has been largely abandoned.

THE ACTUAL CONDUCT OF STRUCTURAL POLICY IN THE FEDERAL REPUBLIC OF GERMANY

In what follows, some evidence on the actual conduct of structural policies is presented. The focus is on the development and the meaning of the most prevalent instrument of structural policy: direct and indirect subsidies.

Table 4.4 shows the total of subsidies for 1973-1985, calculated on the basis of estimated financial subsidies and tax advantages. It is striking that the absolute amounts have continued to increase. The figures are expressed in Billions of German Marks.

Table 4.4
Development of Subsidies 1973-1985

	<i>Subsidies in Billions DM</i>	<i>Subsidies per Employee in DM</i>
1973	55.7	2 382
1979	60.8	2 653
1974	98.1	4 451
1980	100.5	4 513
1981	100.5	4 568
1982	104.1	4 843
1983	109.5	5 200
1984	115.8	5 500
1985	121.5	5 800

Source: Jüttemeier 1984; Gerken 1985.

At an exchange rate of roughly 1.50 German Marks per Canadian dollars, the amount of subsidies has risen from roughly C\$37 Billion in 1973 to C\$81 Billion in 1985. In terms of subsidies per employed person one gets C\$1,588 in 1973 and C\$3,867 in 1985. Taking only the last four years, roughly the term during which the current conservative government has had the chance to reset priorities, it must be concluded that the trend has not been reversed, notwithstanding the federal government's rhetoric towards a more market-oriented concept of structural policy.

At least a part of this phenomenon may be attributed to competition among state jurisdictions for new industries and their desire not to lose resident investors to fellow neighbors. It has already been shown that in some states the decline in jobs has been relatively small, whereas it has been drastic in other states (the North-South problem). This pattern has been partially explained by natural resource endowments, relative scarcities of human resources and capital, and dependence of emerging industries thereupon. However, some states may have simply been more successful in pursuing their structural policy goals than others.

Evidence for this reasoning is available. From Tables 4.2 and 4.5 one can infer that notably Bavaria and Baden-Württemberg have increased their share, while the losses in employment have been relatively modest, whereas other states like Northrhine-Westphalia and Bremen have also increased their share, but have not been able to prevent large drops in employment. At the same time the increase in the share spent for regional purposes from 1979-1981 to 1982-1985 (Table 4.6) corresponds negatively with employment (Table 4.1).

Table 4.5

Subsidies Given by States as Percentages of Total State Subsidies

	1972-1974	1979-1981
Schleswig-Holstein	3.8	3.5
Hamburg	3.8	3.5
Lower Saxony	10.6	8.8
Bremen	1.1	1.5
Northrhine Westphalia	29.3	30.8
Hesse	7.2	5.4
Palatinate	4.9	4.2
Baden-Württemberg	12.5	13.1
Bavaria	17.9	18.1
Saarland	1.5	1.5
Berlin	8.0	9.6

Source: Author's calculation; Jüttemeier 1984; Gerken 1985.

Table 4.6
Subsidies According to Purposes in Percentages

	1973-1974	1979-1981	1982-1985
Regional Policy	9.1	8.6	8.9
Sector Specific Policies	35.7	37.7	36.0
Others	55.2	53.7	55.1

Source: Author's calculation; Jüttemeier 1984; Gerken 1985.

Table 4.6 provides additional information on the purposes for which subsidies have been spent, measured in percentage shares of total subsidies. While the share spent on regional policies has increased from 8.6 per cent in 1979-81 to 8.9 per cent in 1982-85, the sectoral subsidies have dropped from 37.7 per cent in 1979-81 to 36.0 per cent in 1982-85. Apart from the change in the allocation of subsidies, the absolute magnitudes reflected in these numbers need to be kept in mind. What is granted as sector specific subsidies is about four times as much as the support for regional purposes.

It is interesting to look at the sectoral patterns of subsidies in absolute terms, and in terms of subsidies per unit of net value added minus the subsidies granted, no matter where the support comes from and what the ultimate reason for the subsidies is. The figures on subsidies per unit of net value added minus subsidies highlight the extent to which these sectors depend on public money. They measure the effective rate of protection from international competition.

Table 4.7 displays these figures for thirteen sectors from 1973 to 1985. All absolute figures add up to the totals in Table 4.4. In particular, the degrees of subsidization in farming (including forestry and fisheries), coal mining, and the aggregate of transportation and telecommunication are striking. The figures for 1983 indicate that C\$220, C\$85 and C\$38 were spent for each C\$100 of effectively added value, respectively. The numbers on subsidies per person employed in those sectors also dramatically reveal the heavy and increasing involvement of governments in some sectors. In coal mining, subsidies per person employed have risen, again on the basis of 1.50 German Marks per Canadian dollars, from C\$4,553 in 1973 to C\$20,000 in 1984. Similarly, subsidies per person in the transportation-telecommunications sector have risen from C\$5,417 in 1983 to C\$10,467 in 1984. In addition, the figures in Table 4.8 give a related, but more detailed picture of effective subsidization within certain branches.

Table 4.7

Allocation of Subsidies to Thirteen Sectors 1973-1985

	1973	1974	1979	1980	1981	1982	1983	1984	1985
1. Farming, Forestry, Fisheries									
Bill DM	10.2	10.5	16.6	16.7	14.8	14.8	17.2	18.5	20.9
Share (%)	18.3	17.3	16.9	16.6	14.8	14.2	15.7	15.9	17.2
Degree of Subsidization	79.4	98.1	243.8	285.5	164.3	112.2	220.0	-	-
Subsidies per Employee	5288	5712	11239	11599	10562	10700	12560	13500	-
2. Coal Mining									
Bill DM	1.6	1.9	6.7	6.0	5.5	4.7	5.4	6.2	5.9
Share (%)	2.9	3.1	6.8	6.0	5.5	4.5	4.9	5.4	4.8
Degree of Subsidization	30.7	29.8	159.0	102.8	80.7	59.7	85.0	-	-
Subsidies per Employee	6829	8215	31177	27774	24684	21473	25250	30000	-
3. Energy, Other Mining									
Bill DM	0.7	0.7	0.8	1.0	1.0	1.1	1.1	1.1	1.2
Share (%)	1.3	1.2	0.8	1.0	1.0	1.0	1.0	1.0	1.0
Degree of Subsidization	4.5	4.6	3.4	3.9	4.2	3.8	3.6	-	-
Subsidies per Employee	2399	2538	2957	3387	3645	3691	3820	4000	-
4. Steel and Iron									
Bill DM	0.2	0.2	0.3	0.5	0.5	1.2	1.4	2.1	2.0
Share (%)	0.4	0.3	0.3	0.5	0.5	1.2	1.2	1.8	1.6
Degree of Subsidization	0.8	0.8	1.2	1.6	1.8	4.5	5.1	-	-
Subsidies per Employee	212	260	454	650	729	1819	2230	3500	-
5. Electronics, Fine Mechanics, Musical Instruments									
Bill DM	1.0	1.2	1.7	1.7	1.7	1.8	1.9	1.9	1.9
Share (%)	1.8	2.0	1.7	1.7	1.7	1.8	1.7	1.6	1.6
Degree of Subsidization	2.7	3.0	2.9	2.8	2.7	2.8	2.7	-	-
Subsidies per Employee	676	800	1159	1163	1184	1343	1430	1460	-

12. Commerce, Other Services

Bill DM	5.7	6.5	11.3	12.9	12.8	13.5	14.1	14.5	14.8
Share (%)	10.2	10.7	11.5	12.8	12.8	13.0	12.8	12.5	12.2
Degree of Subsidization	3.1	3.3	3.7	3.9	3.5	3.5	3.5	-	-
Subsidies per Employee	877	996	1661	1857	1843	1969	2060	2100	-

13. Non-Profit Organizations

Bill DM	8.4	9.5	13.6	15.2	15.8	16.7	17.3	18.3	18.9
Share (%)	15.1	15.6	13.9	15.1	15.7	16.0	15.8	15.8	15.5
Degree of Subsidization	189.4	185.2	181.7	189.7	177.7	171.3	163.0	-	-
Subsidies per Employee	13904	15472	20041	21219	21660	22051	22430	23100	-

Total

Bill DM	55.7	60.8	98.1	100.5	100.5	104.1	109.5	115.8	121.5
Share (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Degree of Subsidization	9.3	9.6	11.1	10.7	10.3	10.2	10.3	10.4	10.5
Subsidies Per Employee	2382	2653	4451	4513	4568	4843	5200	5500	5800

Source: Jüttemeier 1984; Gerken 1985.

The figures in Tables 4.7 and 4.8 also indicate that financial aid is highly concentrated. Taking the farming (including forestry and fisheries) sector, coal mining, the transportation-telecommunication sector, and housing, i.e., four out of thirteen sectors together, the total share amounts to roughly sixty per cent of all subsidies granted in 1985. Special interest lobbying seems to have been particularly successful recently in farming (including forestry and fisheries) and steel and iron industries as indicated by the share patterns in Table 4.7. It has certainly been most successful to the extent that major cutbacks have not occurred in years of severe fiscal restraints. All in all, it comes as no surprise that the effective rate of protection by subsidization of the German economy has risen continuously since 1981 (Table 4.7).

Table 4.8
Degrees of Subsidization in Selected Branches 1973-1985

	1973	1974	1979	1980	1981	1982	1983
Coal Mining	30.7	29.8	137.0	92.0	74.8	57.3	76.0
Other Mining	9.6	21.0	16.3	15.0	19.1	25.9	19.0
Mechanical Engineering	2.5	2.1	2.6	2.6	2.6	2.8	-
Mineral Oil Processing	3.8	5.2	2.0	2.5	3.8	2.9	-
Electronic Engineering	3.1	3.4	3.3	3.1	3.0	3.1	-
Shipyard Industry	12.5	12.0	23.0	35.3	38.6	22.7	-
Aerospace	65.6	63.8	40.8	33.8	28.4	28.6	-
Textiles	1.2	1.2	1.2	1.1	1.2	1.2	-
Tobacco Processing	4.4	12.1	13.6	20.0	10.9	15.0	-
Office Machinery	6.8	5.9	4.9	3.0	2.4	2.7	-
Paper and Cardboard	1.5	1.6	2.5	3.5	3.0	3.2	-
Plastic Processing	2.3	1.7	1.7	2.0	2.0	2.0	-

Source: Jüttemeier 1984.

CONCLUDING REMARKS

At the conceptual level, structural policy in the Federal Republic of Germany is far from being well-defined. It contains elements of all approaches, ranging from an open market approach to a commitment towards levelling economic disparities among the Länder and towards directing technological developments. Inconsistencies are apparent.

In practice, the market-oriented option of structural policy has not been predominant recently, nor is there any empirical evidence that this option has actually gained ground. To the contrary, the direct involvement of governments in structural policy has increased substantially in the aggregate. Expenses for subsidies per employed person, for example, have more than doubled between 1973 and 1985. The actual magnitudes are perplexing.

It has not been the purpose of this analysis to give a full account of why governmental involvement has increased so much, but two explanations may be advanced. Under the cover of joint tasks and co-financing arrangements be-

tween the federal government and the states an incentive has been provided, first, for state governments to draw on "public" money to finance structural policy initiatives. That is, the costs borne directly by a single state were much lower than the actual costs to the general tax payer. Two consequences are obvious: First, even questionable undertakings get financed, and second, pressure exists towards enlarging the scope of federal co-financing. There is, in turn, no incentive on the part of the general tax payer to resist tax increases implied, because individual costs of lobbying are both borne privately and high, while the benefits are dispersed. Competitive rivalry among the states for new investments adds to this development.⁷

Second, a look at the sectoral pattern of structural policy reveals that subsidies are not granted uniformly to all industries, but that financial aid is highly concentrated as the different degrees of subsidization reveal. This outcome is as expected, since interest groups differ with respect to their lobbying power. Moreover, four out of thirteen sectors got about sixty per cent of all subsidies in 1985, which is at variance with the respective net value added proportions. Apparently, the bargaining strength of special interest groups is a matter of the size of the sector and of regional concentration. In the Federal Republic of Germany, regional interests to a significant extent coincide with sectoral interests, because lagging sectors are regionally concentrated, e.g., the iron and steel industry, coal mining, farming and the shipyard industry. It is not surprising, then, that lobbying has been quite successful in these cases. In a temporal perspective, in particular farming (including forestry and fisheries) and the iron and steel industry have managed to increase their shares in public subsidies substantially.

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Federalism and Industrial Policy in Canada

Michael M. Atkinson and William D. Coleman

It is commonplace to lament the obstacles placed in the way of efficient, consistent and effective economic policy by the federal principle.¹ Competing bureaucracies, when they are not duplicating services, seem to spend an inordinate amount of time coordinating their activities, engaging in jurisdictional contests, or neutralizing the by-products of one another's initiatives (Cairns 1977). There are so many instances of overlapping responsibilities that it is hard not to endorse the view that federalism imposes serious organizational costs on the conduct of economic policy (Breton and Scott 1978).

While this assessment is frequently made, as it stands, it is a misleading indictment. It is misleading because federalism does not exist in a vacuum. As Peter Leslie (1987: 47) has emphasized, federalism is embedded in other organizational features of the state and it assumes importance only within this broader institutional context. In Canada the institutional context is set by what we will describe as a weak state tradition. Some societies, such as France, Germany and Japan inherited a strong state tradition from the absolutist regimes that dissolved in the transition from feudal to capitalist modes of production. The Canadian state, on the other hand, was formed in the developing capitalist environment of British imperialism. State intervention was required to expand and defend the home market, but this did not result in the type of state-building exercise that characterized the French, German or Japanese experience. The early political struggles in Canada were about responsible government, not the top-down extension of state authority over autonomous political units

1 The material in this chapter is drawn from a larger work entitled *State and Industry: Growth and Decline in the Canadian Economy* (Toronto: University of Toronto Press, forthcoming).

(Stewart 1986: Chap. 1). A firmly entrenched federal system and an executive-centred parliamentarism are the institutional legacies.

It is the combination of federalism and Westminster parliamentarism that sets the rules of the game for politicians and bureaucrats in Canada. Together they nurture a weak state tradition that discourages the development of broadly conceived, plan-rational approaches to economic policy. Nowhere is this more evident than in the case of industrial policy. By industrial policy we refer to selective measures, adopted by the state, that are intended to alter patterns of investment and the long term structure of industrial organization (Whiteley 1986: 175-8). There exist different types of industrial policy premised on different assessments of the policy response required, what can be accomplished, and what constitutes an appropriate role for the state in the marketplace (Laux and Molot 1988: 126). Two major alternatives have emerged as ideal types: *anticipatory* industrial policy with its emphasis on intrusive policy instruments, integrated with one another and aimed at structural transformation; and *reactive* industrial policy which is organized around the immediate needs of specific firms (often for distress financing) and is devoted to creating a climate attractive to investment. With few exceptions, industrial policy-making in Canada has followed the reactive model.

In this chapter, we argue that the reactive approach to industrial policy is not simply the product of federalism: no one-to-one relationship obtains between these two variables. Rather, federalism is one institutional feature of an industrial policy process that is coloured, in general, by a weak state tradition. Of particular importance to this tradition is the parliamentary system of government. We begin with a brief discussion of the state tradition in Canada and a review of the basic principles of the Westminster model of parliamentarism. We then proceed to discuss federalism and industrial policy, highlighting the interaction of the federal principle with other macropolitical structures. We

conclude by considering the attitudes of bureaucratic officials towards the role of federalism in the realm of industrial policy.²

THE INSTITUTIONAL CONTEXT

In recent years students of comparative political economy have been hesitant to characterize entire states as "strong" or "weak." They have observed that, depending on a host of contingencies, so-called strong states may yield to societal pressures and weak states may succeed in imposing policy initiatives (Wilks and Wright 1987; Sulieman 1987). On the other hand, political systems may be distinguished by the very *idea* of the state itself. In some societies, Kenneth Dyson (1980) calls them "state societies," the state is recognized as an abstract, impersonal entity. Here the state embodies a sense of the public interest that is more than the sum of private interests in society. Dyson (1980: 232) puts it this way: "The state is seen as a unique collectivity whose dignity and value reside in its embodiment of an impersonal and comprehensive set of moral ideas that have an existence apart from the conflicts and fluctuations of social and political life." Such states are autonomous in the sense that state institutions have their own culture and their own methods of conflict resolution. The core of the state is its administrative-bureaucratic apparatus which is characterized by elite training and by an insistence on the distinctions between government and administration and between public and private law (Armstrong 1973; Dyson 1980: 232-3). The impersonal quality of state action is underlined by the preference for legalistic and formal responses to petitions. The administrative culture is steeped in tradition and responsibility, a responsibility which officials discharge in concert with, not as servants of, elected personnel (Hall 1983: 47, 57). By assuming responsibility for the public interest such a state possesses a built-in rationale for intervention and a predisposition toward anticipatory industrial policy.

- 2 We conducted interviews in 1982 and 1983 with officials in the federal government responsible for the development and implementation of industrial policy. Four industrial sectors were chosen for intensive analysis: food processing, chemicals including pharmaceuticals, textiles and clothing, and telecommunications equipment. Between September 1982 and March 1983, interviews averaging a little more than an hour in length were completed with 102 officials. Research began in the lower levels of the bureaucracy in the line departments responsible for the above sectors and finished at the senior levels of these departments and in central agencies such as the Department of Finance and the Ministry of State for Economic Development (abolished in June 1984). The resulting sample of officials was drawn from seventeen departments and agencies at a range of different ranks.

For Dyson, Britain typifies societies that lack such a tradition. Britain is widely viewed either as a society without a state (Thomas 1978: 82) or one in which both state institutions and the idea of the state as a political and legal concept are underdeveloped (Dyson 1980: 36-44; Badie and Birnbaum 1983: 121-5). Britain is governed through Parliament, not through autonomous administrative institutions. Political and bureaucratic careers are kept apart, reflecting the highly suspect idea that it is possible to separate politics and administration. The permanent public service remains faceless (and, in that sense at least, impersonal), but such autonomy as it enjoys does not arise because it is an emanation of the state. The Civil Service in Britain constitutes what J.P. Nettl has called a "self-sufficient caste." It is separate alright, but it has been "content to regard administration as an unspecific and highly pragmatic form of problem-solving" (Nettl 1968: 580). It has pioneered no administrative techniques nor offered any indication that it subscribes to the view that the problems of political administration are unique. Ministers in this system have acquired a larger than life quality in part because of the doctrine of ministerial responsibility, and in part because statute law frequently confers power either on individual ministers or the ministry as a whole rather than on impersonal state corporations (Dyson 1980: 41).

Canada, like Britain, is not a state society. The study of political institutions in Canada begins, not with the bureaucracy, but with the set of working assumptions that constitute the Westminster model of parliamentary government.³ According to this model a strong and united cabinet governs the country by commanding a working majority in the House of Commons. The Crown in Canada, which might be considered a symbol of constitutional unity, possesses no serious instrumental powers that would give expression to a transcendent authority. It is Parliament that is the political center, the institution that links the public to the executive. Parliament is, first and foremost, a representative institution; its members are drawn from civil society and owe their loyalty to the party leadership and the constituency that elected them. Neither on their own, nor in combination with other elements in the constitutional balance, can they be said to encourage a state tradition.

As a result, Canadians see the state as essentially a complex set of institutions delivering a bundle of services. The key features of the Canadian state are its federal structure and its parliamentary form, but neither have contributed to the development of a statist tradition in Canada. The former has designated a variety of decision-making centres with independent authority; the latter has

3 For an excellent treatment of parliamentary government in Canada which is fundamentally sympathetic to an executive dominated system, see Franks (1987).

required that political power be exercised through party government premised on single member constituencies. In both cases, the representation of geographically defined areas has been the dominant form and legislatures the dominant vehicle. In short, no grand theoretical argument has been made that the state in Canada embodies an authority that is separate from, or in some manner superior to, the authority exercised by the duly constituted government of the day.

It is hard to overemphasize the importance of state tradition for the conduct of industrial policy. Where state tradition is weak, state institutions often reflect the interests of the strongest organizational forces in society. Much of the state's apparatus is devoted to transmitting and responding to these demands. And because these demands are conflicting, and state structure under these circumstances is generally inchoate, industrial policy is typically a rather confusing amalgam of reactive policy initiatives. Policy innovation is inhibited by the absence of political and bureaucratic leadership.

Of course, bureaucratic initiatives, made possible by flexible organizational responses, can occur in spite of a weak state tradition. But these will seldom be evident at the macro level. Here state tradition is reinforced by state structure, and anticipatory industrial policy has very little legitimacy. In what follows we indicate the contribution made by the federal principle to this policy legacy and how federalism affects the attitudes of the industrial policy bureaucracy.

FEDERALISM AND REACTIVE POLICY-MAKING

The association of federalism with "weak government" is an old and worthy idea. Since Dicey (1908), countless observers of federal systems have argued that divided sovereignty cripples government action. In Canada, the principle of divided sovereignty has featured prominently in assessments of economic policy-making. Scholarship on the subject has rallied in recent years around the concept of "province-building" as a way of describing what many see as an unprecedented decentralization in the Canadian federation. Province-building implies the development of strong, willful provincial states bent on pursuing provincially-defined economic strategies (Stevenson 1982). Whatever its source (and there are many interpretations of province-building) these observers argue that the results are clear: provincial efforts to build diversified economies inevitably detract from national economic integration, thus imposing significant welfare losses on society as a whole (Cairns 1979; Maxwell and Pestieau 1980). Efforts by the federal government to intrude into the competition for investment are deeply resented and labelled either as brazen acts of favouritism, or ill-concealed attempts to impose an Ottawa-centred vision of

industrial development on the rest of the country. Recalling the role played by the tariff in structuring the present pattern and character of industrial development, any claim by the federal government to represent regional economic aspirations suffers from a shortage of credibility.

There can be little doubt that the array of policy instruments unleashed by both federal and provincial governments is uncoordinated. In the words of Donald Smiley (1987: 22), "[T]o the extent that effective government requires the rationalization of public policy, federalism stands squarely in the way of this goal." In that case, industrial policy in a federal system will always threaten to deteriorate into a quagmire of competing programs. In support of this perspective observers have pointed to the panoply of provincial programs of industrial assistance to illustrate how the provinces are committed to pursuing independent, and often counterproductive, industrial policies (Tupper 1982). According to many economists, these programs will ultimately reduce the national income of Canadians and retard the growth of firms by limiting the size of the domestic market.

These observations appear to support the presumption that federalism constitutes an independent impediment to coherent industrial policy. It is unwise, however, to endorse this view wholeheartedly. There is little evidence to support the view that, on its own, a federal form can frustrate the wishes of public officials possessed of a consensus on appropriate policy direction. Federalism in the Federal Republic of Germany has not been a serious obstacle to policy development, and there are too many examples of federal-provincial cooperation in the Canadian case to sustain the proposition that federalism is everywhere an impediment to industrial policy-making.

In Canada, the underlying problem is that no consensus exists on the need for an industrial policy that is designed and executed at the macro-level. Federalism plays a role in discouraging this consensus, but primarily because it provides no nourishment for a state tradition. The very idea of divided sovereignty, the notion that either federal or provincial governments might embody and encompass the public interest, is antithetical to the idea of the state. In Nettl's (1968: 568) words, "the necessary overall superordination or sovereignty does not . . . exist."

In this respect federalism reinforces parliamentary government. The oft-remarked incompatibility of Canada's two constitutional premises—federal and parliamentary—arises because the federal form compromises parliamentary supremacy (Verney 1986: 149-71). Beyond that, federalism and Canada's form of parliamentary government are more than compatible, they are mutually reinforcing. Both federalism and parliamentarism embody the ideal of territorial representation and have made it the primary organizing principle of the Canadian state. The single member plurality electoral system, a critical feature

of the Westminster model, is organized around provincial boundaries, further emphasizing the importance of the provinces as distinct units for purposes of national representation (Gibbins 1987). The political parties that animate parliamentary government in Canada act essentially as institutionalized adversaries and electoral machines, not as vehicles for devising alternative economic and social futures. None has been able to integrate the national and provincial electoral arenas. In each province autonomous party systems yield provincial legislatures whose membership is preoccupied with the need to respond to local concerns. Without an institutional counterweight, federalism permits local priorities to emerge full-blown.

This is one of the reasons why, in each province, the object of province-led development is generally the same: to reduce dependence on external capital and to control the costs of labour. Ordinarily, and especially in those provinces dependent on staple exports, this is accomplished by an increasing diversification of the economy and the subjugation of labour (Panitch and Swartz 1988). All provinces have sought, with some success, to improve their technical and political capacities to attract capital, and all are committed to the use of tax expenditures, subsidies and public enterprise as policy instruments. But in the absence of a strong state tradition, this diffusion of political authority has not resulted in widespread policy experimentation. None of the provinces has run off in a policy direction clearly at odds with the federal government because both the provincial and the federal states are a product of the same tradition. As a result, provincial programs are conventional and typically unintrusive; like federal industrial policies, they embody reactive principles.

The political requirements for reactive industrial policy are less demanding than those for anticipatory policy. Reactive industrial policy is delivered through a set of sector-neutral horizontal policies and ad hoc responses to the demands of particular firms (Atkinson and Powers 1987). In the Canadian division of powers, these horizontal policies have been designed and implemented by the federal government with little effective opposition from the provinces. Westminster-based systems are highly responsive to the employment impact of individual firms on local constituencies. Accordingly, each level of government organizes its programs of industrial assistance to meet the needs of individual firms. Under these circumstances, province-building and nation-building are not inherently contradictory strategies (Jenkin 1983: 87-9; Young, Faucher, and Blais 1984: 808-13; Atkinson 1984).

Perhaps because of their reactive character, the impact of federal and provincial programs on the interprovincial flow of goods and services has not been particularly dramatic. Examples of internal barriers to trade are legion. They have included federal transportation and energy pricing policies, provincial agricultural marketing boards, and the licensing requirements, regulations and

industrial incentives of the provinces (Canada, Royal Commission, III, 1985: 116-20). Yet when it comes to assessing their overall impact, researchers are reluctant to claim that the costs are high. In part, this is because interprovincial trade makes up only about 20 per cent of the activity of the Canadian economy, and these particular products and services do not appear to be seriously threatened by trade barriers (Whalley 1983; Jenkin 1983: 95-6). Thus the Macdonald Commission (Canada, Royal Commission, III, 1985: 133-4) was led to the conclusion that "the direct costs of existing interprovincial trade barriers appear to be small."

Turning to the federal level, few observers will quarrel with the observation that "federalism places important constraints on Ottawa's capacity to make industrial policy independent of the provinces" (Tupper 1982: 82). Yet federal powers to intervene remain formidable, especially on those occasions when executive-centred parliamentarism produces political consensus (Franks 1987). And these powers, especially the federal government's spending power, have been used in recent years to address both industrial and regional development problems (Jenkin 1983: 157-8). The result has been a parade of federal programs (Savoie 1986; Aucoin and Bakvis 1984). These programs, and international trading rules, have placed some limits on provincial policy-making (Leslie 1987: 178). Some provincial initiatives make no sense without federal cooperation, while others cannot be contemplated without running afoul of GATT provisions. In light of this, federal and provincial officials have been prepared to cooperate and the effects of federalism on coordination have not been entirely deleterious (Savoie, 1981). The Canadian experience seems to suggest that in the place of categorical judgements about federalism, it is more useful to consider federalism in the context of particular projects and the likelihood that these might disturb the existing federal-provincial consensus on reactive industrial policy.

FEDERAL BUREAUCRATS AND THE FEDERAL PRINCIPLE

Federal officials responsible for the conduct of industrial policy do not consider federalism to be a serious obstacle to the achievement of policy objectives. Only five per cent of those interviewed argued that it was the central obstacle they faced. A further 20 per cent claimed that it was an important obstacle, but not the central one. The remaining 75 per cent described provincial policies and practices either as minor irritants or, and this applies to 45 per cent of the total sample, as constituting no obstacle whatsoever.

When officials saw the provinces as problematic it was generally for two reasons, the first of which might be described as concrete program difficulties. Some federal officials have been embarrassed and annoyed by the aggressive

marketing practices of the provinces or by blatant protectionist policies. The lack of coordination evident in a number of these provincial initiatives has, in their opinion, incurred some unnecessary costs. This has been a particular problem in areas such as agriculture where jurisdictional overlaps demand that care be taken in establishing cooperative arrangements. In such instances the following type of complaint was not uncommon: "We've had instances of Alberta, Ontario, and Quebec fighting for pork markets overseas, using their departments of Agriculture to do it for them. In other words what we are doing on a national scale is being done on a provincial scale without any thought as to whether or not it harms Canada."

The second objection to provincial policies was a broad-based, principled one: the presence of a number of governments, all seeking to change the conditions of competition and the relative prices of commodities, interferes with the smooth operation of the market. In the words of one official:

If you want to put your finger on the biggest constraint to an effective industrial policy it is the problem of the industrial policies of the provinces and the Canadian structure which really gives the provinces much more power than is the case in other countries. . . . hell, you may get too many industrial complexes set up because the provinces are competitively bidding to get facilities. And then you end up with excess capacity, which is a disaster for everybody, or you end up with firms that are too small to get economies of scale, and that's bad too.

These comments notwithstanding, serious complaints against the provinces were offered only by a small minority. In sensitive policy areas such as communications, textiles and clothing, and pharmaceuticals, the level of cooperation described by officials was remarkably high. When asked if the provinces constituted a problem, a Communications department official replied, "Not at all. Not in the field of Communications. On the contrary, we were very glad to see our governments' thrust in high tech complemented by the provincial government's sensitivity to it. . . . The attitude we take is that as officials, civil servants, we do not have a mandate to discuss jurisdiction and the constitution. That has to be left to elected representatives. We are there to cooperate, technically speaking, and the more we cooperate the better it is." Even allowing for halo effects, the essence of this response was repeated across the public service. Only one other position was as popular, namely that the provinces are not very important. A number of officials have little knowledge of, let alone animosity towards, the initiatives of provincial governments. An official in DRIE summed up this perspective in the following manner: "The provinces are not a problem. We just ignore them. Much of what they want to do complements what we want to do anyway. There is a good working relationship and exchange of information at the junior levels, and that paves the way for agreement higher up. But really, the provinces aren't a factor. If we are being very

attentive we will call up a province, maybe the DM, and tell him what we are going to announce the next day and call that consultation."

Not everyone can afford this rather cavalier attitude, especially those whose work involves constant interaction with provincial bureaucracies. But it must be remembered that not all federal officials whose jobs bear on matters of industrial policy are in this position. Many approach the question of federalism in a blissful manner, not only because they do not feel the provinces constitute a threat, but also because they cannot imagine that federal initiatives are so intrusive as to be offensive to provincial sensibilities.

Attitudes toward the provinces are dependent neither on rank (senior executive or junior official) nor on structural location (agency or department) in the bureaucracy. The absence of systematic variation arises from the fact that consensus characterizes these attitudes. The most striking finding is the absence of serious division on the matter of the significance of the provinces. Beyond that, neither animosity, nor even impatience, characterizes bureaucratic relationships. If the center is not embarking on broad-gauged schemes of industrial renewal, the occasion for conflict is much reduced, leaving principled objections to provincial initiatives as the most common form of complaint offered by federal officials.

CONCLUSION

In this discussion of the pattern of industrial policy in Canada we have cast federalism in a supporting role. In this respect we have tried to heed the advice of Peter Leslie (1987: 47) who has argued that federalism is best understood when it is treated as embedded in other variables to which it "bears a reciprocal and evolving relation." The most important of these variables, we have argued, is the Westminster model of parliamentary government. To the extent that this form of parliamentarism discourages the development of a state tradition, federalism provides no counterbalance.

But federalism, on its own, is not responsible for the character of Canadian industrial policy. Indeed, it would be misleading to attribute to federalism, or any other institution, a unique and invariable weight in the policy process. Federalism makes a contribution to a much larger pattern of policy-making, one in which Canada's weak state tradition figures prominently. It is this weak state tradition that has encouraged the broad diffusion of political power and provided only the thinnest of bases on which to erect consensus-building institutions. It has led Canadian politicians and bureaucrats away from projects based on state intervention and toward the liberal, continentalist option in industrial policy-making. Given that the present pattern of industrial policy is rooted in this tradition—that is, in the structures of Canadian government and

in the belief systems of bureaucrats—changing the direction and content of policy will be an exceptionally long and difficult chore.

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Receipts and Burden Sharing, The Taxation System and Fiscal Equalization in the Federal Republic of Germany

Gerd Böckmann

INTRODUCTION

Federalism in Germany enables regional differences and peculiarities to be taken into account. However, the Basic Law (Constitution) requires that living conditions in all parts of the country be uniform. In practice a reduction in regional economic and social disparities has been attempted by striving for minimum standards of public services and infrastructural facilities—without, however, aiming at literally equal living conditions. Historically, in the light of recent experience with totalitarianism, federalism was emphasized in the Basic Law (Grundgesetz) of 1949. The consent of the Federal Council (Bundesrat) is required in all matters of legislation with respect to financial relationships among the Federal Government, the Länder and the local governments. This explains why Article 30 of the Basic Law treats the Länder as self-governing political entities endowed with full powers of statehood.

The purpose of this study is to present an up-to-date discussion of the institutional structure and current developments of fiscal federalism in the Federal Republic of Germany. In the analysis reference is also made to recent data on vertical and horizontal fiscal equalization.¹

1 For an earlier study on fiscal federalism in the Federal Republic of Germany, see report by Zimmermann (1981) done on behalf of the Advisory Commission on Intergovernmental Relations. See also Traber (1980: 261-280).

THE DIVISION OF RESPONSIBILITIES AND BURDEN SHARING AMONG THE GOVERNMENTS

The Basic Law prescribes that the exercise of governmental powers and the discharge of governmental functions shall be incumbent on the Länder. But the general presumption in favor of the Länder is severely restricted by other constitutional provisions. First, there is an extensive catalogue of exclusive legislative responsibilities of the Federal Government (Articles 71 and 73), e.g., foreign affairs, defense, federal railroad, postal services, and telecommunication.² Second, there is an area of concurrent legislation (Articles 72 and 74) in which the Länder have the power to legislate only to the extent that the Federal Government does not exercise its right to legislate. Third, there is the Federal Government's authority to enact skeleton legislation (Article 75) in areas of traditional state functions as, for example, in college and university education and in environmental protection.³

All areas of federal authority have been expanding continuously, largely at the cost of the Länder responsibilities. In most political issues the states act within a framework of federal legislation, but to reiterate, every federal act affecting the interests of the Länder must also pass the Federal Council (Bundesrat).

The Basic Law empowers local governments to regulate all affairs of local concern within the limits set by law (Article 28). The distribution of authority between a state government and the corresponding local units differs from Land to Land. While the Federal Government has the right to legislate, the execution of federal laws is left mainly to Länder and local governments (Article 83). The assignment to legislate and to execute laws to different levels of government has blurred a strict division of responsibilities. This does not apply however, to be sure, to some important fields, for example, at the federal level in defense and in foreign affairs, and at the state level in matters like education, police, cultural activities, and motorway maintenance.

In order to fulfill constitutionally assigned responsibilities, adequate provisions for carrying the financial burdens involved are required. The Basic Law prescribes that the Federation and the Länder shall meet separately the expenditures resulting from the discharge of their respective tasks, unless it provides otherwise (Article 104a). The rules are as follows:

- 2 For a detailed treatment of foreign policy and telecommunication in the contemporary setting see Zöllner (Chapter 14 in this volume) and Conrad (Chapter 10 in this volume).
- 3 Busch has given a detailed review of German environmental policies with particular reference to federal aspects (in Chapter 16 in this volume).

- Where the Länder act as agents of the Federal Government, the Federal Government meets the resulting expenditures, e.g., in construction and maintenance of highways and federal roads.
- Federal law designed to transfer cash benefits to individuals, which is executed by the Länder, may provide that the financial burden is partly or wholly covered by the Federal Government (Article 104a). This pertains, for example, to areas such as subsidies, the housing bonus, state welfare assistance, and educational promotion.
- The Federal Government will share responsibilities with the Länder provided that they are considered important for society as a whole, and provided that federal participation is necessary to grant uniform living conditions. Relevant here are the so-called joint tasks. They include investment projects in universities and university clinics, the improvement of regional structures, aid for improving the agricultural structure and for coastal preservation.
- The Federal Government is also constitutionally permitted to give financial assistance to Länder and local authorities for investment projects in order to counteract unemployment and recession, and to encourage economic growth (Article 104a). Special provisions are included in the so-called Law on Stability (*Stabilitätsgesetz* 1967). This law gives the Federal Government a whole variety of possibilities to direct regional and local investments, despite the constitutional intent to constrain the federal government in these fields. Important tasks such as urban renewal, local transport, and district heating systems are excluded. Investments in hospitals—university clinics are part of the joint tasks referred to above—are no longer under federal influence. Also, federal grants for urban renewal came to an end in 1987.

It should be noted that the details of joint tasks and of grants must be decided upon by federal legislation which requires the consent of the Bundesrat, or else by administrative arrangements. For the purpose of planning joint tasks, joint committees (*Planungsausschüsse*) representing the Federal and all Länder governments have been formed to set up annual skeleton plans (*Rahmenpläne*). These annual plans have to be integrated into medium-term financial planning both at the federal level and the respective state level.

The result of these constitutional provisions is a complicated pattern of financial burdens, tasks, and legislative responsibilities. An important share of investments at the state and the local level is financially supported, and hence largely determined by the Federal Government. Extensive permanent costs of running and maintenance are fully left to the Länder and the local authorities.

As a consequence, the influence of the Federal Government on the state budgets is far greater than aggregate budget figures reveal.⁴

REVENUE SHARING AND FISCAL EQUALIZATION

Contrary to the complicated system of responsibilities and burden sharing sketched above, tax yields are generally distributed unambiguously among the various levels of government by explicit constitutional provisions. Only the receipts of the turnover tax (Mehrwertsteuer) are subject to flexible apportionment between the Federal Government and the Länder by federal law.

THE VERTICAL DISTRIBUTION OF TAX REVENUES AND THE SPECIAL CASE OF THE TURNOVER TAX

All jurisdiction on taxes is *de facto* federal jurisdiction (Article 115, Basic Law) although the consent of the Bundesrat is required for laws relating to taxes that accrue partly or wholly to the Länder or to local governments. Local governments are authorized only to impose local surcharges on the real property and the business tax. Apart from this exception, the tax bases as well as the tax rates are uniform throughout the Federation.

Tax sharing is of utmost importance in German fiscal federalism. Almost 80 per cent of the total tax yields accrue jointly to the three levels of government. The joint taxes comprise the most important revenue sources, i.e., the wages tax, the assessed income tax, the corporate income tax, the turnover tax, and the locally levied business tax. Only about 20 per cent of the total tax revenues are separately assigned by constitutional provisions (Graph 6.1). From its mineral oil tax revenues the Federal Government contributes to the costs of approved projects in road construction and transportation systems in local jurisdictions. Local authorities receive a percentage share of the Länder share from joint taxes, as legislated by the respective Land. Länder legislation will also indicate whether and to what extent the proceeds from the Land's own taxes shall be passed on to the local level.

4 An excellent critique of joint tasks and the notion of cooperative federalism in German federalism is presented in Patzig (1981). For a critical view on cooperative federalism and some (additional) counterintentional consequences see Picht (in Chapter 4 in this volume).

THE TURNOVER TAX IN VERTICAL FISCAL EQUALIZATION

It is highly unlikely that taxes, however assigned to various levels, will develop in accordance with the financial needs when uniform provision of public services is taken as a benchmark. The vertical sharing mode for the yields from the turnover tax has not been fixed in the Basic Law as mentioned above. Therefore, vertical adjustments have to be envisaged periodically by re-negotiating the shares of the turnover tax. The Basic Law accentuates the equal standing and the financial rights of the partners concerned. Their budgetary needs on the basis of medium-term financial planning have to be taken into account. In the light of the political nature of the matter of tax distribution, negotiations are left to the Federal Chancellor and the First Ministers. In practice this has resulted in shares being determined for two years with the consequence that the quarrel about the turnover tax shares is an on-going phenomenon. In addition, it is a source of instability in any medium-term planning pursued by the Federal Government and the Länder governments (Graph 6.2).

THE TURNOVER TAX IN HORIZONTAL FISCAL EQUALIZATION

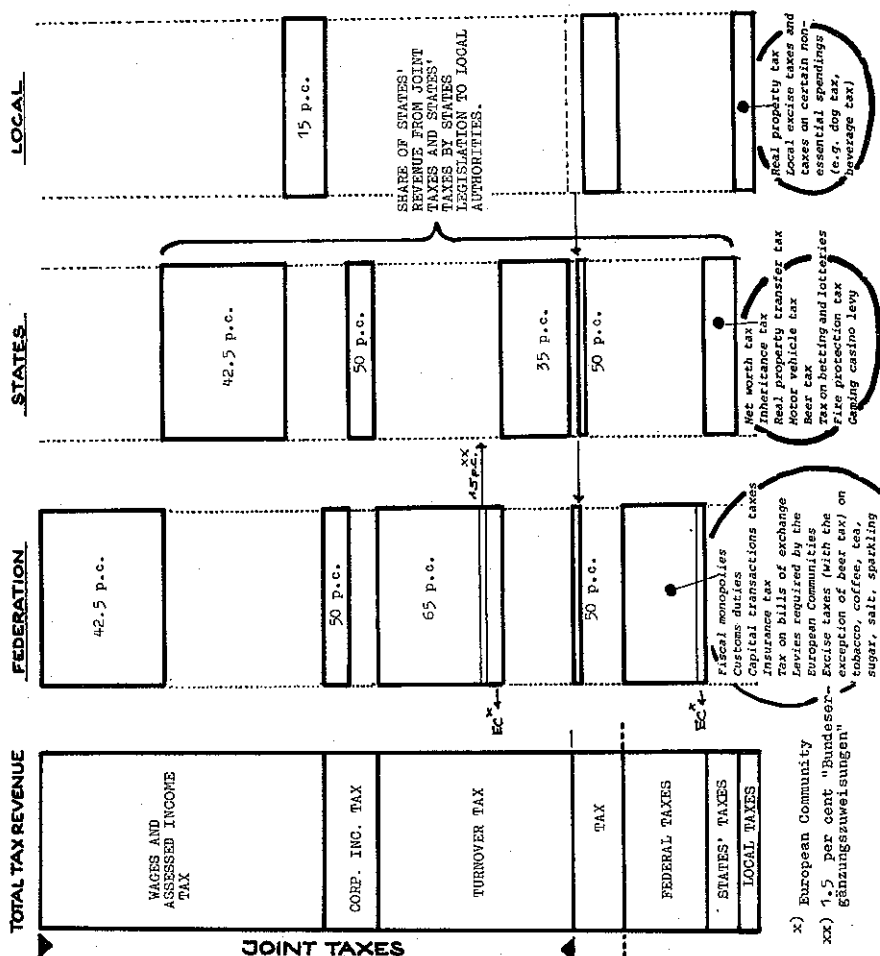
The Länder share of the turnover tax also serves as a means of horizontal redistribution between financially weaker and stronger states (*Länderfinanzausgleich*). This is effected, first, by an equal per capita distribution of 75 per cent of the Land's share (Article 107 Basic Law). All other tax revenues of the Länder—state taxes as well as joint taxes—accrue to the individual Länder in accordance with the respective collections within their boundaries. This results in differing per capita revenues. The equally distributed 75 per cent share of the turnover tax may be seen as a first step towards horizontal equalization. The 25 per cent Land's share is, in turn, explicitly designated for horizontal equalization. This additional share is paid to those Länder whose per capita revenue totals from joint taxes, state taxes, and per capita shared turnover tax are below 92 per cent of the all Länder average (Graph 6.3). The steadily expanding volume of these supplementary payments (Graph 6.4), along with the general pattern of the interstate fiscal equalization to be discussed in what follows, is one cause of current political struggling among Länder governments.

HORIZONTAL FISCAL EQUALIZATION: THE GENERAL PATTERN

Fiscal equalization among the Länder is by definition purely horizontal, i.e., the sum of all payments made by the financially stronger Länder is equal to the sum of the receipts of the financially weaker Länder (Graph 6.5). Berlin (West) is not included in the fiscal equalization scheme. One major step towards interstate equalization (in addition to the horizontal aspects of the turnover tax

Graph 6.1

APPORTIONMENT OF TAX REVENUE



SHARES OF THE FEDERATION AND THE STATES IN THE REVENUE FROM THE TURNOVER TAX (PER CENT) (ART. 106, 3 GG)

100 %

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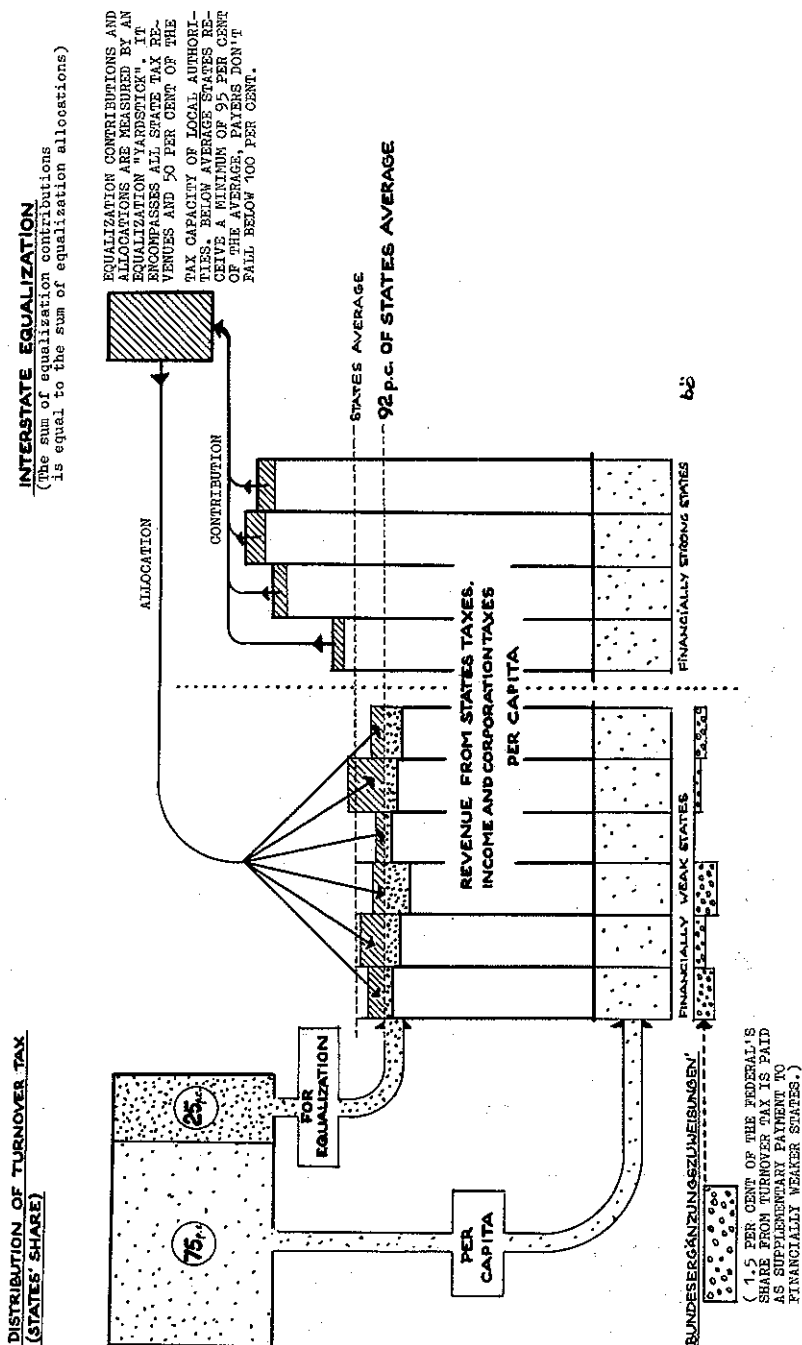
Source of figures: Special document Fed. Min. of Finance,

31.1 1985

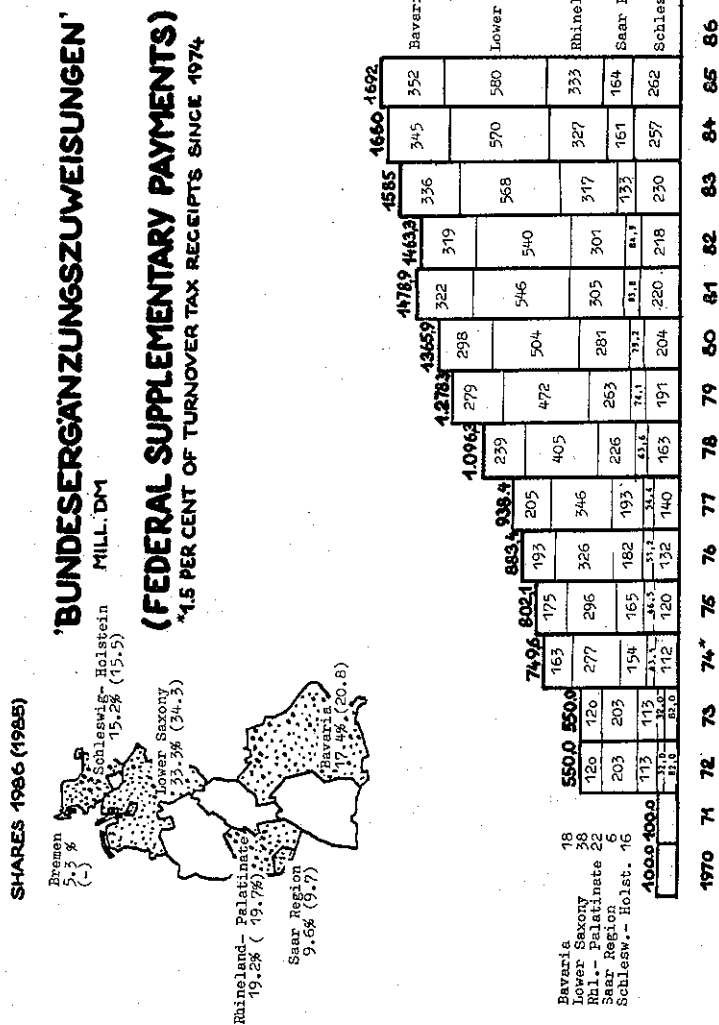
x) "Bundesergänzungszuweisungen"

Graph 6.3

THE FINANCIAL EQUALIZATION SYSTEM



Graph 6.4



Source of figures: Fed. Min. of Finance, Finanzberichte

Graph 6.5

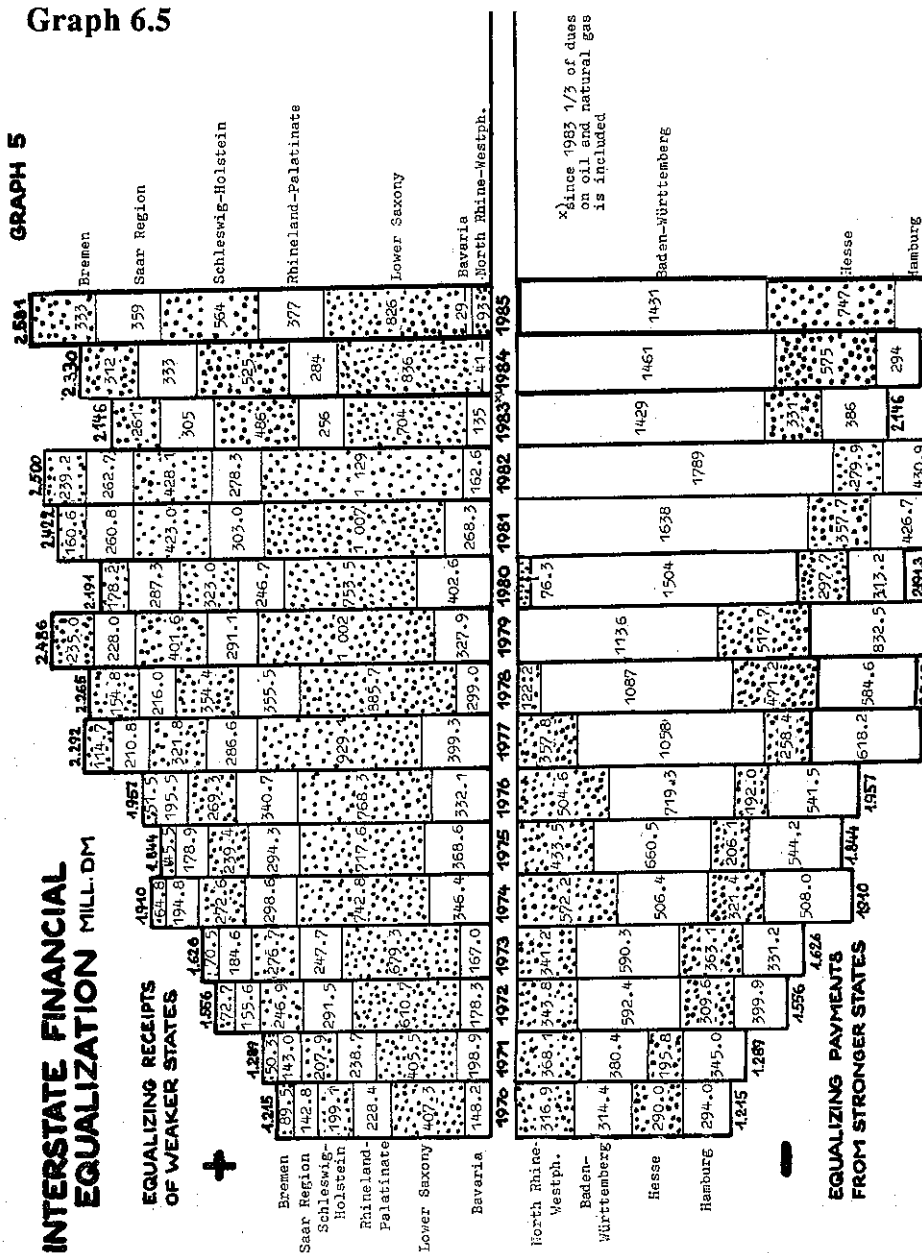
GRAPH 5

INTERSTATE FINANCIAL EQUALIZATION MILL.DM

EQUALIZING RECEIPTS OF WEAKER STATES

+

EQUALIZING PAYMENTS FROM STRONGER STATES



presented in the preceding section) may be seen in the special payments (*Zerlegungszahlungen*) due to differences between the place of collection of the wages tax and the corporate income tax and the place of residence of the taxpayers. The receiving *Länder* under this rule are identical to the financially weaker *Länder*. In this way the volume of the *Länder* fiscal equalization payments is reduced to a remarkable extent.

In the system of horizontal fiscal equalization, the expenditure needs of the respective *Länder* to meet the target of uniform standard of living are generally not taken into account. Exceptions are made only where population density and special burdens such as costs of maintaining harbor facilities are concerned. Interstate equalization is basically built upon an equalization yardstick (*Ausgleichsmesszahl*) defined as per capita tax revenues of the respective *Länder* including one half of the tax yields of the individual *Länder* local governments. *Länder* which rank below average receive a minimum of 95 per cent of this yardstick. *Länder* which are required to make equalization payments are guaranteed not to fall below 100 per cent of the average of all *Länder* taken together.

REMARKS ON CURRENT CONFLICTS IN HORIZONTAL FISCAL EQUALIZATION: THE CASE OF LOWER SAXONY'S OIL AND GAS DUES

Fiscal federalism in Germany has brought about some degree of equalization if measured by the revenues from taxes per capita including equalization payments. However, it has provided insufficient results if one looks at actual living conditions in various parts of the country.⁵ The continuing struggle for greater tax shares and funds is, thus, a crucial aspect of German federalism. The following discussion illustrates the most severe recent conflict in the realm of interstate equalization.

Until 1983 Lower Saxony's oil and gas dues were not taken into account in the interstate equalization scheme as tax equivalent revenues. From then on, however, they were included up to one third of the total royalties. Since 1986 one half of the total proceeds have been included following a political compromise. Continued disagreement among the *Länder* about how to proceed prompted some *Länder* to take the issue to the Federal Constitutional Court (*Bundesverfassungsgericht*). In its decision from June 1986 the Court ruled that all dues on oil and natural gas have to be taken into account in the inter-

5 An empirical account of regional disparities among the various *Länder* in the Federal Republic of Germany including Lower Saxony is given by Picht (in Chapter 4 in this volume).

state equalization scheme. Also, other revenues, e.g., casino levies, have to be included. The Court also ruled that the Länder and the Federal Government need to reach an agreement so that the new scheme would come into operation on 1 January 1988.

In the meantime Lower Saxony's dues on oil and natural gas have declined sharply as a result of the worldwide drop in the oil and gas prices. The government of Lower Saxony has argued that on top of this unalterable development in the energy markets the decision by the Federal Constitutional Court imposes an additional burden upon a Land which is financially depressed. In its defense the Lower Saxony government has, in turn, proposed that the total tax yields of the local governments should be considered in calculating the equalization yardstick in the interstate fiscal equalization scheme rather than only 50 per cent as in the present scheme (referred to above). Financially weaker Länder must also support financially weaker local communities within their boundaries. There is no apparent reason why those revenues should not be fully taken into account. Lower Saxony would stand to gain from this modification. The negotiations on the new horizontal fiscal equalization scheme are, thus, pursued in a larger realm. The argument put forward by Lower Saxony is additionally supported by the Basic Law which generally treats Länder and their local authorities as a unit.

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Adaptations in Canadian Fiscal Federalism

Ronald McGinley

INTRODUCTION

This paper discusses the challenges for fiscal federalism in Canada, and how well we've been meeting these challenges in recent years. In this context, I also propose to comment briefly on how our fiscal arrangements might evolve in the medium term.

In Canada, it is conventional to think of "fiscal federalism" as comprising three basic subjects. *First*, it includes a large array of programs that are jointly funded by the federal and provincial governments. By far the most important of these are the programs for financing health care, post-secondary education, and income support and social services, but federal transfers are also paid in respect of provincial language programs, economic development programs, training programs, and literally dozens of other activities. *Second*, fiscal federalism includes the equalization program, which is now mandated under the constitution. The Canadian equalization program, unlike the German one, is funded entirely by the federal government. Payments are large, amounting to about six per cent of total federal expenditures, and are made to six of the ten provinces. *Third*, the field covers the Tax Collection Agreements, under which a number of provinces stack their income taxes on top of a federally-defined tax base. Relatedly, the subject also embraces issues of tax harmonization and, to a certain extent, fiscal and economic policy coordination.

These three pillars of Canadian fiscal federalism were erected during the late 1950s and '60s, a time of healthy economic growth and relative fiscal abundance. No new pillars have been erected since. We have witnessed, instead, a more-or-less evolutionary process in which the basic building blocks have been refined and adapted in response to the new conditions of the 1970s and '80s. The main environmental factors that have shaped the system in recent years include the advent of fiscal restraint, oil price developments, the rise of efficiency ideology, demographics, and general developments in the international and

domestic economies. I shall examine each of these pressures in turn, and attempt to relate them to specific changes in the fiscal arrangements that have already been made, or are currently being considered.

THE ADVENT OF FISCAL RESTRAINT

Fiscal restraint is the order of the day. The federal deficit in Canada continues to hover around \$30 billion, or 7.1 per cent of GNP. In relative terms, the Canadian deficit is considerably larger than the much-discussed American one. There has been a lively debate in Canada about the causes and economic consequences of this situation, but most commentators now seem to agree the deficit does indeed have to come down. Accordingly, the debate has shifted to one about the timing of the reduction, and about the mix of expenditure cuts and tax increases that should be used to bring it about.

Cash transfers to the provinces amount to approximately one-fifth of total federal expenditures. Such a large component of the budget obviously cannot be overlooked in the search for savings. Its goal of deficit reduction therefore inevitably pits the federal government against the provinces. The potential for conflict is high because the provinces generally perceive themselves as being on the front lines, facing rapidly rising delivery costs due to demographics, utilization rates, and the implementation of new technologies. Moreover, some of the small provinces receive over 40 per cent of their revenues in the form of intergovernmental transfers.

The challenge, in terms of federalism, is to find a way to "manage" the inevitable conflict over transfer levels. If confrontation becomes excessive, the hard-feelings generated in the financial discussions can spill over and jeopardize progress in other areas of intergovernmental relations.

With this in mind, it is useful to review how restraint has been handled so far. As of 1970, the main program transfers in Canada were provided on a cost-shared basis, with the federal government reimbursing provinces for 50 per cent of the approved program costs. Such a generous formula was often essential in winning provincial acceptance of federal involvement in fields of provincial jurisdiction, notably health care and higher education. But as the era of restraint set in, the federal government found this open-ended arrangement increasingly unsatisfactory. It had surrendered control and predictability over a large part of its expenditures, which were now, in effect, driven by the decisions of provincial governments. The first "adaptation" in the fiscal arrangements therefore took the form of arbitrary ceilings on the rate of growth of the federal contributions. The growth of federal transfers for post-secondary education was capped in 1972, and the transfers for Medicare were subjected shortly thereafter to a diminishing series of annual caps.

A second, and major, adaptation occurred with the negotiation of the Established Programs Financing arrangement (EPF) in 1977. There were two main features of EPF. First, federal transfers for health and post-secondary education were rolled into a single "block fund", and set to grow at the average rate of growth of GNP per capita. Second, as GNP escalation implies, federal payments were detached from actual program expenditures, thus converting the former shared cost programs into a single unconditional transfer.

The EPF negotiation was a difficult one, but the new program was widely regarded at the time as a considerable step forward. The federal government achieved its restraint objective by restricting the growth of its transfers to the rate of growth in the economy. At the time, health and post-secondary spending were growing considerably faster than GNP. The provinces, while unhappy with the financial results, were pleased with the promised stability in future transfer growth and the advent of unconditional funding. (Provinces had argued that the eligibility rules design and administer cost-effective programs). Both levels of government expected to benefit from a reduction in administrative red tape.

Unfortunately, EPF was an unstable compromise. It was, in a sense, the victim of its own internal contradictions. Restraint had been achieved, but at the expense of lost federal visibility and control. As the restraint imperative continued to grow, Ottawa found it increasingly awkward to be transferring hundreds of millions of dollars, without any clear provincial accounting of where the money was going or how federal objectives were being served. Experience suggests that donor governments usually do have second thoughts about unconditional funding arrangements. I am merely suggesting here that the environment of restraint accelerated this reaction in Canada.

Thus, the stage was set for further changes. On the one hand, there were further cuts in transfers. A large chunk of the EPF "base" was removed in 1982. For 1983 and 1984, the GNP escalator in respect of post-secondary education was replaced with arbitrary caps of six and five per cent respectively. Yet another push for restraint was initiated in 1985 to reduce the EPF escalator to GNP-2 per cent. All of the recent reductions in health and post-secondary education transfers occurred without compensating concessions to the provinces.

Simultaneously, there were moves to partially "re-conditionalize" EPF. The block-fund was effectively terminated, with health and post-secondary education being more clearly identified as discrete transfers. The Canada Health Act was passed, authorizing the federal government to withhold a part of the transfer payment if a province allowed physicians to charge higher rates than are in the provincial fee schedule, or if it permits hospitals to levy user charges. (Most provincial governments regard these options as "safety valves" for controlling

costs and utilization). Third, several Secretaries of State began to talk, not only about redesigning the transfer payments for higher education, but also about developing specific conditions that might be attached to them.

These developments—all driven by restraint—have produced an enormous amount of federal-provincial animosity in recent years. The transfers have been reduced and restructured, but at the price of consistent, unanimous and vocal opposition. In this sense, it is probably correct to say that the challenge of restraint is not being handled very well. Considerable attention will have to be devoted to minimizing intergovernmental friction, because restraint is an inevitable and continuing pressure.

Obviously, governments will choose to "bash" one another whenever it is in their short-term political interest to do so. Nothing can change this, or should. It is also true that grand compromises can be worked out, in which transfer restraint is traded against completely unrelated matters. But staying within the domain of fiscal federalism, there are a number of possible process responses to the restraint challenge.

For example, more frequent and regular ministerial meetings might help. One of the problems that inhibits the rational discussion of EPF cutbacks is the fact that negotiating mandates are frequently divided. Finance Ministers talk about formulas and dollars, but the program ministers—those closest to the systems' needs and the real impacts of restraint—are more often than not left to talk independently about program design and requirements.

A second possibility might be to break up the fiscal arrangements legislation into more "digestible" pieces. Currently, the biggest transfers, equalization, and the Tax Collection Agreements, are all provided for in a single piece of legislation which is traditionally reviewed every five years. Consistency is the main rationale for treating all these things simultaneously. It can be argued, however, that the result is "systems overload", with busy ministers being unable to contend with so much complex material all at once. To the extent that a more piecemeal approach improves the negotiator's understanding of the individual programs and issues, it could facilitate a more reasoned dialogue about the implications of additional transfer restraint.

The Macdonald Commission and the Quebec Government, among others, have proposed mechanisms for "entrenching" the fiscal arrangements. The essential idea here is that there would be a "treaty" between the two levels of government limiting the extent of permissible cutbacks in federal transfers during the period between two negotiations. This could help reduce intergovernmental friction by restoring a measure of predictability. It would also address the provincial concern that recent cuts have seemed "arbitrary" and a "breach of faith".

A fourth option is resort to bilateral negotiations. Canada is an extremely diverse country, with considerable variety in local needs and programming. The main transfer programs, however, often have a uniform design and tend to be negotiated in plenary sessions of all federal and provincial ministers. Bilateral approaches offer the possibility of working out restraint arrangements that are more sensitive to the views of individual provinces. While the point is more relevant in the context of the various conditional transfers, it is noteworthy that bilateralism has been raised in the context of future negotiations on post-secondary education.

These options are all interesting, and some would clearly be beneficial in limiting the scope for conflict. It is possible to argue, however, that such institutional changes are less important than a change in provincial government strategies. Despite their general support for federal deficit reduction and a decade of living with transfer cuts, provinces do not yet seem to fully comprehend the continuing nature of the restraint problem. They have resisted transfer cuts on an episode-by-episode basis, without a consistent long-term plan for "shaping" them. Provinces have argued, with considerable force, that the cuts merely shift the deficit burden from one level of government to another, and are unreasonable and unfair. But they have not succeeded in winning a great deal of public support for this view, partly because the public does not understand the issues, partly because there is widespread support for federal restraint, and partly because the interest groups have generally been unwilling to take sides.

Put differently, the provinces have simply attempted to protect the status quo. They have not succeeded in developing a set of positive demands of their own to put on the negotiating table. Thus, there has been no basis for exchange—no basis on which to compromise. Without the possibility of trade-offs, the negotiations will almost inevitably end in acrimony. The challenge, therefore, is for provinces to work together on a plan for desired structural changes in the transfer programs, especially EPF; to develop whatever leverage they can; and to push these claims forward as a reasonable price for their acceptance of further cuts. In short, future adaptations in Canadian fiscal federalism will depend largely on the ability of the provinces to create the conditions for mutually satisfactory deal-making.

OIL PRICES

If restraint has been the main environmental factor shaping the fiscal arrangements in Canada, oil price developments have been a close second. World oil prices quadrupled in the mid 1970s, and doubled again following the Iranian revolution. As recently as 1984, people were talking seriously about \$90 oil.

It is essential to recognize that, in Canada, the ownership of natural resources is vested in the Provincial Crown, and that about 85 per cent of the oil and gas resource is situated in a single province. The oil price explosion created enormous strains within the Canadian Confederation, as it did within the world economy. Oil exporting provinces demanded world prices; oil importing provinces felt that the price increases should be moderated to protect the consumer. The federal government, in addition to trying to mediate these regional interests, also sought to wrest a share of the huge economic rents that were accruing to Alberta.

From the narrow perspective of fiscal federalism, oil price developments posed two challenges: what to do about the skyrocketing fiscal capacity of Alberta, and relatedly, how to adapt the equalization formula.

Even with controlled oil prices, Alberta's fiscal capacity grew to over twice the national average by the early 1980s. Such a disparity was totally unprecedented. In the past, the wealthiest province had never been more than 25 per cent above the average. Alberta's oil wealth enables it to have very high per capita expenditures, combined with extremely low tax effort. This established the potential for major fiscally-induced distortions in the allocation of capital and labour, and also directly exerted leverage on spending and tax levels in other provinces.

In attempting to solve this new problem of horizontal imbalance, Canadian academics and policy makers took a close look at the German equalization system. The result was a series of two-tier equalization proposals. The first two-tier would consist of equalization in respect of the conventional revenue sources and be funded, as at present, entirely from federal revenues; the second tier would consist of equalization in respect of natural resource wealthy provinces. These proposals did not succeed. Not only were there technical problems, but both Alberta and the equalization recipients balked at the concept of an inter-provincial revenue sharing pool.

Thus, the challenge of horizontal imbalance remains. The 1982 change in the equalization formula did not address this problem, but merely stepped around it. Of course, the urgency of the situation has eroded entirely with the recent collapse of oil prices and the continuing economic difficulties of Alberta. On the other hand, one might reasonably expect this issue to return to prominence during the 1990s.

Oil price changes did, nevertheless, force a host of technical adaptations to the equalization program. As Alberta's wealth grew, the federal government found it increasingly difficult to fully equalize all the rents, particularly given its own small share of these rents and the over-arching concern with restraint. More fundamentally, Alberta became so wealthy that it pulled the national average level of fiscal capacity up above Ontario's level, meaning that, without

changes in the formula, Ontario would qualify for equalization payments. Aside from the cost implications of such a development, it was felt that paying Ontario would strain the credibility of the program.

Accordingly, a number of special adjustments were made. In 1974, and again in 1977, it was decided to limit the portion of provincial oil and gas revenues that were subject to equalization. When this proved an insufficient response, certain natural resource revenues were taken right out of the formula. In the end, however, it was necessary to exclude Ontario by what amounted to legislative fiat. These various ad hoc interventions left the basic equalization program in considerable disrepair, and created pressure for more fundamental reform.

In 1982, Ontario bit the bullet and replaced the historic national average standard. Its original proposal was to relate equalization payments to the Ontario level of fiscal capacity, but the final legislation established a standard based on the average fiscal capacity of the five mid-wealthy provinces. Under this system, Alberta's oil revenues cease to drive the equalization entitlements of the recipient provinces, and the problem of Ontario's potential eligibility is effectively solved.

Unfortunately, the five province standard is not entirely satisfactory, for a number of technical reasons that I need not go into here. Despite this, it was generally expected that there would be no significant changes in equalization when the program was relegislated in 1987. However, the fall in oil prices once again altered the situation. With oil expected to remain below \$20 for a considerable period, and with the Ontario economy once again booming, it is not unreasonable to argue for a return to a national average standard of equalization. The rationale underlying the adoption of the five province standard no longer exists, and pressures to replace it can be expected to mount. In this respect, oil prices continue to be a major determining factor in the evolution of Canadian fiscal federalism.

THE RISE OF EFFICIENCY IDEOLOGY

A third force has been what I shall call the rise of efficiency ideology. Efficiency has several meanings. To the layman, it primarily indicates the streamlining of programs and the elimination of overlap and duplication. The drive for this kind of efficiency has been building steam for some time, as most recently reflected in the Nielsen reports. In intergovernmental terms, the challenge will be to discover and resolve genuine instances of overlap, while at the same time avoiding the appearance that costs and responsibilities are merely being transferred from one level of government to another.

A more sophisticated notion of efficiency deals with the type of incentives we build into our programs and whether or not they facilitate appropriate forms of response. This focus on incentives has grown considerably in the past decade or so, fuelled by restraint and the resurgence of conservative, market-oriented economics.

One example of how this relates to fiscal federalism has already been given. The shared cost programs of the early 1970s embodied an important *disincentive* effect, in that provinces were discouraged from introducing new, cost saving approaches, especially in health care. High cost services were shareable, but lower cost alternatives often were not, meaning that it was cheaper from the provincial point of view to choose the "wrong" delivery mechanism. This problem was resolved in 1977 with the move to unconditional blockfunding under EPF.

A second example relates to the internal dynamics of the equalization program. A number of provinces have complained that it is not in their own interest to spend funds promoting economic development, since any improvement in their economic base relative to the standard results in a fall in equalization entitlements. A somewhat related problem raised by recipients is that revenues are equalized on a gross rather than a net basis. The failure to deduct the expenditures a recipient province makes in developing its forest or mineral resources sometimes reduces its equalization, thereby contributing to a suboptimal level of investment. The validity of these complaints has been debated at length, but the issue remains.

It has also been argued that 50-50 cost sharing of welfare under the Canada Assistance Plan encourages poor provinces to have excessively high minimum wages. This is because provinces escape the full welfare costs of creating unemployment through inappropriate wage scales. This particular argument has not received much attention at the intergovernmental level, but it stands as a good example of the concern with incentives.

A final example is the Canada Health Act. As mentioned earlier, this Act penalizes provinces financially for permitting hospital user charges. Naturally, the provinces argue they need as much flexibility as possible to experiment with techniques to control costs and utilization rates. They see the Canada Health Act as a retrograde step because it restricts their degrees of freedom and forces them to follow inefficient pricing practices.

The challenge for fiscal federalism is therefore to incorporate efficiency-enhancing incentives into the various programs, but without compromising the equity principles that are at the heart of most of them. Clearly, this will be a difficult task.

It is a task of increasing relevance, however, and not only because of restraint. There is a growing recognition in Canada that the massive fiscal in-

fusions from the federal government into the poorer provinces have not succeeded in narrowing the gap in market incomes. Market incomes in Newfoundland, for example, are about 60 per cent of the national average, essentially where they were in 1965. The unemployment rate in the poorer regions has not converged towards the Canadian norm. Such facts obviously draw into question the cost-effectiveness of all our mechanisms of regional redistribution. For the future, the thrust must be toward facilitating change and out-migration, as opposed to continued subsidization of non-competitive enterprises. It is in this broader context that the issue of enhanced efficiency in intergovernmental transfers must be played out.

DEMOGRAPHICS

One does not have to be a demographic determinist to admit that the so-called baby boom bulge moving through the population structure has had an enormous influence on the Canadian economy and fiscal system. The educational system had to be expanded dramatically in the 1960s. The major federal initiative related to post-secondary education finance was, in fact, closely linked to the new demands for university and college placements. Somewhat later, the baby boom hit the labour market, co-incidentally with slowing economic growth, thus producing high levels of youth unemployment and a major challenge to public policy. Currently, as the bulge moves forward, the challenge is gradually shifting from youth unemployment to retraining for those in the 25-40 year age range.

For the future, there will be a growing challenge from population aging. The aging phenomenon has clear and important implications for the cost of government programs, notably health care. The health care costs of an elderly person are upwards of four times those of a young person. Provinces have been citing population aging as an important variable in explaining cost escalation, but the issue has not yet come up in any meaningful way in the federal-provincial discussions about EPF. This is likely to change in the medium term. For example, one of the many things the provinces could push for is a special "weighting" of the population used in EPF to acknowledge both the higher costs of serving the elderly and the gradual shift towards an older population.

Aging also implies the need to gradually shift resources away from education and towards health care. The system of intergovernmental transfers should not be such as to impede this inevitable reallocation. In this connection, it should be noted that the splitting of the EPF blockfund into separate health and education transfers, when combined with the increasing federal interest in reconditionalization, will in fact reduce provincial flexibility to make the necessary reallocations. This would suggest that the challenge of demographics is

not being sufficiently acknowledged in the intergovernmental discussions on transfer mechanisms.

A final point here is that demographic movements may put considerable pressure on Canadian governments to renegotiate the division of powers between Ottawa and the provinces. The fiscal decentralization that took place in Canada in the 1950s and '60s coincided with the demand of the baby boom generation for services such as education, which fall primarily within provincial jurisdiction. Since about 1970, the vertical balance between the federal and provincial governments has been more-or-less stable. For the longer term, however, we may be looking at a demographically driven recentralization. The thought here is that the federal government could come under relatively greater expenditure pressures as a result of the aging phenomenon due to its responsibility for Old Age Pensions, and so on. This, of course, is highly speculative stuff, but it does offer an interesting rationale for re-examining the division of tax and expenditure responsibilities. And that, needless to say, would entail a simultaneous rethinking of the intergovernmental transfer system.

THE ECONOMIC ENVIRONMENT

There are a number of pressures on the fiscal arrangements that derive from general conditions in the world and domestic market place. For example, world trade liberalization has focussed attention on the need to expand domestic markets by reducing interprovincial barriers to trade. The Tax Collection Agreements are important in this context since they were originally put in place for the purpose of securing tax harmonization. These agreements are now under considerable pressure. The impulse towards province-building has led to provinces wanting greater flexibility to design various tax credits. Some opening up in this respect did occur in the 1970s, but most provinces argue that it hasn't gone far enough. It therefore remains a major challenge to find ways of accommodating provincial demands without, at the same time, opening the doors to new interprovincial barriers that could be created through discriminatory tax provisions. A code of tax conduct is one option that has been proposed.

Provinces have also complained increasingly about unilateral federal changes to the joint tax base. These changes are often costly to the provincial treasuries. Moreover, as in the case of the \$500,000 lifetime capital gains exemption, provinces often find themselves philosophically out of step with the measures that the federal government is taking. There is considerable reason for provinces to consider withdrawing and establishing independent tax systems. A number of suggestions have been made to preclude this outcome, in-

cluding a proposal to have provinces tax federally-defined income, rather than simply to piggyback their taxes on the federal basic tax.

Trade liberalization is also forcing Canadian governments to work on new approaches to fiscal policy coordination. Canada has an increasingly open economy, with exports and imports each amounting to about 31 per cent of GNP today, compared to about 20 per cent in the mid 1960s. We rely increasingly on external sources for much of our stimulus to aggregate demand; increasingly, our domestically engineered stimulus leaks away in the form of imports. These facts, combined with the large federal deficit and the highly regionalized nature of the Canadian economy, work to undermine the utility of conventional fiscal policy as an instrument of macro-economic stabilization. It is therefore more important than ever to ensure that, minimally, federal and provincial policies are consistent.

Given the eclipse of fiscal policy, increasing attention is being given to the role of industrial policy in diversifying the economic base and creating the micro-economic foundations for overall stability. This will necessarily involve closer working relationships between the two orders of government than was generally the case in the past.

Finally, there is an implicit challenge to fiscal federalism from free trade with the United States. In seeking secure and enhanced access to the American market through a bilateral agreement, Canada may find it necessary to change or modify a number of its domestic policies. Social programs, regional development grants, and equalization are not going to be surrendered, but they could be subject to pressures for change at the margin. Provinces have insisted on the right to full participation in the trade talks, primarily because a number of their own subsidy and regulatory practices will be on the table in the context of creating a "level playing field" between the two nations. It is clear, however, that they also have an interest in following, from the start, any discussion about changes in strictly federal programs that could meaningfully affect their revenues or responsibilities.

CONCLUSION

I have attempted in this essay to briefly survey some of the main pressures that are shaping the evolution of fiscal federalism in Canada. Clearly, each of the themes could be explored in much greater depth.

There will be major challenges in the years ahead, but, to a large extent, these will be challenges we are already grappling with. In that respect, one should expect an intensification of the current debates, rather than a shift onto new planes. However, it is clearly necessary to start looking more at the longer term,

and laying the technical and political foundations for more thorough-going change by the next cycle in 1992.



III

Policy Field Comparisons

An End to a Consensus on Health Care in the Federal Republic of Germany?

Christa Altenstetter

INTRODUCTION

During the last 15 years American health policy comparativists have paid considerable attention to the financing of health care in the Federal Republic of Germany (Stone 1977, 1980; Glaser 1978, 1983, 1984, 1986; Reinhardt 1981; Landsberger 1981, 1986; Henke and Reinhardt 1983).¹ Several factors account for this interest. First, advocates of universal health insurance have considered some features of the 100-year old German NHI to be highly relevant to the American debate. These include comprehensive coverage, the financing of NHI by contributions from employers and employees, a governance model—*Selbstverwaltung*—which assigns the state a limited role in health policy and service delivery and which leaves the bargaining and negotiating over policy details to corporatist structures of providers and third party payers, and decentralized administration within a framework of broad national priorities. Second, because of rising expenditures caused by Medicare and Medicaid American health policy analysts have looked to efforts abroad for lessons on cost-containment. Having passed legislation on cost containment—*Krankenversicherungs-Kostendämpfungsgesetz* (KVK) in 1977, Germany illustrated that it was politically possible for a federal government to legislate against the powerful interests of medical and dental providers and the pharmaceutical industry. Finally, the creation of a 60-member national council (*Konzertierte Aktion*)—legislated by the same federal law—reflected an approach to conflict management and problem solution in tune with American political preferences. It was this advisory body, rather than the federal government, which would become responsible for recommending policy on how to contain costs.

The purpose of this chapter is to review federal actions over the last 15 years and to identify some of their consequences. In essence, and regardless of who

1 An earlier version of this article appeared in *The Journal of Health Politics, Policy and Law* (Summer 1987).

was in the federal coalition, since the mid-1970s the Federal Government has helped to shift the responsibility for the financing of services and benefits to third parties: individuals, corporatist and other groups, and non-federal governmental sectors. While successive federal governments have invariably used the term "cost containment policy"—*Kostendämpfungspolitik*—they often supported measures which actually increased aggregate medical care costs. However, this does not mean that they increased benefits or services. Rather, prior to 1983 and after 1983, the Federal Government simultaneously pursued several strategies, only some of which involved cost-containment.

The analysis below is in five parts. It begins with a brief description of the current political climate in which health policy issues are addressed. Next, it describes the basic organizational and financial features of NHI and summarizes recent federal action in response to rising NHI expenditures. Then, three cases are discussed which document how the Federal Government has helped to shift the responsibility for cost-containment to third parties. A fourth section speaks to attitudes towards incentives and competition. A final section comments on future prospects and evaluation.

Each case is illustrative of changing political relations and of the distinctive features of health and medical-care politics in the federal polity in Germany. The first case—on hospital care, hospital investment and hospital reimbursement policy—concerns Federal-Land relations and illustrates the dynamics of regional politics in intergovernmental relations. A second case underscores the limits of sectoral medical and hospital care policies. The third case addresses government-group relations by examining a regional initiative—the *Bayern-Vertrag*—which has been presented as cost control strategy.

THE NEW SOCIAL PHILOSOPHY

Demands for reforms—*Strukturreform*—have long been regular features of the politics of health in Germany, but their focus and content have dynamically shifted in recent decades, as political and economic conditions have changed. At present, a growing number of elderly and disabled persons with distinct health and medical services needs, new diseases caused in part by environmental and in part by occupational factors, and rapid medical, pharmaceutical and technological progress combine to place new items on the political agenda.

A new political, new-conservative and economic neo-liberal orientation—echoing some of the dominant values of the 1950s and 1960s when the Christian Democrats were in power—has challenged the national consensus that is embodied in statutory health insurance (NHI). Reform proposals, not all of which are shared by the German public, concern the reorganization of NHI, reviewing the scope of benefits, cost-sharing, replacing hospital services by am-

bulatory services, rearranging provider reimbursement, intensifying information technology and encouraging the use of computer intelligence, developing an indicator-based health reporting system and, finally, prepaid group practice.

The council of economic advisors, in its 1983/1984 and 1984/1985 annual reports on the German economy, addressed the central issue of resource distribution and allocation. The experts suggested that NHI and the health care delivery system should be overhauled by privatizing elements of the financing, organization, and production of health services and by strengthening competitive forces in the health "market". A seven-member expert committee in health was created in December 1985 and is attached to the national *Konzertierte Aktion*. Seven working groups are reviewing the German health care delivery system. Topics on the agenda range from traditional concerns about ambulatory and hospital care and medication and expenditures to utilization, health education, demographics, and the oversupply of hospital facilities and undersupply of alternative forms of delivering nursing and other services. (Der Bundesminister für Arbeit und Sozialordnung 18 March 1986a; Deutscher Bundestag 10. Wahlperiode, Drucksache 10/3374). The full committee is expected to submit its recommendations soon.

It is not clear which reforms will be recommended for implementation. Even when we know details, it is essential to remember that the realms of political rhetoric (Edelman 1977), policy choice (Scharpf et al. 1978) and implementation (Mayntz 1980, 1983) in Germany are governed by entirely different sets of rules and constraints, and that analysis should not confuse policy style with substance.

To be sure, the concept of policy style is difficult to operationalize precisely (Richardson, et al. 1982; Richardson 1982; Freeman 1985). However, there does seem to be agreement that policy styles, whether consensual or adversarial have serious consequences for the decisions which are and can be made under existing policy arrangements. In turn, these policy arrangements further reinforce whatever style prevails (Scharpf, et al. 1978; Vogel 1986).

The German policy style is known to encourage the discussion of policy issues and choices at a fairly abstract and intellectual level and is conducted in a highly ideological way (Dyson 1982; Coppock 1985). At the same time, corporatist and other groups regularly participate in policy formation and implementation. Yet, this participation does not necessarily secure exclusive influence or control over policy decisions.

Scholars researching implementation drew attention to the differences—sometimes considerable—between a formulated and an implemented policy (Scharpf, et al. 1976, 1978; Mayntz 1980, 1983). Two inferences from the comparative perspective are relevant. First, it is necessary to distinguish what is formally stated from what is done, because they may consist of considerably

different things. Second, political and organizational dimensions of medical and health policy, including the minutiae of program decisions, need closer attention than they have received by health care comparativists.

POLICY AND INSTITUTIONAL CONTEXT

NHI has been based on the idea of *Solidarität* from its very inception in 1883. Groups spread over the entire political spectrum have recently invoked the need for reviving *Solidarität*—a concept rooted in political developments of the late 19th century. As Friedhard Hegner correctly points out, this concept today has come to mean different things to different people and political camps. In the context of NHI, *Solidarität* has meant redistribution from the healthy to the sick members of NHI.

Today, redistribution occurs from the higher to lower income groups, from the healthy to the sick, from the young to the old, from those without children to those with children, and encompasses coverage for the non-working spouse. Contributions to NHI are income-related rather than risk-related. NHI rests on mandatory membership of the working population, subject to an income ceiling which has risen steadily since the 19th century. German employers and employees, rather than taxpayers, have financed the scope of redistribution jointly through a payroll tax levied equally on employers and employees.

Subject to a few limitations, members choose their own primary care physician who can be either a general practitioner or a specialist, as long as the provider is certified to practice medicine with NHI. In theory, members also can choose their own hospital. Technically, they are supposed to go to the closest and most adequate hospital, but in practice they depend on their physician for a referral. If, for example, they are referred to an expensive university hospital, a literal interpretation of the health insurance code would require them to pay the difference. However, in reality admitting physicians or admitting hospitals do not check for residential eligibility, nor do sickness funds enforce these rules (Potthoff and Leidl 1986; John, et al. 1986).

The hospitalization payments of over 90 per cent of the German population is governed by contracts agreed on by hospitals and sickness funds, which pay the bulk of the operating budgets of hospitals, while general tax revenues pay for hospital investments, including technological equipment. The hospitalization of Germans who carry PHI (7.5 per cent of the German population plus 8.5 per cent of those NHI-members who want a choice of hospital physician) is governed by private contracts. Hospital laws of the Länder secure the delivery of hospital services to any patient, regardless of his/her financial means or social status (Sticken 1985).

Over the past 100 years NHI has undergone a fundamental transformation by becoming an all-inclusive health-protection and income maintenance program for which the term insurance may have become a misnomer. This transformation resulted from decisions of the federal government as much as from corporatist NHI-policy actors—operating nationally and regionally—(Herder-Dorneich 1980, 1982) and from court rulings.

In 1883 NHI insured about 10 per cent of the population. That figure has grown to more than 90 per cent in 1985 or 56,584 million out of a total of 61,307 million population (Der Bundesminister für Arbeit und Sozialordnung 1986a, 1985, 1984). Employment status has provided membership and coverage ever since its origin. It extends to all employed individuals who earn less than DM 4,300 (U.S. \$2,150) a month. Exempt from mandatory membership are those whose earnings exceed that amount, and those who are employed for brief periods only, or up to 50 working days a year, or who earn less than DM 390 (U.S. \$180) a month. NHI covers spouses and dependents; the unemployed, as long as they are entitled to unemployment benefits by the Federal Agency of Labor; farmers; students, unless they are covered otherwise; certain groups of disabled persons; and the retired.

Benefits. NHI provides fairly comprehensive coverage for chronic or temporary illness and for physical, mental, or emotional disability. It also provides income protection at full pay for the first six weeks of disability and 80 per cent of last earnings thereafter, including a cash payment to the survivors for funeral expenses. It provides for all inpatient and outpatient diagnostic and therapeutic services that are necessary and medically feasible. It provides maternity benefits, including neo-natal and post-natal care; some assistance for reproductive health; sterilization; and abortion under specified circumstances (Der Bundesminister für Arbeit und Sozialordnung 1981: sections 179-224, 1986a; Keiner 1986; Henning 1986). The federal government pays subsidies to the NHI fund for maternity benefits and the fund for the health insurance of former agricultural workers.

The thrust of NHI continues to be on curative and operative medicine. However, sickness funds, acting either individually or jointly with community or other groups, have sponsored prevention through health education and health promotion. Though benefits for accidents at work were available in the 19th century, and occupational diseases benefits became covered risks in 1926, occupational health requires further action (Kondratowitz 1986; Naschold 1981).

The Federal government pays allowances of DM 600 a month during maternity leave until the child is 12 months old. Women are entitled to their full net earnings six weeks prior and eight weeks after childbirth. Non-working women receive a single payment of DM 150. Women who seek neo-natal and post-natal

care are rewarded by a cash payment of DM 100. Members are entitled to a household aid when hospitalized and when receiving convalescent treatment in spas and special facilities or when a child under eight or a disabled child lives in the family. Finally, members are entitled to receive home nursing by a qualified nurse or another suitable person.

The Administration of NHI. The administration of NHI is based on the principle of self-governance—*Selbstverwaltung*—and, while subject to state supervision, is formally independent of public-sector administration (Tennstedt 1977; von Ferber 1978, 1985; Mayntz et al. 1982; Wuster 1985). The governing boards of about 950 insurance funds are controlled by an equal number of employee and employer representatives. The funds are organized either by geographic district, by occupation, or by enterprise. Substitute funds continue to be organized by social class. In short, the administration of NHI is highly decentralized and pluralist.

Financing Health Care. A payroll tax levied equally on employers and employees pays for health care in Germany for over 90 per cent of the population. About 95 per cent of a fund's income comes from contributions which are calculated as a percentage of wages and salaries and are subject to a national income ceiling. Each fund sets the actual percentage as a function: of (a) local salary and wage developments, and (b) expenditures of a fund. In 1986 the average contribution rate was about 12 per cent (Der Bundesminister für Arbeit und Sozialordnung 1986a: 1, 1986b, Table 11), but the extremes ranged from 6.5 to 14.8 per cent.

Social insurance pays for the health insurance of the elderly and of retirees (KVdR). These contributions only covered 45.5 per cent of total health care expenditures of the elderly. The difference is paid by the members of NHI. According to an equalization formula legislated in 1977, funds with an unusually high proportion of retirees (and, hence, expenditures) receive funds from those with fewer retirees.

In 1969 the cost of income protection for the first six weeks was privatized. Employees and their political allies requested the transfer of these benefits to the private sector, while employers fought this transfer from the statutory scheme to the private sector. Until 1969 there were differences in the amount and the administration of income protection for white-collar and blue-collar workers (Immergut 1985). German employers also pay for the 14 weeks of earnings which pregnant women are entitled to.

Medical Care Costs: 1960-1986. As of March 1986, 32.20 per cent of the total NHI-budget went for hospital care; 18.20 per cent went for medical care; 13.2 per cent went for dental care and dental appliances; 15.20 per cent went for prescription drugs; 5.9 per cent went for medical and other aids; 5.9 per cent

for income allowances paid after the first six weeks, when the responsibility of employers to pay a salary ends; and 9.3 per cent went for other benefits, including, for example, maternity benefits (Der Bundesminister für Arbeit und Sozialordnung 1986a: Table 6).

Because NHI is a fairly universal insurance program, increases as small as half a percentage point in the cost of services, hospital care, therapeutic drugs, technology, hospital construction, and above all, in the salaries and wages of hospital workers present serious financial implications for both the NHI and the total national health budget. Table 8.1 indicates annual changes in the relative proportion of expenditures for types of benefits from 1976 to 1984.

Table 8.1

Developments in NHI Financing—Annual Change per Member in Per Cent.
1976-1984

	1976	1977	1978	1979	1980	1981	1982	1983	1984
I. Health Expenditures									
Total	9.0	4.0	5.6	6.9	9.3	6.2	0.2	3.5	7.3
Med. care	5.6	4.0	4.0	5.6	7.0	6.3	2.3	5.1	5.9
Dental care	3.8	6.4	6.1	3.7	4.0	6.5	2.0	3.5	3.9
Dental supplies	26.8	0.9	4.8	11.0	11.8	9.2	-14.1	-4.6	9.5
Medication in pharmacies	8.0	1.4	6.4	5.4	8.8	7.3	0.7	4.9	7.0
Med. and other aids	18.0	8.5	13.3	11.8	10.3	6.9	-4.6	3.8	15.2
Hospital care	9.5	5.5	5.2	4.9	7.8	6.2	8.0	4.7	6.6
II. Wage and Salary Developments									
Basic wages per member	7.5	6.7	5.0	6.2	5.4	5.0	4.4	3.8	4.5
Gross wage per employee	7.0	6.8	5.4	5.6	6.6	4.9	4.2	3.4	3.05
III. General Contribution Rate in % of Basic Wage									
	11.28	11.37	11.41	11.26	11.38	11.79	12.00	11.83	11.44

Data on the percentage change in total expenditures (first row) in 1979 and 1980 include changes in maternity leave. Excluding maternity leave the corresponding figures for 1979 are 6.6%, and for 1980, 8.5%

Data on gross wages per employee in 1981-1984 are estimates.

Source: Der Bundesminister für Jugend, Familie und Gesundheit (Hrsg.) *Daten des Gesundheitswesens—Ausgabe 1985*, p. 218.

The percentage of GNP which NHI alone spent on health rose from 6.4 per cent in 1970 to 9.4 per cent in 1975. This percentage has remained fairly stable since then—a remarkable achievement considering the comprehensive coverage and almost universal entitlement, as well as the record of other industrialized nations (OECD 1985; 1986). The rate of increase varied markedly for different types of expenditures and different time periods between 1960 and 1980, as indicated in Table 8.2. The increases in the period from 1970 to 1975 in dental care, dental appliances and hospital care largely reflect changes in legislation and benefits.

Table 8.2

Percentage Changes in Expenditure Items of the Statutory Health Insurance Program (NHI)

<i>Period of Time</i>	<i>Medical Care</i>	<i>Dental Care</i>	<i>Dental Appl.</i>	<i>Pres. Drugs</i>	<i>Other Drugs</i>	<i>Hosp. Care</i>
1960-1965	11.3	15.3	8.4	13.1	12.0	13.1
1965-1970	11.4	12.4	15.6	15.9	12.4	15.3
1970-1975	15.6	19.3	38.2	16.1	31.1	23.9
1975-1980	6.4	6.0	12.0	7.2	13.6	7.7
<hr/>						
Change per member						
1970-1975	13.5	17.2	35.8	14.0		21.7
1975-1980	5.2	4.8	10.7	6.0		6.6
<hr/>						
Annual Change						
1980-1981	6.3	6.5	9.2	7.3		6.2
1981-1982	2.3	2.0	-14.1	0.7		8.0
1982-1983	5.1	3.5	-4.6	4.9		4.7
1983-1984	5.9	3.9	9.5	7.0		6.6

Source of data in first section: Der Bundesminister für Arbeit und Sozialordnung. "Daten zum Krankenhausbereich," 16 Mai 1983, "F1 Aufwendungen der GKV nach Leistungsarten" (internal document).

Source of data in second and third section: Der Bundesminister für Jugend, Familie und Gesundheit. *Daten des Gesundheitswesens—Ausgabe 1985* Stuttgart: Kohlhammer. Schriftenreihe des Bundesministers für Jugend, Familie und Gesundheit. Band 154. 1985, p. 218.

Increases in hospital care have outpaced those for medical care. The hospital sector accounted for 32.2 per cent of NHI's total health expenditures in 1986, in contrast to about 20 per cent ten years earlier (See Table 8.3). Table 8.4 indicates the consequences of amendments of the hospital financing law and of a federal regulation on user charges, both of which will be discussed in Case One.

Table 8.3

Relative Share of Service Categories in Total NHI Expenditure, in Percentages, 1960-1986

Year	Medical care	Dental care	Dental supplies	Medication etc. in pharmacies	Medical aids	Hosp. care	Cash	Prevention ¹	Maternity ²	Other ³
1960	20.9	5.2	3.0	12.2	2.4	17.5	30.0	0.9	4.4	3.5
1965	21.4	6.4	2.7	13.5	2.5	19.8	24.8	1.0	4.6	3.3
1970	22.9	7.2	3.5	17.7	2.8	25.2	10.3	1.0	4.6	4.8
1975	19.4	7.1	7.2	15.3	4.4	30.1	8.0	1.8	2.9	3.8
1980	17.9	6.4	8.6	14.6	5.7	29.6	7.7	1.0	3.5	5.0
1982	18.3	6.6	7.5	14.8	5.4	31.9	6.4	1.0	3.3	4.8
1984	18.3	6.3	7.1	15.0	5.8	32.1	6.1	0.8	2.6	5.9
1986	18.2	6.2	7.0	15.0	5.9	32.2	-	-	-	-

¹Prevention includes early screening and services in-kind and cash to pay for other services, notably Kuren²Maternity benefits include services in-kind and cash, including check-ups during pregnancy³Other includes services rendered by health staff (e.g., vertrauensärztliche Dienst, Genesendenfürsorge, sonstige Hilfen, Betriebs- und Haushaltshilfe, Sterbegeld etc.)

Source: Der Bundesminister für Arbeit und Sozialordnung. Referat Vb—42600. Tabelle 2.43. Stand: August 1985.

Source for 1986: Der Bundesminister für Arbeit und Sozialordnung, "Pressemittteilung", 18. März 1986.

Table 8.4
Hospital Financing by the Public Sector and NHI

Year	Public Sector Investment Funds		Expenditures of NHI on Hospital Care	
	Mrd. DM	Per cent	Mrd. DM	Per cent
1973	3.2	21.5	11.7	78.5
1974	3.5	18.7	15.2	81.3
1975	3.5	16.3	17.5	83.7
1976	3.5	15.4	19.3	84.6
1977	3.2	13.5	20.5	86.5
1978	3.6	14.1	21.9	85.9
1979	3.5	13.1	23.1	86.9
1980	4.0	13.7	25.3	86.3

Source: Gerdemann, W. "Krankenhausfinanzierung." In: Wissenschaftliches Institut der Ortskrankenkassen/von Ferber, Ch., Reinhardt, U.E./Schaefer, H./Thiemeyer (Hrsg). *Kosten und Effizienz im Gesundheitswesen*, München: Oldenbourg Verlag, 1985, p. 183.

The most startling observation is the dramatic growth in the relative share of NHI in total health expenditures. As a consequence of federal policy, the NHI share grew prodigiously from 34.7 per cent in 1970 to 46.2 per cent 13 years later. Table 8.5 indicates the relative proportion of expenditures financed by different sources from 1970 to 1983.

Finally, why have expenditures stabilized at around 9.3 per cent of GNP after 1975? Of many plausible explanations, Brian Abel-Smith's continues to be convincing and accurate. "The system works as well as it does because the key provider groups are well aware that if the system does not work reasonably well over the years, more drastic compulsory action would be likely to follow" (1985: 8). There are other explanations, however.

Table 8.5

Relative Proportions of Medical Care Expenditures Financed by Different Sources: 1970-1983

In Percentages

	1970	1972	1974	1976	1978	1980	1982	1983
Public								
Sector	14.0	13.7	13.6	13.2	13.5	14.3	14.4	14.2
NHI	34.7	37.5	41.2	44.8	43.4	43.7	46.0	46.2
Social								
Insurance	9.5	8.9	8.7	8.2	7.7	7.4	8.3	8.1
Accident								
Insurance	3.6	3.3	3.1	3.2	3.2	3.1	3.6	3.4
PHI	5.1	4.6	4.5	4.6	4.3	4.4	4.9	5.1
Employers	24.6	23.3	20.2	17.8	19.7	18.8	16.5	16.1
Private								
Households	8.5	8.7	8.7	8.1	8.1	8.3	6.3	6.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Klaus-Dirk Henke, "Gesundheitsausgaben in der Bundesrepublik Deutschland: Ein zu hoher Preis für die Gesundheitsversorgung?" in: *Kosten und Effizienz im Gesundheitswesen*, edited by Wissenschaftliches Institut der Ortskrankenkassen, Ch. von Ferber, U.E. Reinhardt, H. Schaefer, T. Thiemeyer (Hrsg.), München: Oldenbourg Verlag, 1985, p. 483. Data for 1982 and 1983 Der Bundesminister für Jugend, Familie und Gesundheit. *Daten des Gesundheitswesens—Ausgabe 1985*. Stuttgart: W. Kohlhammer Verlag, 1985, p. 323.

Note: It is not clear whether the two sources use the same computations and sources, and why the percentage of private household spending is low for 1982 and 1983. As reported in various sources used in this paper, private household spending due to cost-sharing increased.

Recent Federal Actions Concerning Medical Care. The Social-Liberal coalition rediscovered cost-sharing in 1982 and passed a law (KVEG) that introduced new elements of cost-sharing into NHI. Prior to this, and with the exception of a few years at the end of the Weimar Republic (1919-1933), NHI contained very few cost-sharing components. To ease the finances of RVO-funds, NHI-members were asked to contribute to the cab fare when consulting a physician, or when receiving physical therapy treatment. They were also asked to contribute a modest amount toward hospitalization per day (DM 5 or less than \$2.50 for the first 14 days, or a total of DM 70 per calendar year). The federal law reduced benefits for medical and other aids, rehabilitation, follow-

up and after care services. Patients now contribute 10 DM per day for these services (Der Bundesminister für Arbeit und Sozialordnung 1984: 19-24).

The federal budget laws of 1983 and 1984 were even more financially restrictive. Cost-sharing was increased from DM 1.50 to DM 2 per medication, although some exceptions were possible. Over-the-counter-drugs were no longer reimbursed by NHI. Benefits were also cut in some assistance and means-tested welfare programs—what is called "social aid" in Germany.

The social insurance law of 1982 reduced by DM 1.2 billion social insurance contributions to NHI for the cost of medical care for the elderly. Instead, the retired and the NHI-community at-large were asked to pay for medical-care expenditures of the elderly (KVdR). Reduced retirement income in general and newly legislated contributions of the elderly to NHI combine to reduce their net income. Pfeiffer et al. (1986) calculated that the income of the elderly rose by 1.31 per cent, while the bills paid by them rose 2.5 per cent. Cash payments for medical rehabilitation for the retired were reduced from 90 to 75 per cent of net income (Der Bundesminister für Arbeit und Sozialordnung 1984). What is significant, however, is that medical services continue to be provided when medically necessary.

Case One: Financing Hospital Investments and Technology.

This case is illustrative of how existing policy arrangements have limited the formulation of the content and the implementation of hospital policy. Contrasting the Hospital Reform Law (KHNG), which became effective on 1 January 1985, with the Hospital Finance Law of 1972 (KGH) will serve to illustrate how the relations of the Federal Government with the governments of the ten Länder and West Berlin concerning the financing of hospital infrastructures have changed in recent years.

To properly appreciate the new hospital politics, an understanding of the basic intergovernmental arrangements for hospital policy making are necessary. Some institutional features are common to all federally organized societies (Duchacek 1970) and need not be summarized here. Others are unique to the Federal Republic of Germany and impact upon intergovernmental relations in many significant ways.

In part, the unique features of federal policy making arrangements result from two constitutional provisions. First, the Basic Law of 1949 reassigned the Länder important responsibilities over hospital and many other health-related matters while retaining exclusive federal authority over NHI. Second, it built on a system of public administration characteristic of both the Continental European tradition and the specific German tradition. (Aberbach et al. 1981). In Germany, federal departments have very few field offices, so that most

programs, even those which are genuine federal programs, are administered by the Länder (Scharpf et al. 1976; Wagener 1983; Schreckenberger 1983; Klatt 1986; von Beyme 1984).

Another unique feature is the extent to which the Länder fully participate in national legislative and regulatory policy-making processes through the *Bundesrat*. The *Bundesrat*'s influence is notably strong in all matters pertaining to intergovernmental relations, grants-in-aid, and administrative procedures (Schreckenberger 1983:67).

These arrangements require an unprecedented number of compromises between the governments in Bonn and the regional capitals before any legislation or regulation is passed. As many studies have found, support or opposition by a Land to the initiatives of the federal executive branch does not necessarily follow strict party lines, since regional policies may reflect the autonomy of Land governments in relation to the federal government, even when the same political majorities are in power in Bonn and in a Land (Schmidt 1980: 1982; Alber 1982; Beyme 1984). The fact that only 31 draft bills out of a total of 3,196 pieces of legislation introduced since 1949 failed to become law (Schreckenberger 1983: 67) emphasizes the extent to which a need to compromise on policy substance is built into the policy-making arrangements, or what F.W. Scharpf (1985) calls "the joint decision trap".

This general pattern also extends to the passing of federal regulations which in any way touch upon the administrative and supervisory authority of the Länder. It applies, for example, to their supervisory authority over corporate organizations of professional associations, NHI-medicine and dentistry, sickness funds, and the like. In addition, the Länder must approve federal regulations on NHI-matters, health manpower, medical and dental education, and the training of other health professionals, just to mention a few important areas. However, because hospital care is financed through NHI for 90 per cent of the German population, because NHI is a federal responsibility, and because the constitution secures the right to health under NHI, the Federal Government sets fairly specific legislative and regulatory details on hospital care which the Länder cannot challenge.

Prior to 1972 the Länder, local governments, and private not-for-profit associations financed hospital facilities and investments (Altenstetter 1985a: 29-40). In 1969 a constitutional amendment paved the way for the institutionalization of joint federal-Land financing of medical schools in 1971, and short-term hospitals in 1972. Despite joint control from 1972 to 1984, the Länder have continuously asserted their interests. They own medical schools and maintain some teaching hospitals. Once a teaching hospital is accredited, it has a claim of sorts over the Land because of the latter's responsibility to pay for part of the cost of research and medical education. In addition, the Länder

enforce the accreditation, licensing and qualification of all facilities and staff employed in health or social services. They also supervise medical education and research. Most important, they remain responsible for the effective and efficient allocation and distribution of resources and medical capacities through "hospital-need" planning (Altenstetter 1985a; 1985b). Moreover, the Länder play an important role in most areas pertaining to social welfare and nursing services, public assistance, youth services, and social work (Schulte and Trenk-Hinterberger 1986).

The Hospital Reform Law (KHNG) became effective on 1 January 1985 after major compromises were reached between the CDU/CSU controlled Länder and the federal Conservative-Liberal coalition. The Länder, notably the CDU-governed ones, disliked joint financing because it meant joint control and the interference of a federal Social-Liberal coalition in the regional politics of each Land.

By restoring to the Länder sole responsibility over hospital investment financing, a situation which had prevailed until 1972, the KHNG places them in a position to prove their claim that they are better equipped than the Federal Government to set priorities and meet current *and* future needs. The Länder are seizing the new opportunity by busily amending their hospital laws (Clade 1986). Among the Länder which toyed with the idea of abolishing the privileges of senior physicians, two were controlled by the Social Democrats (SPD) and two by the Christian Democrats (CDU) in 1986 (BR-Drucksache 625/85). This is an illustration of the importance of regional politics in hospital affairs.

A new federal regulation to reimburse hospitals for the delivery of care (BpflV) also became effective on 1 January 1986. It continues both federal authority to set broad policy and Land authority to specify details of administration and program operations (*Bundesgesetzblatt* 1985). The new regulation is rather complex and only the most pertinent changes can be discussed. Prospective budgeting replaces an open-ended and retrospective hospital reimbursement system. A flexible and prospective hospital budget is now calculated on the basis of anticipated occupancy rates in the forthcoming year. Hospitals and sickness funds must agree on what items make up the budget or, if they fail to agree, a neutral and non-governmental arbitration office is called upon to fix them. A key issue is whether civil service and legal experts will be able to resolve their differences concerning the relationship between the arbitration office and the regular administrative offices controlled by the regional ministries. A strong civil service tradition in the Länder makes it doubtful that the ministries will voluntarily abdicate their power.

The Länder had engaged in different administrative practices in the past, so it was not surprising that in 1986 they were considering different approaches to financing the cost of arbitration where conflict between a hospital and third

party payer arises. Some Länder planned to finance the cost of arbitration fully or partially through the per-day-charges negotiated with third party payers (Bavaria, Hamburg, Lower Saxony and Rhineland Palatinate). North Rhine-Westphalia was planning to fix an amount which would depend on the number of beds in a hospital and which would have to be shared between a hospital and all third party payers. To discourage abuse of arbitration, representatives of private health insurance (PHI) took the position that up to DM 10,100 should be charged for each arbitration case.

As I have elaborated in detail elsewhere (Altenstetter 1986b), hospitals now can balance surpluses against losses in subsequent years. They could not do this previously. Only revenues raised from per-diem rates not from other hospital assets are supposed to constitute a basis for balancing the budget (Zimmer 1985). Hospitals and sickness funds can negotiate so-called investment contracts financed by revenues raised from per-diem rates. The formal justification for this is optimization of resources. The data contained in such contracts are not necessarily meaningful for this purpose because too many definitional aspects remain open. This had been the case after 1972 and had led to considerable differences between what the law intended and how it was applied (Altenstetter 1985a).

Further, the law stresses the need to improve hospital management and to reduce the length of stay, thereby optimizing occupancy rates. These fell over the last two decades from an average of 92.2 per cent in 1960 to about 83 per cent in 1980 (Der Bundesminister für Arbeit und Sozialordnung May 1986b, Table C). This decline was the result of a myriad of factors other than hospital policy.

If hospitals fall short of anticipated revenues based on the agreed upon and assumed occupancy rate for each hospital, they still receive 75 per cent of the anticipated revenues from sickness funds and PHI. This enables hospitals to operate and to honor employment contracts. If they achieve a higher than expected occupancy rate, and hence earn a higher rate-income, they must repay 75 per cent of these additional revenues to the funds and PHI.

Hospital payment remains directly related neither to diagnoses of individual patients nor occupancy rates. This means that hospitals are not penalized for serving patients who may be old, destitute and socially vulnerable. Occupancy rates have varied greatly across disciplines and subdisciplines, and hospitals have always made adjustments in their budget between different wards.

Can hospital expenditures in Germany be controlled by means of this prospective approach? A comprehensive answer is outside the scope of this chapter. However, a few assessments are possible.

To judge by the first negotiations on per-diem rates, which were conducted in 1986, the effectiveness of the BPfIV as a cost containment instrument is

limited. The KHNG and the BPfIV allowed for a few months' transition and intended the new budget to be in place for the entire year of 1986. In some Länder (Baden-Wuerttemberg, Hesse and Hamburg) the rates for 1986 were set according to the old provisions. Hospitals and sickness funds negotiated increases of seven per cent or even more, instead of the 3.25 per cent recommended by the *Konzertierte Aktion* (Der Bundesminister für Arbeit und Sozialordnung, March 1986a).

A report from the city-state of Bremen, for example, showed in 1986 that prospective rates would increase between 4.5 and 8 per cent, although general inflation in July 1986 was -0.5 per cent. One reason was that personnel costs (resulting from collective bargaining agreements negotiated outside the hospital sector and from other social policy decisions) rose by 4.49 per cent in 1986. General price increases also called into question the *Konzertierte Aktion's* assumption that non-personnel costs would rise by only 1.5 per cent (Deutsches Ärzteblatt 1986; Heitzer 1986b: 324). Because all hospitals are affected by collective bargaining agreements and other welfare policies, the experiences in other regions and cities were similar.

The new BPfIV requires many compromises from hospitals and sickness funds. Questions of particular interest to hospitals concern the time horizon for which per-diem rates and investment contracts would be negotiated (Baumgarten 1986), and whether the new *Kosten-und Leistungsrechnung* will turn out to be an effective cost containment tool. Ironically this tool replaced the previous *Selbstkostenblatt* at around the time when the latter, having been refined over the years, began to produce some meaningful comparative hospital data. When preparing for rate-negotiations, hospitals must now provide information on 9537 separate entries, instead of information on 816 entries, as previously required (Zimmer 1986a: 276; 1986b).

In the current era politicians and others have toyed with the idea of moving closer to a DRG-based reimbursement scheme. In preparation for this, hospitals are required to collect diagnosis-related statistics by age and sex and to report diagnosis by wards starting in 1987. There are two reasons to question the premise that DRGs will provide better guidance on how to reimburse each hospital for care than did the previous arrangements. First, unlike most other European countries, Germany does not include in hospital discharge statistics information on diagnoses, surgical procedures, outpatient visits (U.S. Department of Health and Human Services 1985) or other, sophisticated, data necessary for hospital-need planning (Neutmann and Mildner 1986; Heise and Ros 1986; Prößdorf 1986). This results from both legal and organizational barriers and a strong desire to protect patients' data, which are the product of bitter historical experience.

Second, it seems doubtful that the key actors—hospitals, third party payers and their respective political allies—will be able to abandon the widely shared national consensus about health, and to endorse the notion that nothing is wrong when hospital reimbursement policy discriminates against patients on the basis of medical diagnoses. Over the last decades the trend has been going in the opposite direction. Cost control measures have not been associated with disease and such things as an "all-payers" DRG system, "uncompensated care" or "disproportionate share hospitals" do not exist (Bulletin of the New York Academy of Medicine 1986). On balance, it is personal and institutional providers, rather than the users/patients, that have been the targets of cost controls.

However, it is quite likely that a new legislative or regulatory initiative may force hospitals to accept something similar to the 467 disease-categories. A strong political and research lobby pushes to improve the quality of hospital data and information. Even if some kind of DRGs are adopted, it is unlikely that the objectives served by DRGs in American hospitals will be served by their German counterparts. William P. Brandon (1986: 666) described the American context:

DRG systems fit the model of a tech-fix solution because they purport to be a mechanism to reimburse hospitals which does not raise the issues of entitlement, rights, access or social engineering involved in national health insurance. Our political and administrative structures are better at arranging the compromises and accommodations necessary to realize such tech-fix solutions than in making abrupt political changes.

Over a 100-year history, health care politics in Germany has had to address these same issues. The fact that most of them have been settled is one reason why major innovations towards market forces and competition have been impossible in the past.

In the meantime the political show of raising expectations about the effectiveness of the new BPfIV as a "cost-containment" approach goes on. Federal actors feel that the new hospital law and the regulation on per-diem rates will achieve their goals (Vollmer and Hoffman 1985a; 1985b; 1986a; 1986c). From an implementation perspective it is clear that these actors overestimate legal provisions and underestimate the dynamics of hospital politics and organizational processes. Whatever their influence over action from Bonn, they have little control over crucial issues which are decided in a Land, and between hospitals and third party payers. Underneath the conflicts over legal interpretations of the law and the regulation are not only political conflicts between the federal and the Land-governments but also differences between the federal and regional civil services. Framing these as legal rather than policy issues, however, is illustrative of the prevailing policy style in Germany.

Case Two: The Grassroots and the Limits of Sectoral Policies

In the past four decades the limited involvement of local governments in the formulation of medical and hospital policy posed no major problem. Their role was limited to operating tertiary care and special facilities. They exercised little or no control over hospital policy, although depending on the Land, they contributed between about one third to one-half of the funds used to finance the Land's hospital program. However, in the face of changing demographics, unemployment, social and political transformations, and federal action over the last 15 years, the inadequacy of sectoral medical and hospital care policies has increasingly been revealed.

Four features of the changing demographics pose severe financial and other challenges to local governments, as they do to NHI: the growing number and the rising age of the elderly, their multimorbidity, and their greater need for all kinds of services. In 1982 almost 46 per cent of all acute hospital bed utilization was generated by the elderly, who constituted only 20 per cent of the total population. About 38 per cent of total NHI expenditure was spent on health care for the elderly (KdVR), who constitute 29 per cent of total NHI-membership. About 38 per cent of all patients treated in doctors' offices in 1978 were 60 years and older (Merschbrock-Bäuerle et al. 1985: 1).

Funds currently earmarked for hospital care (mostly paid by NHI) and nursing homes (tax funds) cannot be used for home nursing, semi-outpatient nursing or other care alternatives. For political reasons, it has been next to impossible to change these laws. The concept of illness differs, depending upon whether a patient is cared for in a hospital (*Krankenhauspflege*) or in a nursing home (*Krankenpflege*). This means that no transfer of funds between these two sources are possible. Where a patient is hospitalized determines which funds (NHI or tax funds) pay for his/her care and largely explain why the "right" patients are not always in the "right" places. As previously mentioned, hospitalization is preferred over nursing homes. Furthermore, illness as defined by NHI-legislation differs from illness as defined by the courts. Court rulings went beyond the NHI-definitions of rights to health care and secured general access to the most advanced medical care (Sticken 1985).

In 1986, a discussion on the growing numbers and needs of the disabled and elderly, which had gone on for more than ten years, finally reached the federal policy adoption stage. The Länder, local communities, and interest groups representing a wide range of statutory, voluntary and denominational organizations, put considerable pressure on the Federal Government to pass a law on nursing insurance. Although the Federal Government had refused to act as late as 1984, it submitted a draft bill in May 1986, just in time for several Land elec-

tions in the fall of 1986 and the federal election of January 1987 (BR-Drucksache 270/86).

Three regional initiatives—from Hesse, Bavaria and Rhineland-Palatinate—and an initiative of the parliamentary faction of the Greens in the *Bundestag* preceded this draft bill (BR-Drucksache 81/86, 137/86, 138/86). All of these proposals had in common a priority for home nursing over institutional nursing but varied widely in terms of benefits, eligibility, control, financing and administration (Igl 1986a; 1986b). As the social insurance program had served as an aid to federal campaigns in the past, it looked as if a speedy federal solution would be possible. However, the elections took place without federal action on the bill, and the prospects of a national solution are now slim. Several *Länder* have initiated programs on nursing alternatives.

Another local preoccupation is the unemployed, whose regional distribution varies. Many studies confirm that the need for medical and health services is anticyclical to the growth of the economy (Schwefel 1985). A study by Hegner (1986b: 148-149) further showed that during the period of "full employment" from 1960 to 1972 localities spent between eight and nine per cent of total local expenditures for a national budget category "family, social aid and youth", while from 1974 to 1981, when unemployment was high, they spent between 11 and 12.7 per cent. In addition, local expenditures on "health, sports, recreation" oscillated between nine and 11 per cent from 1960 to 1972, and between 13 and 15 per cent afterwards.

The four groups hurt most under the current situation are the young (in both absolute and in relative terms); young women between the ages 20 and 30 (constituting almost 40 per cent of all unemployed women); the long-term unemployed, which include many persons who were forced into early retirement; and skilled and educated persons. Women also constitute a large number in the latter group (Riedmüller 1986b).

County governments, unincorporated cities, and regional voluntary organizations have been responsible for providing aid to persons who are ineligible under NHI or any other program. Since 1949 "social aid" funds subject to a means test have been used for this purpose. As the intended or unintended consequence of budget consolidation, labour and employment policies (Hegner 1985; Hauser 1985; Hoppensack und Wenzel 1985) and the "privatization" of social risks manifest themselves (Hartmann 1985; Schulte and Trenk-Hinterberger 1986: 1-36), the importance of "social aid" has been growing. From 1977 to 1984 local expenditures for "social aid" grew four-and-half-fold. This increase in what was described as "forced" local spending was financed by local investment funds (Pfeiffer et al. 1986). With two-thirds of all public investment in Germany generated by the local governmental sector, the increase in "social

aid" spending has led to a significant reduction in the amount of local funds available for other purposes.

Two other developments help to explain the expansion of the role of local governments since the early 1970s. First, federal legislation in the 1960s and 1970s extended benefits to some social groups and made local governments responsible for the provision of these services, but failed to provide them with additional funds. The influence of local and county governments in intergovernmental relations under the Bonn constitution has been weak in comparison to that exercised by the federal and the Land-governments. The latter control most tax revenues and intergovernmental grants-in-aid (Reissert and Schäfer 1985; Huster 1985; Gunlicks 1986). The budget law of 1975 was the first of a series of restrictive federal budgetary measures. In subsequent years, notably starting in 1981, communities became further victims of federal and Land austerity and budget consolidation policies (Huster 1985).

Second, the Federal Government has been withdrawing from the financing of social security in Germany for some time. Its involvement in what is called the "social budget" was 38.8 per cent in 1975, 35.5 per cent in 1983, and is estimated to go down to 33 per cent by 1987 (Pfeiffer et al. 1986). Further, the Federal Agency of Labor reduced its contribution to social insurance. This put an added burden on the current recipients of retirement pay and the current contributors to the retirement program, i.e., the working population. Private households are picking up a larger share than before.

Whether the communities will become a permanent pillar of social security programs and return to a role that they played in the 19th and early 20th century, as some observers suggest (Hauser et al. 1985; Hoppensack and Wenzel 1985; Leibfried and Tennstedt 1985; Blanke et al. 1986; Hegner 1986a) is doubtful. Local communities are hardly the agents which determine the fate of the German welfare state, nor can they initiate a reversal of the nationalizing trend of the last 100 years. It is true that local initiatives which are unfolding in response to social and demographic transformations have been greatly influenced by new social movements and by the political mobilization of the communities (Schmidt 1986), but other factors are also present. The presence of all kinds of groups at risk has left its mark on all local governments (municipalities and counties) independent of political persuasion.

Case Three: Government-Groups Relations: A Regional Case Study

This case will look at a regional initiative in order to understand how government-group relations (Stone 1980; Offe 1983) have been changing and how difficult it is for one single policy measure to impact upon the social and politi-

cal values underlying the health care system and the behaviour of providers and users (Schwefel et al. 1986a; 1986b; Satzinger 1986a; 1986b).

In 1979 corporatist policy actors—*Die Bayerische Kassenärztliche Vereinigung und der Landesverband der RVO-Kassen*—in Bavaria launched the so-called *Bayern-Vertrag* in response to what Conservative political forces in general and those in Bavaria in particular saw as a growing centralization in health policy-making since 1977. They also perceived it as a growing interference with an established pattern of government-group relations and relations between federal and regional corporatist groups.

Federal legislation, central recommendations of the national advisory council (Wiesenthal 1982) and the Federal Association of Sickness Funds (BdO) threatened this pattern. Sickness funds were pressured to follow central solutions when negotiating and bargaining with each other. For example, hospitals and sickness funds negotiated hospital rates for each hospital individually according to documented hospital expenditures. The central actors suggested a flat increase which was below the salary and wage increases that were being negotiated at the same time in another policy-making arena.

The "Bavarian Contract" was presented as a cost control measure. In reality, as Schwefel et al. (1986a; 1986b) convincingly demonstrate, it pursued three different, albeit highly interdependent, objectives. The Contract was:

- an attempt to contain costs in the ambulatory care sector;
- an effort to strengthen the primary care sector and to facilitate transitions from costly hospital to ambulatory care and home nursing;
- an initiative directed, above all, against the federal Social-Liberal coalition in power then.

The initiative was described as "anti-Bonn", "anti-centralist" and "anti-government" (Satzinger 1986a; 1986b; Schwefel et al. 1986b).

The health profession collectively, and all providers certified to practice medicine with NHI individually, were targets of the agreement. Corporatist organizations of physicians and sickness funds always have had responsibility within a national fee-schedule for setting specific policies by negotiating regional agreements and for setting the total amount of money available for reimbursing office-physicians in a region (Glaser 1978; Stone 1980).

The federal policy actors from 1977 onwards and the Bavarian actors both shared the goal of stabilizing the contributions to RVO-funds paid by employers and employees but differed on the means to accomplish it. Federal recommendations, whether legislated, regulated or advisory only, approached each of the health care subsectors defined by standard NHI-expenditure categories separately and suggested a ceiling on each in line with wage and salary developments. In contrast, the Bavarian actors did not envisage ceilings on each sub-

sector. Increases in subsectors were permissible, as long as they could be balanced off by savings in other categories, and as long as they remained within the overall increase of six per cent in spending that they considered to be reasonable and affordable. In their view, the federal strategy by expanding cost-sharing elements still allowed for across-the-board expenditure increases. During the period (1977-1984) the total national health care expenditures of private households rose from DM 1.9 billions to DM 5.5 billions (Pfaff 1986).

The regional strategy depended on the willingness and ability of providers—individually and collectively—to take responsibility for the costs which they cause—an important key to past, present and future expenditure developments. Physicians in NHI-certified office-practice were asked to influence expenditure developments by changing their medical behaviour in relation to four areas. They were asked to reduce:

- referrals of patients to hospitals and, instead, use referrals to colleagues;
- the prescription of medications and medical aids;
- the number of certificates of disability to work; and
- the prescription of physical therapies.

While the findings on the attainment of these four objectives are by no means clear-cut, as the 1000-page publication indicates, other findings are. The contract largely provided collective incentives by strengthening the monopoly and the power of the corporatist groups in relation to the state, legislators and the national advisory body. The profession retained exclusive control over ambulatory care; sickness funds controlled the financing of hospital and medical care. One main conclusion is that the contract offered few individual economic incentives which would have made it worthwhile for doctors to change their routines in the practice of medicine.

As Schwefel et al. (1986b) show, both corporatist groups—the organization of NHI-physicians and sickness funds—engaged in massive appeals, information campaigns, and strategies of persuasion addressed almost unilaterally to physicians in offices. Everything would fall into place, so the feeling seems to have been, as long as physicians voluntarily accepted the norms and values of the negotiated contract.

There are reasons to question the premise that the Contract would ever achieve its care objectives. To reorient the medical and hospital care systems toward non-institutional care required much more than a narrowly defined sectoral policy that had to respect established legal and political domains and that was also influenced by a strong desire of the two corporatist actors to obtain public visibility as policy initiators. For example, the cooperation of hospital physicians and myriad other decision makers in social security offices, health

insurance funds, disability programs, welfare assistance offices and labour offices would have been necessary.

Finally, the cooperation of patients, their families, neighbours and/or friends is a vital component in any attempt that seeks both to control expenditures and reorient the medical-care system toward community-based, coordinated networks of health and social support, in addition to medical and hospital care.

These networks are not available in all regions and cities in Germany (Bonß and Riedmüller 1982; Müller and Wasem 1984; Labisch 1985). Some cities, such as Berlin and Munich, have started experiments with alternative housing and nursing care (Schmidt-Urban and Röss 1984; Riedmüller 1986). With an unusually high proportion of the elderly and other socially vulnerable groups, Berlin, currently ruled by the Conservatives, has become a pioneer in experimenting with alternative approaches (Fink 1986). However, these are meeting with severe criticism from analysts of another political persuasion (Grottian et al. 1986).

Schwefel et al.'s findings on referrals and discharges from hospitals (Pothoff 1986: 248-268; John et al. 1986) leave little doubt that if these services had been available, physicians would have been able to influence referrals and discharges more than they have. Supplementary services are crucial in the communities which are missing and, as the two previous cases indicated, are under the control of other policy actors. One major recommendation of the research team is, therefore, to make home services and housing alternatives a prime target of future policy (Schwefel et al. 1986b: 985).

The expectations of the organizational elites that the Contract would become a success were based on their exclusive authority and control over mandatory members—office physicians and sickness funds. These also provided the Contract with the necessary legitimacy. From an implementation perspective several important pieces were missing. They overemphasized control, enforcement, and compliance which the leadership imposed upon office physicians but underemphasized guidance and organizational processes, and the need to produce suitable information for all who were affected by the policy: office and hospital physicians, patients, their families, and others (Altenstetter 1986d). Their solution was politically acceptable and organizationally implementable within the framework of the corporatist domains.

If they had little concern or perception of physicians as change agents rather than as economically motivated individuals who comply with policy imposed unilaterally from above and who maximize their economic interests. As change agents physicians are not independent of the broader political, professional and cultural environment. They play key roles in the delivery of care, while at the same time they are also targets and/or executors of many other welfare state

policies and complex legal provisions which are not without ambivalence some times. (Kaufmann 1984; Zacher 1985; Deutsch and Schreiber 1985).

The organizational elites did not address the question of how physicians should resolve role conflicts when treating patients and responding to their individual demands. Should they give the best medical care according to the latest medical and technological knowledge regardless of costs? Should they cut corners in care? Should they save on referrals and prescription drugs? Of course, they were supposed to do all these things. Beyond public exhortations, however, the two corporatist groups did little to clarify how physicians should do so.

Professional rights to practice medicine and individual rights to receive the best advanced medical care available are both well grounded. Disentangling specific influences from general influences in the development of the health care system in Germany is beyond the scope of this chapter, but one thing is clear. The "Bavarian Contract" asserted without justification that the impossible could be achieved.

It also had an impact in several other ways, which changing economic and political circumstances facilitated. The Social-Liberal coalition, in power from 1969 to 1982, began to lose support in regional elections. In the fall of 1982 Chancellor Schmidt lost a vote of confidence to a newly constituted Conservative-Liberal coalition which was subsequently confirmed in the federal elections of March 1983 and January 1987.

In late 1985 the umbrella organization of sickness funds (BdO) professed support of the concept of "structured budgeting"—similar to the philosophy of the Bavarian approach. It pursues a "wage-and salary-oriented cost-containment policy". Three preconditions to the success of "structured budgeting" are essential (Smigielski 1986): first, consensus about the goals to be reached; second, an indicator-based health reporting system to allow for health forecasts; third, clearly specified priorities. This summary reaffirms the primacy of political judgements in setting goals and priorities and consensus.

In the assessment of the chairman of the BdO—the employer spokesperson of a rotating chair of the Federal Association of Sickness Funds from Bavaria—the corporatist structures of sickness funds and professions were successful in influencing the price and volume of health and medical services in relation to the revenues obtained from wages and salaries. They did so by reviewing the national fee-schedule and reducing the income potential of providers, stressing dental prevention over repair, emphasizing personal medical services, and discouraging "high-tech" services in the ambulatory-care sector. The consequences of these measures were lower rates of increase for medical and dental expenditures in comparison to those for prescription drugs, medical and other

aids, and hospital services. This is indicated in Table 8.5 (Heitzer 1986b; Der Bundesminister für Arbeit und Sozialordnung 1986a).

To maintain the past record, the Federal Committee of Physicians and Sickness Funds passed guidelines on maternity, medical and other aids, large-scale bio-medical devices, and on several other aspects of medical care. On balance these edited guidelines secure access to the latest medical progress (*Der Bundesanzeiger* 1986). In March 1986 the members of this committee reached agreement to review further the national fee-schedule. While these measures are efforts to contain costs, they also are ways to reestablish the old pattern of government-group relations which prevailed prior to 1977. Many studies confirm the consolidation of the collective power base of the medical profession, while individual physicians have been losing influence and even income (Wittig and Partsch 1986; Eberle 1986; Döhler 1986; 1987). What is significant, however, is that these developments are the result of a myriad of factors other than the corporate dynamics of a profit-oriented health care system in America.

ATTITUDES TOWARDS INCENTIVES AND COMPETITION, OR HOW CLOSE IS THE END OF A NATIONAL CONSENSUS?

This question is difficult for two reasons. First, social and political changes are not brought about by the stroke of the pen. Even if some changes are mandated by legislation, implementation is a slow, complex and uncertain process. Second, much depends on the new coalition agreements and the health problems which will receive priority in the future.

It may be recalled that in their annual reports for 1984 and 1985, the council of economic advisors (or the "five wise men", as they are often called) stressed market forces and competition in the German health care system. They also recommended a reduced public role in the financing, the organization and the production of medical services and reduction of regulations.

Two leading health economists (Pfaff 1986; Thiemeyer 1986) have responded in detail to the recommendation of these "five wise men". While not all of their arguments can be discussed here, a few are noteworthy because they are shared by groups of different political persuasion, and also because they highlight the limitations of a form of economic reasoning which ignores political realities and the prevailing social and political values associated with most elements of the health care system and which most decision makers and the public until now considered to be affordable (Lockart 1985; Scharf 1985; Wissenschaftliches Institut 1985). This reasoning coincides with the political and ideological preferences of the present coalition.

If policy-makers were to move in the direction of additional cost-sharing and competition, implementation would mean, as Pfaff (1986) and Thiemeyer (1986) convincingly argue:

- the abolition of the monopoly of the professional corporatist organizations;
- the abolition of the monopoly of NHI;
- the reduction of entry controls on pharmaceutical products;
- an increase in patient choice over kind and scope of insurance coverage and medical services over and above the choices they already have (half of all NHI members do have a choice between RVO funds and substitute funds, and a smaller number of Germans have a choice between PHI and NHI);
- the reduction of over-utilization (Pfaff 1986: 118).

While the agenda of the "five wise men" is formidable, even revolutionary, it is also unrealistic. For the present coalition to endorse competition and incentives on principle is one thing, but to undermine the economic interests of their own political supporters by acting on ideological oratory is something else. This is yet another illustration of the prevailing policy style in Germany.

If the proposals to change from income-based contributions to NHI to risk-based premiums of PHI were adopted, this would terminate the social sharing of risks which inspired the creation and the expansion of NHI and other welfare state programs over a period of 100 years. According to Pfaff it would specifically mean:

- the abolition of insurance coverage for children and non-working spouse;
- women as a higher risk group would pay higher, men would pay lower contributions;
- single men and women—a group that includes many elderly—would pay higher contributions;
- low income individuals, who constitute a higher risk group, would pay higher, and middle and higher income earners would pay lower contributions.

Only the sharing of risks between the healthy and the sick and the young and the old would remain. These recommendations, if they are realized, would also touch upon many other programs of the welfare state. From a comparative perspective Pfaff rightly argues that cost-sharing has one serious drawback. If organized in such a way that it remains "socially acceptable", it has limited cost-containment potential; if it is provided with a reasonable cost-containment

potential, it becomes "*socially unacceptable*" by the values which have guided the development of medical and health care in Germany.

FUTURE PROSPECTS AND EVALUATION

By way of summary, Case One underscored the vitality and dynamics of regional politics and the interdependence of policies on hospital care, bio-medical technology and hospital investments with other policies of the German welfare state. This case in particular highlighted how existing policy arrangements have limited the formulation of the content and the implementation of hospital policy. Case Two described the social and demographic transformations which are taking place in German society and the corresponding problems which manifest themselves in local communities. Case Three analyzed a regional initiative in which corporatist actors—office physicians and sickness funds—assumed policy leadership and put forward an alternative approach to contain expenditures and to initiate a transition from hospital to ambulatory care.

What insights into comparative health policy do we gain from these cases? Though they address different policy issues, they share similar political and institutional constraints in the development, adoption and implementation of health policy. These allow for few real policy innovations, but provide many opportunities for an animated, abstract and ideological discourse on policy.

There are several lessons. First, all policy ventures since the mid-1970s have been political responses to changing social and economic circumstances. Historically, it is political rather than economic judgements that have served as an effective guide for determining important features of NHI and social security programs and securing the resources needed to finance them. They remain critical components of the consensus underlying the present arrangements for health policy making and for financing medical and health care. Dispersed responsibilities and controls and the need for decision makers to respect established legal, organizational and territorial boundaries when considering policy alternatives considerably weaken the problem solving abilities of all political actors: the Federal Government, the Länd governments, local governments, and corporatist structures. Indeed, no single policy sector, class or group controls medical and health care.

Second, over the last 15 years the Federal Government has animated the political debate about rising health care expenditures but has provided little leadership in solving these problems or in addressing other issues on the national agenda: the need to respond to changing demographics, and to the needs of the long-term unemployed, the socially vulnerable groups, and the disabled.

Although the Conservative-Liberal coalition replaced the Social-Liberal coalition in 1982, and political rhetoric changed accordingly, both endorsed

fairly similar policy approaches in their efforts to consolidate the federal budget. They shifted the burden of payment for the medical and hospital care of the elderly to the NHI community, and they asked the retired to contribute to NHI from their retirement income. While the SPD-FDP government rediscovered cost-sharing and expanded rehabilitation benefits in 1975, it placed the burden of payment for some of them on local governments, private households and individuals. When the Conservative-Liberal coalition came to power, it expanded cost-sharing and increased maternity and child care benefits while cutting, for example, rehabilitation benefits. The trend away from a decisive federal role accelerated after 1983. A "passive" rather than an "active" policy role of the Federal Government began to be preferred.

Third, coalition situations typically create conflicts and dilemmas. Conflicts entail political risks and hamper formation, and even continuation of coalitions. Concessions and compromises are, therefore, a *sine qua non* to policy development and political survival. "Passing the buck" is a fairly convenient and relatively risk-free way out of dilemmas. Under such circumstances, which have prevailed in German politics for the past two decades, inadequate responses and palliatives rather than real policy solutions will be repeated. Health policy reform proposals encounter an added political factor primarily when the Conservatives are in office. Three political camps are engaged in federal coalition politics: the Christian Democrats (CDU), the Bavarian Christian Social Union (CSU) and the Free Democrats (FDP). The Bavarian party is a strong player in the federal coalition and in the Bundesrat, so reform proposals will have to accommodate the interests of all three coalition partners.

Fourth, the discussion about rising expenditures has animated the debate since the mid-1970s and resulted in several federal legislative and other initiatives. The recent debate about reform proposals implies drastic departures from the *status quo*. However, the political and organizational constraints in debating, adopting and implementing policy leave little leeway to depart drastically from the past pattern of adopted policies. Nor have governmental leaders, bureaucrats, corporatist decision makers and others indicated a willingness to give up strategic positions and controls over the legislative and regulatory process. To make the passage of radical reforms possible and implementation feasible, such steps would be necessary.

Fifth, the policy actors' perception of the importance of a policy arena—federal or regional—has changed since the mid-1970s. Regional politics is very much alive. Policy coalitions at the Land-level will become even more important as prime movers than they have been in the past. While their composition depends on the identity of the dominant regional political forces, four structural forces influencing the politics of medical, hospital and other care will always

be important; the Land governments, their bureaucracies, and the corporatist structures of physicians and sickness funds.

The Länder remain gatekeepers to the hospital sector and social services, and regional politics is very much a function of labour markets and economic activities. Now that almost full control over all these matters is placed in the Länder, the intensity of regional and local politics can be expected to increase with greater diversity in priorities and problem-solving approaches.

Sixth, disagreements among policy elites should not obscure the fact that a national consensus continues to exist in medical and health care. Germans may disagree about diverse aspects of social, political and economic life but much less so over health. The social courts and the Constitutional Court have protected the economic and legal rights of Germans access to the best, most advanced medical care.

Seventh, the standards of "affordability" and "social acceptability" are standards which have guided both the 100-year old NHI program and the development of the German welfare state. They are good values which, until now, one of the richest countries of the industrialized nations has been able to meet through contributions by the working population and the employers. Germany is, and should be, able to afford the scope and extent of health protection and the ethical values underlying health care policies in the future.

Eighth, some authors referred to in Case Two suggested that in the future there will be greater division between the jobholders and non-jobholders, the skilled and unskilled, those with a work history securing full welfare state benefits and those with temporary and irregular work records. There is also the issue of the pauperization of women, notably the old and the very old, the problems of the chronically unemployed and of other socially vulnerable groups. While these issues are disturbing amidst a society of abundance, they also have to be seen in some perspective. Most Germans enjoy a high standard of living, income, employment, comprehensive health and other protection.

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Federalism and Canadian Health Policy

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One of the central and recurring issues of comparative public policy is the relationship between the institutional organization of the state and its policy outputs. Some scholars have sought to address this issue by attempting to identify an independent effect of institutional factors on policy, holding other factors constant. Some have argued that the effect of institutions is slight, and is dominated by the technical and political characteristics of particular policy arenas, or by broader aspects of the political culture or economy. Increasingly, however (to the despair of those who seek "determinate" explanations in political science) this relationship between institutions and policy has been seen as one involving intersecting sets of factors, yielding patterns of policy development which are unique to particular political systems. Institutions, on this view do make a difference—but the difference they make depends on how they intersect with other factors, such as the organization of interests, partisan support, ideological factors, cycles of policy "ideas" and the characteristics of particular policy challenges.

Recent studies of the relationship between federalism and public policy illustrate these developments within comparative public policy. Cameron (1978) and Castles and McKinley (1979) have shown, through regression analyses of cross-national revenue and expenditure data, an association between federalism and relatively "limited" government—federal structures appear to act as a brake on government activity. These associations, however, are not strong; and the studies differ as to the relative strength of the effect of federalism once partisan and economic factors are taken into account. Evidence for a consistent effect of federal structures across nations on aggregate levels of government activity is hence not impressive.

Other scholars have undertaken more focussed and intensive studies of the effects of federalism (or other forms of territorial decentralization of political institutions) in one or two jurisdictions. Arnold Heidenheimer has attributed the

fact that Britain allocates a considerably smaller proportion of its GNP to health care than does Sweden due in large part to the greater centralization of health care financing in Britain than in Sweden, where the counties play a much larger role (Heidenheimer, et al. 1975:28). Keith Banting (1987) has argued that a progressive centralization of control over income security programs within the Canadian federal system facilitated an expansion of the scope of such programs (and that, by implication, the federal system itself may act as modest constraint on the growth of income security spending). Christopher Leman (1977) has contrasted the impact of Canadian and American federal institutions on patterns of social policy development in those two countries, arguing that the particular characteristics of Canadian federalism have resulted in a continuous incremental pattern of policy development as opposed to the episodic "big bang" pattern of the U.S. He argues that the relative strength of Canadian provincial governments and of inter-regional conflict leads to a continual pressure on the federal system to accommodate provincial initiatives. (In the United States, by contrast, the relevant institutional explanation lies at least as much with the division of powers *within* the national government as with the federal structure—together these factors mean that change occurs only when pressure builds to the extent that it explodes through these institutional barriers to change and establish a new *status quo* which is in turn extremely resistant to change.) Peter Katzenstein (1987: 35) has similarly identified West German federalism as one of the "nodes" of a policy network which constrains bold policy initiatives but promotes continuous incremental policy development.

Heidenheimer, Banting, Leman and Katzenstein, moreover, all emphasize that the effects of federalism in a particular jurisdiction depend on how the federal system intersects with other factors: other dimensions of the institutional organization of the state such as parliamentary or congressional systems, bureaucratic structures; ideological and partisan complexion and conflict; and the organization of interests. In Banting's terms, "[I]nstitutions on their own have no substantive policy implications. Their influence operates exclusively through their interaction with the economic, cultural and political patterns of a country." (Banting 1987:39)

The approach to be adopted in the present chapter follows in this line. The Canadian federal system (entailing both the constitutional division of powers between levels of government and the *climate* of federal-provincial relations at any given point in time) will be presented as one of a number of intersecting factors which have shaped Canadian responses to the challenge of health policy in the last half-century. Furthermore, the policy responses adopted by the Canadian governments as a result of these complex interactions will be seen to have had economic and political effects which contained the seeds of future policy challenges.

THE INTERSECTION OF FEDERALISM WITH OTHER SETS OF FACTORS IN THE CANADIAN HEALTH POLICY ARENA

One of the most significant intersections of influences on Canadian health policy is that between federalism and the *party system*. The Canadian national government, and several provincial governments, have been marked over the last forty years by long periods of dominance by a single party—the Liberals in Ottawa, the Conservatives in Ontario, Social Credit and then the Conservatives in Alberta, Social Credit (with an NDP interlude) in British Columbia, the NDP (with Liberal and Conservative interludes) in Saskatchewan. The result has been that partisan conflict has tended to occur along the federal-provincial interface as much if not more than it occurs within national or provincial governments. The federal-provincial arena, in other words, has become a major locus of partisan as well as regional and jurisdictional conflict. The effect of this intersection of federalism and partisanship has at times been to exacerbate conflict, but in general to produce policy outputs such as might have been expected from a large coalition government. Similar effects in the West German case have been observed by Lehmbruch (1977) and Katzenstein (1987: 378-79). Furthermore, these provincial footholds, together with considerable provincial autonomy, have allowed parties to experiment with programs which were out of step with prevailing policy directions at the national level.

Another significant intersection is that between cycles of cooperation and conflict in federal-provincial relations and cycles of prevailing policy "*ideas*". As will be argued below, for example, if the climate of federal-provincial relations in 1945-46 had been favourable to the adoption of health insurance cost-shared between the two levels of government, the program design would have been more influenced by the Beveridge approach in Britain at that time than was the program subsequently adopted in Canada in 1966.

Federalism in Canada also intersects with the *organization of interests* in the health care field. Most groups of health care providers are organized on both a provincial and a federal basis. These groups, depending on their own objectives and resources, may either hasten or retard the diffusion of policy innovations. This phenomenon is particularly apparent in the arena of the regulation of health care practitioners.

Finally, each of these sets of influence is intersected at any given point in time by another: the *economic and technical aspects* of the operation of the health care system. The way in which "problems" requiring policy responses are defined will depend on these economic and technical factors as well as on the balance of federal and provincial powers, the climate of federal-provincial relations, partisan factors, the organization of interests and prevailing policy

ideas. The remainder of this chapter will trace out these intersecting influences in more detail.

THE ADOPTION OF NATIONAL HEALTH INSURANCE

The "watershed" issue of Canadian health policy in the twentieth century was the removal of financial barriers to access to hospital and medical services for individual Canadian residents. The problem was defined as one of ensuring that hospital and medical services were universally accessible on uniform terms and conditions. The response was the adoption of a national governmental insurance plan for hospital services in 1957 and for medical services in 1966, both cost-shared between federal and provincial levels of government. (Constitutionally, health care delivery in Canada is a matter of exclusive provincial jurisdiction; but the federal government, through the use of its spending power, has been heavily involved in the field throughout the post-war era.) The pattern of policy development can briefly be summarized as follows.

In 1945-46, there existed a remarkable consensus among medical, hospital and insurance interests favourable to the establishment of a comprehensive health insurance plan in the public sector. Viewing national health insurance as "necessary, and ... probably inevitable" (Taylor 1978:23) these groups supported such a plan in principle and sought to maximize their influence in its development and implementation. The sense of necessity and inevitability arose in part from awareness of developments in other jurisdictions, notably Britain, where the National Health Service was being born. Had national health insurance been adopted in Canada at that time, it would almost certainly have borne a closer resemblance to the NHS than does the program ultimately adopted. As Taylor reports:

Dr. J.J. Haegerty, the principal federal health expert, and the CMA/Canadian Medical Association committee advising him saw the insurance system not only as a means of financing personal health services but also as an instrument for improving and reorienting their delivery. The model draft bill for the provinces provided for health regions, preselection of a family physician who would be responsible for his 'list' and who would also be paid an additional sum to serve as a medical health officer providing personal preventive services. As discussed both by the CMA General Council and the House of Commons Committee, it was expected that the general practitioner would be paid by the capitation method.... Regional medical officers would be appointed to supervise the distribution and quality of services which would be based, wherever possible, on health centres as outlined in a 1942 British Medical Association proposal. (Taylor 1973:33)

While these proposals may well not have survived intact in any program which might have been adopted in 1945-46, they nonetheless suggest the tenor of thinking among key actors, and the extent of British influence.

The federal proposals for a cost-shared national health insurance program, presented at the Federal-Provincial Conference on Post-War Reconstruction in 1945 ultimately sank to defeat under the weight of the larger package of inter-governmental financial arrangements to which they were bound. The provinces, alarmed at the expansion of the powers of the federal government during the war time emergency, and suspicious of federal attempts to redress problems of "fiscal imbalance" by proposing a re-allocation of revenue sources, finally rejected the entire complex package. In the process, the first propitious moment for the introduction of national health insurance was lost.

The climate of federal-provincial relations, then, delayed the introduction of national health insurance in Canada. But the *extent* of the delay cannot be attributed solely to the complications of federalism. After all, another social policy component of the 1945-46 proposal—Old Age Security—was enacted within six years, notwithstanding the fact that it entailed a constitutional amendment. But as Keith Banting has pointed out, the health policy arena is more densely populated with organized interests and institutions than is the arena of income security, which involves a relatively simple and direct exchange between citizen and state. (Banting 1987:51). In the health field, the delay following the collapse of the Reconstruction Conference gave private health insurance plans time to develop and expand—plans which demonstrated to the medical, hospital and insurance communities the viability of alternatives to government-sponsored health insurance. These developments also blunted some of the general public pressure for government health insurance by providing coverage for the actuarially "insurable". As a result, the strategic consensus in favour of a comprehensive public-sector plan began to unravel, to be replaced by a preference among medical, hospital, and insurance industry spokesmen for government identification or partial subsidization of the "uninsurable" and the medically indigent, as a supplement to the private sector plans.

While the support for comprehensive health insurance among strategic interests in the health field was unravelling, however, a more favourable climate of federal-provincial relations was slowly developing. The provinces' post-war suspiciousness that the federal government would consolidate its wartime centralization of power had abated somewhat. Moreover, the "demonstration effect" of provincial hospital insurance plans in Saskatchewan and British Columbia, adopted unilaterally by those provinces in 1947 and 1948 after the collapse of the federal-provincial negotiations, added further impetus to provincial action. In 1957, accordingly, the climate of federal-provincial relations again dominated the politics of the health care field—this time with the result

that a national hospital insurance program, cost-shared between the federal and provincial governments, was adopted in the face of the opposition of providers of hospital care and insurance.

With respect to the introduction of *medical* care insurance, the intersecting influences of federalism, partisanship and organized interests are even more apparent. It was a social democratic party, with a foothold provided by the provincial government of Saskatchewan, which in 1962 exercised the political will necessary to adopt a comprehensive public sector medical care insurance program in the face of medical opposition culminating in a physicians' strike. The consequences of this pivotal episode were several. First, medical incomes increased dramatically in the first few years of the program, reducing the likelihood of militant medical opposition to the adoption of a similar program nation-wide. Second, the physicians' option to bill his patients directly, at rates above the fee covered by the public plan, without jeopardizing his patients' right to reimbursement from the public plan, was part of the strike-settling agreement—and was henceforth viewed by the medical profession as a hard-won right.

Finally, physicians who had been brought from Britain on contract by the Saskatchewan government to provide services during the strike remained to staff the nascent community clinics in the province. This development exacerbated the politicization of the community clinic movement in the province, and the opposition to it, in its formative stages.

The catharsis and the demonstration effect of the Saskatchewan program eased the introduction of national health insurance in 1966. But the adoption of the program was not without conflict. Medical and insurance interests continued to favour government supplementation of private sector programs. It is significant, however, that the conflict was again channelled along federal-provincial fault lines, not along partisan lines within the national or provincial governments. The Medical Care Act was passed in 1966 under a minority government, with only two dissenting votes in Parliament. But the provincial level was the locus of considerable opposition. Ontario, for example, protested that its entry into the program was practically coerced by the federal imposition of a supplementary tax introduced to pay for it. Taylor quotes John Robarts, then Premier of Ontario:

Medicare is a glowing example of a Machiavellian scheme that is in my humble opinion one of the greatest political frauds that has been perpetrated on the people of this country. The position is this: you are taxing our people to the tune for \$225 million a year to pay for a plan for which we get nothing because it has a low priority in our plans for Ontario. (Taylor 1978:375)

Indeed, in the mid- to late 1960s the government of Ontario and organized medicine in the province appeared to be virtually of one mind on the issue of health insurance. The Ontario Medical Services Insurance Plan (OMSIP), established in 1966, provided for a governmentally sponsored plan, with open enrollment and subsidized premiums on a sliding scale related to income, existing alongside commercial and physician-sponsored plans. This program was fully endorsed by the Ontario Medical Association. The OMA Board of Directors announced in 1965 that "the principles embodied in the [draft OMSIP] legislation were supported by [OMA] Council and thus represent the present policy of this association" (Ontario Medical Association 1965:207). Although subsequent modifications to the draft legislation tempered the profession's enthusiastic endorsement of the OMSIP program, this rapport remained essentially intact. It was doomed with the advent of national medical care insurance.

Between 1968 and 1971, all Canadian provinces entered the national health insurance program. The program went a long way towards resolving problems of access to health services, but it contained the seeds of future policy challenges. Most immediately, in essentially underwriting the existing "open-ended" financial structure of fee for service and per diem payments to providers, it did nothing at the outset to contain the rising costs of health care. In virtually all advanced industrial nations (although to varying degrees) the increasing proportion of GDP devoted to health care became a matter of growing public policy concern throughout the 1970s and 1980s (Schieber 1985). "Cost control" replaced "access" as the dominant theme of the international climate of policy ideas.

IN THE WAKE OF MEDICARE

In Canada, by virtue of the federal-provincial division of powers and the deteriorating climate of federal-provincial relations over the 1970s and early 1980s, the challenge of controlling costs was felt most strongly at the provincial level. The adoption of medicare made provincial governments major cost-bearers in the Canadian health care system. Cost-sharing formulas under hospital and medical insurance until the mid-1970s provided for essentially a 50/50 split of costs between the federal and provincial levels. In the mid-1970s the federal government moved unilaterally to cap the open end of its financial commitment; and under the Established Programs Financing arrangements negotiated in 1977, increases in the federal cash contribution to provincial hospital and medical insurance plans are limited to the rate of increase in GNP and population. Under these arrangements, that is, provincial governments are 100 per cent at risk for cost increases in health care over and above rates of increase in GNP and population. As I have argued elsewhere, (Tuohy 1976, 1986)

Canadian provincial governments have basically three types of leverage on the control of these costs (not including the transfer of costs to the private sector—an option to which I shall return below). They may attempt to hold down rate increases in negotiations with providers; they may restrict the supply of manpower, facilities, and services; and they may seek to improve the efficiency of the system through organizational change. Provincial experimentation with these options has characterized Canadian health care policy in the 1970s and 1980s.

a) Price and supply constraints

Let us consider the first option cited: in particular, the attempt to hold down, through negotiation or unilateral action, the unit price of services. With regard to physicians' services, considerable variation across provinces in the generosity of fee schedule increases can be observed throughout the 1970s and 1980s (Barer and Evans 1986: 76ff). British Columbia, Alberta and Nova Scotia have fairly consistently maintained more generous medical fee schedules under their health insurance plans than have other provinces; Newfoundland and New Brunswick have maintained, on balance, the least generous schedules; and Ontario and Quebec have shown a progressive decline, relative to other provinces, in the level of their fee schedules (Weiler 1982:15). These cross-provincial variations do not appear to be related to partisan differences among governing parties: B.C. maintained its first-ranked position under both Social Credit and New Democratic parties; Quebec's relative decline continued fairly steadily under both the Liberals and the Parti Québécois.

Two caveats regarding this cross-provincial variation need to be issued, however. Most provinces have been essentially similar in *what* is negotiated—namely, the over-all percentage increase in the fee schedule. The allocation of this increase across individual items in the fee schedule (benefitting, for example, specialists as opposed to general practitioners or *vice versa*) has been carried out internally by the provincial medical associations. Secondly, the inter-provincial rankings in terms of the generosity of fee schedules bears little relationship to the ranking in terms of medical *incomes*, and in terms of general practitioner/specialist differentials in this respect. Quebec specialists, for example, do relatively poorly in the inter-provincial income sweepstakes, but general practitioners in that province are among the highest-earning general practitioners in Canada (Weiler 1982:17). It should also be noted that there is considerably less cross-provincial variation in the level of medical *incomes* than in the level of medical *fees* (Barer and Evans 1986:96).

These differences reflect the particular intra-professional and profession-state relationships which characterize different provincial policy arenas. They

also highlight the fact that it is not only the price, but also the volume and mix of services provided (the so-called "utilization factor") which determines the incomes of providers (and conversely the cost of service). The rate of increase in per capita "utilization" has varied considerably across provinces, roughly inversely with the increase in the level of medical fees. (As Barer and Evans point out, this observation is consistent with a "target income" theory of physician practice behaviour—the view that physicians manipulate the instruments of price, volume and mix so as to achieve "income targets" (Barer and Evans 1986:84). Provincial governments, for their part, have adopted a variety of policies aimed at constraining not only the price but the volume and mix of medical services.

Provincial governments have attempted to constrain volume primarily by placing restrictions on the supply of practitioners and of facilities. The development of policies to limit the supply of physicians has in most cases involved collaboration between federal and provincial governments and the medical education and regulatory establishments. Limitations on the immigration of physicians were instituted in the mid-1970s through collaboration between federal and provincial governments and the medical licensing bodies. Recently, the Federal-Provincial Advisory Committee on Health and Human Resources, composed of representatives of both levels of government and the medical profession, recommended further restrictions on the immigration of foreign medical graduates, as well as reductions in residency training places for family practice and the medical specialties and in first-year medical school enrollments. Several provinces have moved with little or no consultation to limit or re-distribute the supply of physicians. Quebec and Manitoba, for example, have instituted reductions in first-year medical school enrollments. British Columbia and Quebec have adopted policies directed at newly graduated physicians. B.C. has instituted restrictions on billing numbers: for the first two years of their practice in the province, physicians will be issued billing numbers only if they practice in designated regions. Quebec has adopted a "bonus-malus" payment schedule for new graduates in an attempt to influence their location decisions: for the first three years of practice, physicians are remunerated at a specified percentage above the regular payment schedule if they locate in remote areas, and at a specific percentage below the regular schedule if they locate in major metropolitan areas. Despite these measures, however, (most of which are either in the proposal stage or only recently implemented) the physician: population ratio continues to increase (Inglehart 1986; Barer and Evans 1986: 84ff).

In addition to these attempts to limit the over-all supply of practitioners, several provinces have attempted to develop mechanisms of limiting the volume of service provided by individual practitioners. Again, these policies

have involved negotiation and collaboration with the profession. Quebec, for example, prorates fee-for-service payments to general practitioners beyond a negotiated target income, and links specialist fee increases to utilization trends in order to establish a year-to-year rolling global limit on payments to specialists.

All provinces, indeed, have experimented with programs constraining the discretion of individual physicians over not only the volume but the mix of the services they provide—that is, the costliness of the particular set of diagnostic and therapeutic tools brought to bear in given cases. These measures have so far been limited, but again they have been developed and adopted through collaboration between governments and the profession. Under these various arrangements, governmental health insurance agencies identify, through their computerized claims systems, aberrant "practice profiles" of individual physicians. These profiles are then referred for further investigation to professional committees, variously constituted in the licensing bodies, the medical associations, or in the interstices between these bodies and the governmental agencies.

In the hospital sector, public policies of restraint have had more substantive effects, and they have done so not so much through the control of price as of volume and mix. Hospital wage and unit price increases outpaced general inflation through most of the 1970s. But over-all costs in the hospital sector did not increase accordingly, reflecting the fact that the actual level of hospital facilities—manpower, beds, supplies and equipment—available *per capita* actually declined slightly toward the end of the 1970s (Bird 1981). These declines reflect the policies of provincial governments, as first Ontario and then other provinces, moved from a *per diem* to a global budgeting method of hospital financing (although these budgets were not infrequently breached as provincial governments covered hospital deficits.) Detsky et. al. (1973) have shown that hospital inputs per patient day remained virtually constant in Ontario from 1972-1981, as a result of restrictions on the number of beds and man-hours which were approved by the province as the bases for negotiating hospital global budgets. Barer and Evans report that, although provinces varied in the alacrity with which they joined the "downsizing" movement, the period since 1976 has been one of "significant convergence" in the reductions of beds per capita (Barer and Evans 1986: 106).

b) Organizational change

In international perspective, these attempts at cost control have been relatively successful. Canada ranks in the mid-range of 16 OECD nations in terms of the proportion of GNP allocated to health care—about 8.5 per cent in 1983, as

compared with 10.9 per cent in the U.S. (Schieber 1985). Barer and Evans point out, however, that there is considerable cross-provincial variation in this "success story", not only in the over-all levels but in the components of health care expenditure. One of their arresting observations is that, if Canadian growth rates as a whole had followed the pattern of the three western-most provinces, total health costs in 1982 would have been in the range of 9.3 to 9.6 per cent of GNP—almost halving the difference between Canada and the U.S. and ranking Canada roughly equivalent to West Germany (Barer and Evans 1986: 72).

In any event, these attempts to constrain price and supply have involved relatively blunt policy instruments. Increasingly, however, policy debate in the cross-national health arena is coming to emphasize more finely-tuned instruments directed not simply at cost control but at improvements in efficiency—at changes in the incentives facing providers of health care (Schieber, 1985). At least two inter-related policy issues are involved here: the regulation and remuneration of various types of health practitioners, and the organization of the institutions of health care delivery. With regard to the first of these issues, Canada has seen, since the adoption of medicare, much in the way of political activity but little in the way of tangible result. Various groups of health practitioners have lobbied strenuously in attempts to have their services made eligible for coverage under medicare and to expand their scopes of practice under regulatory legislation. This lobbying activity has often involved a form of whip-sawing of governments, largely at the provincial level but at times involving the federal level as well; and it has occurred against the active or passive resistance of the medical profession. It is worth highlighting a few dimensions of this activity.

Late in the legislative process leading to the passage of the Medical Care Act in 1966, an amendment was adopted, largely as a result of lobbying efforts by optometrical and chiropractic associations, enabling the federal government to specify by regulation "any health services rendered by a person lawfully entitled to render such services in the place where they are so rendered ... and if the provincial law so provides" as services whose costs would be shared between the provincial and federal governments. [SC 1966-67. CH. 64, s. 4(3)] Despite attempts by non-medical groups (notably chiropractors and optometrists) to whip-saw governments by seeking to have their services covered by provincial plans and to have costs shared by the federal government, however, the federal government has so far resisted defining any non-medical services (other than certain oral surgical procedures performed by dentists) as eligible for cost-sharing; and coverage of the services of non-medical health practitioners varies considerably across provinces. (Arguably, the considerable "deconditionalization" of federal transfers under the 1977 Established Programs Financing arrangements allows provincial governments flexibility in

this regard, but the costs of these non-medical services do not form part of the base on which increases in federal transfers are calculated.)

Inter-provincial whip-sawing has also occurred, with very limited effect, in the arena of professional regulation. Substantial revisions to the legislation governing the health professions have been undertaken in Ontario, Quebec and Alberta. A few non-medical groups have won concessions in those provinces in the form of self-regulatory status and rights to independent or exclusive practice (Boase, 1986); and have used these concessions to attempt to make similar gains in other provincial jurisdictions. Nurses, for example, have been granted an exclusive right to practice in Alberta (as opposed to the right to title which they hold in other provinces). Several other groups have gained a limited right to independent practice in that province. In Ontario, denture therapists have won a limited right to independent practice, but several other groups (such as physiotherapists and dental hygienists) have unsuccessfully attempted to negotiate with the "senior" professions of medicine and dentistry respectively, regulatory changes expanding their scopes of practice and/or loosening supervision requirements.

In general, these revisions to professional legislation have served largely to emphasize the social responsibilities of corporate professional bodies and to signal a closer scrutiny of their operations. These changes have had, to date, virtually no effect on the allocation of functions among health care personnel, although they have in some cases constrained the entrepreneurial discretion of individual professionals or the economic monopoly power of professional groups (Tuohy 1986). Both the Ontario and the Quebec legislation contain "delegation" clauses (permissive in Ontario, mandatory in Quebec) providing for various professions to designate by regulation the functions within their respective scopes of practice which might be performed by persons other than their members. Attempts to rationalize the allocation of functions through regulations under "delegation" clauses, however, have been frustrated by the strategic behaviour of professional groups attempting to "delegate" (and hence claim jurisdiction over) functions already arguably within the scope of practice of the delegatee group. Those regulations which have been passed under delegation clauses have had little or no effect in practice. (Contandriopoulos et. al. 1986) In Ontario, no regulations have been passed under "delegation" clauses; nor is this likely pending the completion of a current review of the legislation governing all health disciplines in the province.

As for experimentation with forms of health care delivery alternative to private fee-for-service practice (for example, clinics funded on a capitation or global budget basis under contract with the government insurance plan) such models are developed in some provinces (notably Saskatchewan and Quebec) than in others; but they remain peripheral to the mainstream health care delivery

system. In Ontario, Health Service Organizations (H.S.O.'s), on the model of American H.M.O.'s, have been treated as perennial pilot projects whose development has been hampered by lack of systematic evaluation and constraints in existing funding mechanisms, and the fact that, as Stoddart has noted, "funds for innovation or experimentation with potentially cost-effective alternative financing and delivery arrangements are severely limited due to the sheer size of financial commitments to existing programs." (Stoddart 1984:5)

c) cost-shifting

There is, of course, yet another option potentially open to governments concerned about the magnitude of health costs in their budgets—the option not to control but to shift costs to the private sector through charges to patients, either uniform across providers or imposed at the provider's discretion. It is around this option that much recent debate in Canada has centred. Throughout the 1970s and early 1980s some provinces experimented with various forms of "user charges" for hospital and medical services. British Columbia, New Brunswick and Newfoundland, for example, levied small per diem or admission charges for acute hospital services; Alberta allowed hospitals to levy per diem charges at their own discretion up to specified maxima. More contentious were policies in Ontario, Alberta, Saskatchewan, Manitoba, New Brunswick and Nova Scotia allowing physicians to "extra-bill" their patients—to bill them, that is, for an amount over and above the level of payment provided by the government provided by the government plan. The particular provisions for extra-billing varied considerably across provinces, reflecting both economic conditions and the nature of the accommodation between medicine and the state in each province (Tuohy 1988).

The existence of these user charges, and particularly of medical extra-billing became in the early 1980s the most hotly contested issue of Canadian health policy. The over-all economic impact of extra-billing was relatively slight (a rough estimate would put it at about 1.3 per cent of total billings for insured medical services) and only a minority of Canadian physicians (about 10 per cent) were involved in the practice. Even in Ontario, where the impact was greatest, the comparable figures were about 2.4 per cent and 12 per cent respectively. The political significance of the issue, then, appears initially to present a puzzle—one which has been explored at greater length elsewhere. (Tuohy 1988). What is most relevant in this context is that, once again, an important part of the explanation lies in the realm of federal-provincial relations.

Both for governments and for the medical profession, extra-billing functioned as a significant "condensational" symbol (Edelman 1964). For some in the profession, it symbolized "private" fee for service practice. For government-

tal politicians the extra-billing issue drew upon and summarized in a limited context issues of the universality of social programs, and the appropriate level of state and private spending in the health care arena. These connotations of the issue suited it to be seized upon by protagonists in intergovernmental and partisan, as well as government-profession disputes. Responding to provincial opposition to the Established Programs Financing arrangements established in 1977, and to the rapid (although, in retrospect, transitory) increase in rates of opting out and extra-billing following the end of anti-inflation program controls in the late 1970s, the Conservatives appointed a one-man commission of inquiry into the health care system during their brief period in office federally in 1979-80. The report of this Commission in September 1980, delivered to the Liberal government which had by then replaced the Conservatives, provided little comfort to the provinces. It generally supported the federal government's assertion that its share of health care expenditures was not declining, and identified extra-billing as a major potential distortion of universal health insurance, threatening to create a "two-tier" medical system.

In 1983, the federal Liberal government, declining in popularity and facing non-Liberal governments in each of the provinces seized upon the extra-billing issue as a way of signifying its commitment to defend the "universality" of the country's most popular social program. The general climate of federal-provincial relations was extremely sour. The federal government developed, with only the most perfunctory discussion with the provinces, legislation reducing federal cash transfers to any province allowing direct patient charges to be made for insured services. The federal transfers were to be reduced by an amount equal to the dollar amount of charges to patients for insured services above governmental insurance coverage—a "dollar for dollar penalty" for direct charges. In defence of the proposed legislation, the federal government issued a position paper, whose title, "Preserving Universal Medicare", clearly summarized its major theme:

The Government of Canada invites concerned Canadians and provincial governments to work together to preserve Medicare. In the following pages, the current challenges are reviewed more fully. Throughout this discussion there is one common thread: a vision of Canada as a humane and caring society, a society that has undertaken to care for all its people through a comprehensive social security program system. Throughout the economic crisis, which is now passing, we have preserved programs such as the Old Age Security and Guaranteed Income Supplement, Family Allowance, and the Canada Assistance Program. Now the challenge is Medicare. (Government of Canada 1983: 7-8)

The federal document also defended the feasibility of banning extra-billing by pointing to the policies of Quebec and, to a lesser extent, British Columbia—provinces in which extra-billing had been effectively banned.

Because of its implications regarding the commitment to universality, as well as its more specific distributive implications, the principle behind the proposed legislation drew support from a broad coalition of welfare, labour and church-related groups (including the Catholic Hospital Association). It was also supported by a number of health professional groups, most actively by organized nursing. And, perhaps because of the relatively small overall financial stakes, the groups which had supported the medical profession on medicare-related issues in the past—the insurance industry and business groups more generally—were not as active in this case. Furthermore, public opinion surveys had consistently shown strong majorities opposed to extra-billing and in favour of legislative action against it.

For the federal Liberal government, then, the attack on extra-billing to symbolize the defense of universality was an attempt to win broad public support for the federal government *vis-à-vis* the provinces, and the Liberal party *vis-à-vis* the opposition Progressive Conservatives. In the latter respect at least, the strategy misfired. The federal Progressive Conservatives responded by supporting the legislation despite the opposition of their provincial counterparts, thereby depriving the Liberals of an election issue. Like its predecessor, the Medical Care Act in 1966, the Canada Health Act was passed in April 1984 with the support of all parties at the federal level.

The implementation of the Canada Health Act evinced considerable inter-provincial variation—both in the nature of the accommodation reached between the state and the profession regarding the terms and conditions of the "ban" on extra-billing, and in the process leading to that accommodation. In Ontario, in particular, for reasons having to do largely with an abrupt shift in the partisan complexion and of the provincial government and its relationship with organized medicine, the process was marked by greater conflict than elsewhere. By 1 April 1987 the end of the three-year "grace period" provided by the Canada Health Act (during which the federal government was to retain in trust all penalty funds withheld from a province and was to release those funds to the province as soon as it ceased to allow direct patient charges) all provinces were formally in compliance with the Act. In a number of provinces, however, the spectre of extra-billing was not entirely laid to rest, as physicians continued to levy charges for "uninsured services" and appeared to be expanding the definition of what services were "uninsured" (such as renewing prescriptions by telephone) and hence directly chargeable to patients. Concerns have been raised that such charges could violate the Canada Health Act's requirement that provincial plans, to be eligible for federal cost-sharing be "comprehensive" in their coverage; and negotiations continue between provincial governments and the respective medical association on the one hand and the federal government on the other.

FUTURE DIRECTIONS

Canadian governments have not yet responded to the third of the major challenges which followed in the wake of medicare: improving the efficiency of health care delivery organization. As noted earlier, more flexible policies of professional regulation which could enable if not encourage a re-allocation of functions among health care personnel have so far not been adopted—even such legislative changes as have occurred have foundered at the implementation stage. And alternatives to private fee-for-service practice as a delivery mechanism have been developed only on a very limited scale.

It is precisely with regard to these issues of efficiency and organizational innovation, however, that the current climate of policy ideas is most concerned. The burgeoning literature on the cost-effectiveness of H.M.O.-type delivery mechanisms and on "pro-competitive reform" (much of it summarized in Starr 1982) attests to the vitality and the ideological variety of this debate. Among the most innovative of these various proposals are those which attempt to introduce market forces into publicly-financed systems (Stoddart and Seldon 1983; Enthoven 1985).

The development and implementation of new forms of health care delivery presents a policy challenge to which decentralized political systems are well suited. Experiments can be conducted in sub-national "laboratories" and, if successful, nationally diffused. Arguably, one of the few public policy benefits of Reagan's "New Federalism" in the United States has been this type of experimentation and innovation at the state level (Meyer 1982; Etheridge 1985).

In Canada, sub-national experimentation is somewhat constrained by the interest of the federal government in ensuring that inter-regional disparities in access to care are minimized. Hence the requirements of the Canada Health Act that provincial health insurance plans, to be eligible for cost sharing, ensure that medical and hospital services are universally accessible on uniform terms and conditions may, as Greg Stoddart has pointed out, present obstacles to experimentation with alternative delivery modalities and particularly to the increased use of market forces within a publicly financed system (Stoddart 1984). Another potential legislative obstacle to change at the federal level was removed through an eleventh-hour amendment to the Canada Health Act, making the services of "health care practitioners" (not only "medical practitioners") eligible for cost-shared coverage. This amendment was adopted in response to intensive lobbying by non-medical groups, notably by organized nursing, but its effect in practice may be no greater than was that of s.4(3) of the Medical Care Act, noted above (Boase 1986:131). Whether or not it facilitates a re-allocation of functions covered under health insurance will

depend in large part on the activities of increasingly politicized non-medical groups at the provincial level.

In the current Canadian health care system, the sorts of "innovation" for which federal action is most appropriate are across-the-board measures: changes in the level of financing; banning extra-billing. What is needed now, however, is experimentation and flexibility; and in that respect the role of the federal government is to maintain a balance between such experimentation and access to an acceptable standard of care across provinces. And the interpretation of what constitutes an acceptable balance is likely to depend on the prevailing climate of federal-provincial relations.

The current tenuous truce in intergovernmental relations (associated in part with the end of a number of political dynasties at both levels) may allow for a period of federal "benign neglect" of provincial health policy, and hence allow the provinces some scope for experimentation. (It must be noted that such experimentation is likely to occur only if federal financial contributions are indeed benign. The "productivity paradox" applies in health care as in other arenas: efficiency-enhancing innovations are likely to involve substantial front-end costs.)

Taking the formulation of health policy largely out of the federal-provincial arena for a time would make it more accessible to organized interests (Simeon 1972) and lessen constraints on provincial governing parties to function as part of a "grand coalition". Hence the extent to which provincial governments were to draw upon prevailing policy ideas would depend very much on their partisan complexion and on the provincial structure of organized interests. The most that can be said is that at this particular conjuncture of Canadian federalism with partisan factors, organized interests and the climate of policy ideas, the opportunity for such experimentation exists.

CONCLUSIONS

This review of the relationship of federalism to policy development in the health care arena in Canada suggests that the effect of federalism has essentially been two-fold.

1. Because changes in the climate of federal-provincial relations result in alternating periods of time in which policy initiatives are favoured or frustrated, federalism has affected the *timing* of policy initiatives, and hence the international climate of policy ideas upon which these innovations draw.
2. Because of a jurisdictional division of power which has placed the instruments of health care policy largely in the hands of provincial governments while affording the federal government broad revenue

sources and spending powers, federalism has created both provincial "niches" for provincial experimentation with policies which may be out of favour in other provinces or at the national level, as well as the means for diffusing provincially-generated policies.

The first of these effects may well be generalizable to other policy arenas; the second probably results from characteristics of the health field which are less generalizable. The reasons for policy innovation and diffusion lie not only in the structures of the state but also in the structure of organized interests and the nature of policy challenges. Health care providers serve local "markets"; hence, unlike many areas of industrial policy, providers in one locality or region are not economically pitted against those in other areas. Furthermore, the organization of provider interests in health field mirrors the federal structure of the state. Professional and hospital groups, while locally based, are most cohesively organized at the provincial level, and maintain relatively loose national federations. Considerable cross-provincial variation, then, is likely to arise out of the particular accommodations between these interests and the state in individual provinces; but mechanisms for and pressures towards policy diffusion also exist. One mechanism is provided by the federal structure of the state; which, as noted, has had an *episodic* effect on diffusion. Another type of mechanism, however, lies in the federal structure of organized interests, which facilitates ongoing communication and coordination of strategy among provincial associations; the effects of this type of mechanism has tended to be more *continuous*. Finally, given cross-provincial similarities in medical technology and established patterns of delivery, policy challenges have been similar as well.

In the last analysis, indeed, it is the accommodation of interests, arising from the interplay of economic and ideological factors, and the logic of the policy challenges which result from this accommodation, which define the range of the possible in Canadian health care policy. The effects of federalism are to allow for a variety of accommodations within this range, and to provide both periodic and ongoing pressures towards convergence.

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Post and Telecommunications in the Federal Republic of Germany

Carl-August Conrad

In the Federal Republic of Germany a substantial relationship exists between telecommunications services on the one hand, and (traditional) media services on the other. Correspondingly, the Deutsche Bundespost (German Federal Mail) is engaged both in (traditional) postal services and in telecommunications services. Specific legal provisions relate to both media services broadly conceived and the Deutsche Bundespost. Telecommunications in the Federal Republic of Germany is, thus, embedded in a complex set of rules. The purpose of this chapter is to clarify the nature of this policy sector and to identify potential shortcomings from a federalism perspective.

TELECOMMUNICATIONS AND MEDIA LAW

In Germany, communications policy ranks among the major topics in the current political debate. Because of the central role that the Deutsche Bundespost plays in supplying telecommunications facilities used to transmit electronic media, there is a direct connection between telecommunications and media policy in general. This link may also be explained by the significant degrees of complementarity and substitutability between print and electronic media. However, this relationship is not always evident because radio and television broadcasting falls within state rather than federal jurisdiction in the Federal Republic. Each Land may operate its own radio and television stations and shape its own broadcasting legislation as specified in the Basic Law (Articles 30 and 70).¹ Since 1983 the Länder have established many new regulations in

1 Grundgesetz (1949), Articles 30 and 70.

the field of broadcasting, such as the laws on pilot cable projects in Rhineland-Palatinate, North Rhine-Westphalia and Berlin (West), and the new broadcasting laws in Lower Saxony, Saarland, and Schleswig-Holstein.²

The main purpose of these new regulations is to create conditions for the admission of private broadcasting organizations. This requires that the details be specified in law. Special importance is attached to broadcasting in the Basic Law due to its impact potential on freedom of expression.³ These laws formulate conditions that must be met by the programs as well as special duties of the providers. Moreover, they set up the financial principles to be followed and include regulations on the broadcasting of existing programs to cable networks.

The broadcasting sovereignty of the *Länder* is derived from their legislative authority in cultural and educational matters and this clearly refers to the contents of broadcasting. The *Länder* are entrusted with the regulation and development of broadcasting as agents for the transmission of information and opinions broadly understood. The technical aspects of broadcasting, i.e., the technical processes of transporting signals from the place of origin to the subscribers, remain untouched. The Federal Constitutional Court has not dealt with the technical possibilities of broadcasting as a subject of regulation under Land legislative authority but regards them as necessary prerequisites for performance.⁴ However, the technical task of providing broadcasting programs is one major aspect of telecommunications policy. As will be seen in the next section, it is a task which pertains to the Deutsche Bundespost.⁵

TELECOMMUNICATIONS AND THE DEUTSCHE BUNDESPOST (DBP)

In media policy the federal parliament only has the authority to establish framework law, but it has the exclusive right to enact laws in postal affairs and telecommunications.⁶ Only beyond that line are postal and telecommunications services matters for the *Länder*. In the Federal Republic of Germany, quite in contrast to other countries, postal and telecommunications services are managed by one enterprise, that is, the Deutsche Bundespost.

Article 87 of the Basic Law declares that the federal postal service is a matter of direct federal administration with its own administrative substructure. The Postal Administration Law (*Postverwaltungsgesetz*) of 1953 defines its

2 See *Landesrundfunkgesetz* (1984).

3 *Entscheidung des Bundesverfassungsgerichtes*, June 16, 1981: 295-360.

4 *Ibid.*

5 *Entscheidung des Bundesverfassungsgerichtes*, February 28, 1961: 205-264.

6 *Grundgesetz* (1949), Article 73, Section 7.

legal status as a "direct federal administration". Financial means allocated to postal services and telecommunications form a special fund within the federal budget. They are administered separately from other funds of the Federation (*Postverwaltungsgesetz* 1953).

The DBP is run by the Federal Ministry of Post and Telecommunications. It is supported as well as controlled by an administrative council. This council consists of five members of the Federal Parliament (Bundestag), five members of the Federal Council (Bundesrat), five members from various sectors of the business community, seven members as representatives of the DBP staff, one expert from the field of communications, and finally one expert from the field of finance. The functions of the administrative council include the adoption of the estimate of the DBP, approval of the annual financial statement, and the provision of regulations concerning the use of postal and telecommunications services.

The five Land representatives in the council do not make the DBP a joint enterprise of the Federation and the Länder. They are better seen as corrective rather than an instrument for policy participation. Land initiatives in the administrative council often are attempts to gain advantage for their respective constituency rather than attempts to limit the influence of the Federation in the council or in the management as a whole. However, there have been Länder efforts to enhance their influence in the field of teledistribution. Teledistribution by underground cables offers technical possibilities already being exploited to a remarkable extent in the Federal Republic. The installation of those systems characteristically involves substantial investments.

A number of legal and economic problems are raised as well. A major one involves the granting of access to the system at reasonable prices because there is no compulsory connection to telecommunications networks. The DBP is supposed to offer the services not only in highly populated but also in less populated regions. According to the Postal Administration Law, the Federal Minister of Post and Telecommunications is responsible for directing the DBP to maximize the benefits for the Federal Republic particularly as it pertains to matters of transport, economic and financial policy, and social policy.⁷

An important provision in this law states that the DBP must meet its expenditures from its own revenues; subsidies from the Federal treasury are not granted. On the contrary, the DBP must pay levies to the Federation from its annual operating income which currently amounts to 10 per cent. Savings and rationalization measures and the commitment to be financially self-sustaining

7 On the relevant legal provisions, see *Postverwaltungsgesetz* (1953), Paragraphs 1, 2, 3, 5 and 15.

have created a sound financial basis in recent years. The DBP has been able to improve its capital structure with surpluses from previous years and has even accumulated substantial reserves.

Another legal aspect is that the term "telecommunications" has not been defined in the Basic Law. The definition contained in the Telecommunications Installations Act has been adopted without change.⁸ Article 1 of this act defines telecommunications as "the installation and operation of telecommunications systems" and states at the same time that this right is exclusively reserved to the Federation, i.e., to the DBP. According to Articles 2 and 3 of the Telecommunications Installations Act, other persons and institutions also are entitled to install and operate telecommunications systems under certain conditions, the type of equipment is characterized by the fact that it may only serve the operator's internal purposes and may only be established outside the telecommunications networks of the DBP. In order to install and operate, approval is needed based either on law or on a grant of authority to the holder of the sole right in each individual case. For this reason Articles 2 and 3 do not represent an exemption to the Federation's sovereignty in telecommunications but confirm instead its application without restrictions.

The definition of telecommunications in Article 1 of the Telecommunications Installations Act shows that the DBP not only has rights but that it is obliged as well to provide telecommunications systems, i.e., to render telecommunications services available and to guarantee the supply of these services. Article 2 Section 3 of the Postal Administration Law and Article 7 Section 8 of the Telecommunications Installations Act give the provision concrete form by obliging the DBP to develop these systems technically and operationally in accordance with traffic demands and to grant to all the right to use telecommunications services.⁹

An accurate definition of the responsibilities assigned to the DBP requires a description of the meaning of telecommunications systems not included in law. In 1889 a definition was given by the Supreme Court of the German Reich (Weichert and Schmidt, 1984: 1). In view of this interpretation, a firm definition was already considered dispensable when the Telegraph Act was enacted, because the term seemed to be sufficiently protected against misinterpretation.¹⁰ According to current views, the definition holds that signals emitted must be reproduced at the place where the message is received. In this respect it is irrelevant what technique is being used, or whether the message can directly be perceived at the place of reception. Only those installations which require

8 Fernmeldegesetz (1977), Paragraph 1.

9 Fernmeldegesetz (1977), Paragraph 2, Section 3.

10 Verhandlungen des Deutschen Reichstages, 1890/91: 2702.

no special equipment at the place of reception for the receiving and the reproducing of messages to be transmitted are excluded as telecommunications systems (for instance, lighthouses.) It is essential to note that the meaning of the term follows the development of technology. The Federal Constitutional Court has stated in this respect that the term has been left open by the legislature to allow for new, still unknown techniques. In other words, the term applies not only to those types of message transmission which were known when the Telecommunications Installations Act was established but refers to all techniques of reporting and transmitting signals including the digital transmission of messages.¹¹

REGIONAL POLICY ASPECTS

The Postal Administration Law extends regional policy tasks with the condition that the DBP must cover its own expenses from its own receipts. This means that the DBP has to balance the principle of economic efficiency against the obligation of equal supply of modern telecommunications services throughout the country when extending its networks. Furthermore, charges must be applied equally. Consequently, the DBP's actions have to be based on effective demand backed by purchasing power.

This principle does not exclude the possibility of arranging for new services, for example, by providing the necessary network infrastructure at an early date by financing these activities out of current incomes from other services. In many cases such arrangements are required for introducing services to the market and promoting the acceptance by prospective users. The limits are set by the technical and financial possibilities of the DBP. The large investments required can, therefore, not be made everywhere simultaneously without concrete evidence of demand.

For reasons of efficiency, however, the use of surpluses achieved in one branch to balance deficits in another is somewhat problematic. For example, at present the use of profits made in telecommunications to subsidize the postal branch has been criticized because the telecommunications charges are higher and the postal charges are lower than the respective costs, implying a too low and a too high level of service supply respectively. At the same time, this kind of cross-subsidization restricts the possibility of financing investments in new telecommunications facilities. The adjustment of charges to actual costs is therefore one of the DBP's policy objectives to which increasing importance is attached. However, the present tariff and cost structure in postal and telecom-

11 Entscheidung des Bundesverfassungsgerichtes, October 12, 1977: 120-160.

munications services still leads to considerable cross-subsidization between the service categories and, thus, to discrimination between different user groups.

The principle of nation-wide uniform user charges is important from the regional policy point of view. Together with the requirement of universal service supply at moderate charges it implies that equivalent services are offered at different places within a geographical area at the same price even if the costs differ considerably from region to region. Due to topographical conditions, population density, and differential use patterns, costs in fact differ regionally, leading to considerable cross-subsidization between regions. The regional policy argument is expanded upon briefly below.

The costs of connections into local networks drop in proportion to the increase in the number of subscribers tied into the network and the geographical density of connections. Consequently, connection costs in large local networks with a high density are lower than those in small local networks with scattered population. The costs of local calls can hardly be related to the size of the local network and the characteristics of the settlement structure. Further, the costs of trunk calls depend on the distance between the parties to a conversation and the traffic density between the two places. They increase in proportion to distance and drop in relation to increased use. The costs of trunk calls between two distant metropolitan areas may actually be lower than those of trunk calls between two rural towns much closer to each other. It follows from both illustrations that the principle of nation-wide uniform charges favors rural peripheral regions at the expense of metropolitan areas.

THE ROLE OF COMPETITION

The obligation of the DBP to provide communications facilities for all to maximize public benefit is contingent upon receiving something in return: protection against providers of similar services. The Postal Administration Law, which defines the relationship between the DBP and its customers, consequently contains a conveyance proviso. It says that the setting up and operating of installations for the conveyance of items containing written messages or other communications from one person to another for a fee is reserved exclusively to the DBP.

Interest in the role of the DBP in telecommunications began to increase when a governmental report attracted public and scholarly attention to technological advances many of which are now being commercially realized. More recently the so-called monopoly commission has issued a report and commissioned three economists with telecommunications expertise to contribute to it (Monopolkommission, 1981). Since new types of telecommunications services have developed, the question is whether services should be offered exclusive-

ly by the DBP, exclusively by private enterprises, or by both. It has been and remains the position of the DBP to make these decisions on a case-by-case basis. It is incumbent upon the DBP to offer particular terminal equipment services, and to do so as a monopolist, or to allow for competition by private suppliers. The DBP is currently the sole provider of public switching and transmission systems. They are designed and also installed by the DBP. The services include maintenance of equipment and regulation of use patterns of the network (*Fernmeldegesetz* 1977, Paragraph 15).

Besides providing terminal equipment services the question of licensing of terminal equipment devices also arises. Licensing plays an important role for the DBP. The criteria for licensing are above all standards of security for the users and the network and compatibility between networks and terminal equipment. The guarantee of permanent maintenance is another important criterion because suppliers who want to make a fast dollar may spoil the market.

FEDERAL STRAINS IN COMMUNICATIONS POLICY

While the classic postal services in Germany are largely undisputed between the Federation and the *Länder*, the emergence of new media has lead to discussion and even to political strains. The new medium of interactive videotext permits the retrieval of information, the transmission of individual messages from one substitute to another, and the use of DBP and external computers simply by use of a telephone and television set at home. The providers of information services are both private and public enterprise, and institutions. The information services relate to economic, educational, and social matters. The new medium offers a wide variety of applications.

Disagreement between the Federal Government and the *Länder* over legislative authority concerning interactive videotext has been a major obstacle to the nation-wide introduction of this communications technique. While the *Länder* have claimed extensive authority to regulate all pertinent questions in this area, the Federal Government has conceded state competence in journalistic matters only. It has invoked its own legal authority to deal with this question referring to the exclusive federal legislative power in postal and communications affairs (*Grundgesetz* 1949, Article 73, Section 7).

In 1983, negotiations led to an informal settlement. The *Länder* concluded an interstate agreement which defined their legislative activities by restricting them to relevant journalistic aspects, i.e., to programs for the public at large. The Federal Government understood this as an implicit abandonment of their original claim. The construction and evaluation of the interstate arrangement was based on the assumption that the *Länder* had left the area of interpersonal communications as well as business related communications to the Federal

Government. This pragmatic way of delimiting and fixing the boundaries of the respective legislative bodies eliminated the uncertainties which had previously prevented the nation-wide introduction of videotext. The settlement by interstate agreement has proved to be a stable and workable solution. At the same time the framework was sufficiently flexible. Thus, the federal system has once more demonstrated its ability to cope with new challenges in the presence of diverging interests and positions.

LOCAL GOVERNMENTS AND TELECOMMUNICATIONS POLICY

Article 28 Section 2 of the Basic Law grants exclusive authority to management and control of local affairs to local governments, i.e., to municipalities and counties. Limitations of this right require appropriate acts through parliament. Self-government of local entities has been considered a "fundamental matter" by the Federal Constitutional Court. It is, thus, only the legislature that is empowered to deal with "local aspects" of communications systems.

Cable networks with a frequency range of about five megahertz which permit the transmission of pictures and sound, commonly referred to as broad band cable networks, are an example of considerable interest to local governments, since the establishment of attractive new industrial areas is largely dependent upon the availability of an advanced electronic communications infrastructure. At present, an interested municipality cannot participate in the planning and development of respective facilities, i.e., it is the DBP alone that decides where, when, and to what extent broad band cable networks will be set up. The DBP derives the authority in this matter from the 1899 Law on Routes for Telegraph Lines. It empowers only public networks to control communications over wire. Although the DBP is required to hear the local authorities in this matter, the act does not provide for an effective right to participation in the decision-making process. Arguably the constitutional guarantee of Article 28 Section 2 overrides the provisions made in this Law. In other words, the act may not sufficiently authorize the extensive restrictions imposed on local governments by decisions of the Federal Post in this matter. The 1899 Law is incomplete. Important questions like local ownership, access of local authorities, and local shares of the construction and maintenance costs are not dealt with. Courts as well as the executive have no guidelines to decide in these matters. The need for a legislative solution is clearly apparent.

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Telecommunications Policy and Regulation in Canada: Sectoral Corporatism in the Context of Divided Jurisdiction

Kenneth Woodside and R. Brian Woodrow

Telecommunications policy and regulation in Canada takes place squarely within the context of divided jurisdiction. To put it succinctly, the federal government - through the CRTC - regulates the two largest private sector telephone companies in the country - Bell Canada operating in Ontario and Quebec and B.C. Tel in British Columbia - with regard to their local and long distance service as well as Telesat Canada with regard to satellite transmission and is also primarily responsible for formulating national and international telecommunications policy in Canada. In each of the seven other provinces, it is the provincial government which establishes policy and, through independent agencies, regulates local and long distance telephone operations and, in the case of the three prairie provinces, actually owns the major telephone company within its boundaries. This irregular pattern of divided jurisdiction between the two levels of government has grown up piecemeal and often for quite idiosyncratic reasons over the past century and is further complicated by an equally unique set of public/private sector relations. For the provision of long distance and certain other services, the major telephone companies across the country have grouped themselves together in Telecom Canada - an unincorporated and until now unregulated organization - while CNCP Telecommunications - itself a public/private sector partnership - provides limited competition with Telecom Canada in private line and certain other services. Richard Schultz has referred most appropriately to this pattern of policy and regulation as a kind of "Rube Goldberg" machine where the parts fit together most haphazardly and seemingly in defiance of any rationality but which, in the final analysis, gets the job done (Schultz 1982:43). Until now, Canada's telecommunications system has, indeed, worked - and worked exceedingly well - but in recent decades this has involved considerable effort on the part of governments and industry

to cope with the problems posed by divided jurisdiction. Given current pressures and present day difficulties, however, it is not clear that such "coping" behavior will prove good enough in the years to come.

What makes the problem of coping with the difficulties of divided jurisdiction in the telecommunications field even more exacting are the twin challenges posed by rapid technological change and increased industry competition. Observers are virtually unanimous in seeing technology as the "big wheel" which drives all the "little wheels" in promoting change within the telecommunications sector and the broader "information business" (Porat 1978:12-14). Advances in switching technology, digitalization and multiplexing, cable distribution systems as at least a partial alternative to the telephone network, satellite versus microwave transmission, fibre optics which greatly enhances carrying capacity, cellular mobile radio, videotex, among other technological developments continue to drive and transform the telecommunications system. Technology, then, has the potential to be "the great deregulator" in its own right, undermining the traditional concepts of regulation and monopoly which have difficulty coping with a dynamic environment. Technological advance makes possible increased competition in the provision of telecommunications goods and services, not only within the traditional telecommunications sector itself but also among a wide range of communications and computer-based companies and threatens to distort and even erode longstanding boundaries between industries and markets (Irwin 1981; Irwin 1984). Increased competition then presents itself alternatively as a strategy, a goal, or as many believe, simply a "fact of life" in advanced industrial nations which, nonetheless, runs headlong into the tradition of regulated monopoly in Canadian telecommunications. Except for its very early years, Canada has had no significant degree of competition within the telephone industry (Janisch 1983). Nevertheless, recent pressures for increased competition coming from actual and prospective entrants, the demands of user groups and especially big business and the "demonstration effect" of deregulation American-style, not to mention the slowly changing attitudes of many Canadian policy-makers and regulators, are gradually swinging the balance in favour of increased competition (Woodrow and Woodside 1986).

This chapter proposes to examine how Canada has been able to cope, although not without increasing difficulty in recent years, with the problem of divided jurisdiction and public/private sector relations in the telecommunications field. The explanation for this relative success to date, we suggest, lies in a form of sectoral corporatism which became prevalent in telecommunications policy-making and regulation and which served to mediate the difficulties of divided jurisdiction. Divided jurisdiction and its associated pattern of public/private sector relations within a federal state have given rise to many

difficult issues but we will focus specifically on only three: the particular problems facing Telecom Canada in terms of revenue-sharing and managerial direction as it faces the prospect of reconciling member interests that are beginning to diverge as well as new interests that may not be adequately represented within the organization; the problem of interconnection among telecommunications companies regulated by different levels of government and varying terminal attachment policies across federal and provincial jurisdictions; and finally, the continuing difficulties which the federal and provincial governments have faced in their unsuccessful attempts over the past decade to agree to constitutional and regulatory reform in the telecommunications field. Treatment of these three issues will allow us to demonstrate how traditional ways of coping with the problems posed by divided jurisdiction and its associated pattern of public/private sector relations are coming under greater pressure as a result of technological change and increased competition. As well, it will allow us to explore possible ways of resolving the serious problems presently facing Canadian telecommunications policy and regulation.

SECTORAL CORPORATION AS THE TRADITIONAL PATTERN OF POLICY AND REGULATION

The industrial structure, policy and regulation of telecommunications in Canada is currently in the throes of rapid change as government and industry are forced to confront and respond to the consequences of transformative technological changes in telecommunications and computers and the new competitive possibilities they have engendered. These developments have resulted in a period of uncertainty as to the direction of change to be anticipated in telecommunications policy and regulation. They also pose a serious threat to the established ways and processes through which the telecommunications carriers themselves have been able to resolve their problems and coordinate the evolution of a widely-admired telephone system. However, before we describe the dimensions of this threat, it is useful to first characterize that traditional pattern of telecommunications policy and regulation in Canada.

We propose to typify it as an instance of sectoral corporatism. Corporatism is a term used to describe "a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, non-competitive, hierarchically ordered and functionally differentiated ... [sectors] ... recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective ... [sectors] ..." (Schmitter 1974:13). Corporatist institutional arrangements are most effective where actor interests are largely congruent and, thus, consensus politics can be more readily practiced. Where serious conflicts of interest emerge, the corporatist struc-

tures may be endangered and rendered ineffective. Corporatist institutional structures can exist on a societal-wide basis or on a more limited sectoral basis (Lehmbruch 1984:61-62). This latter form of corporatism may co-exist with other non-corporatist institutional structures but is more commonly found in countries where collectivist decision-making is part of the historical tradition. Such corporatist structures are found relatively infrequently in pluralist countries like Canada where, in comparison to most of continental Europe, support for state intervention is less popular. Moreover, it is unusual to find corporatist structures operative in the context of fragmented responsibility among governments - as is decidedly the case in the telecommunications sector in Canada - such that many governments must be accommodated in the making of telecommunications policy. Nevertheless, we believe that sectoral corporatism best describes the role played by Telecom Canada and its member companies in the conduct and coordination of telecommunications activities and, in a *de facto* sense, the making of key aspects of telecommunications policy in Canada.

In order to understand Canadian telecommunications policy and regulation, one must begin with, at least, a cursory description of the complicated jurisdictional and regulatory structure that governs industry behavior. As this system has been thoroughly described and documented elsewhere, we will confine ourselves to a few summary observations (Schultz and Alexandroff 1985:63-76; Woodrow and Woodside 1986:98-159). Jurisdiction over telecommunications in Canada is shared by the federal and some provincial governments but the full extent of federal authority in the field remains unsettled (Dalfen and Dunbar 1985; Boon 1985). As things presently stand, the federal government, seven provincial governments and several municipalities exercise regulatory authority over one or more carriers, with the federal CRTC responsible for the largest number of subscribers, about 70 per cent of all telephone lines in Canada. Given the number of governments actively involved in exercising jurisdiction over telecommunications along with their regulatory agencies and the growing number of firms that are interested in participating in the emerging telecommunications markets, it has been and remains a very complex area of policy-making.

Carriers in Canada are wholly regulated by one or another level of government, i.e., all of their business, both interprovincial and intraprovincial, will be under the direction of a single government and there is no "two-tier" regulation as in the United States. The carriers have, until recently, been treated exclusively as natural monopolies and this still remains the case for most of their business. As well, regulatory authorities exercise no authority over equipment suppliers and, thus, over vertical integration where it has existed. Finally, this pattern has been characterized until fairly recently by relatively little direct

government involvement. Rate change requests and regulatory hearings were infrequent until the 1970s and, normally, they occurred in response to infrequent requests by the carriers for the introduction of new services. While the carriers were regulated with respect to their overall performance, the prices of individual services and other decisions such as those relating to quality of service were in practical terms left to the carriers themselves (Schultz and Alexandroff 1985:76-86; Woodrow and Woodside 1986:106-109;).

National telecommunications standards and practices in Canada have been largely the product of managerial decisions by the individual carriers themselves as well as their collaborative venture, originally known as the Trans-Canada Telephone System (TCTS) but recently renamed Telecom Canada. Although the industry is a mix of private, public, foreign-owned and joint public and privately-owned companies, about 75 per cent of the Canadian market is served by shareholder-owned carriers. Founded in 1931 in order to create an all-Canadian long distance transmission system, Telecom Canada is an organization which includes the ten major terrestrial carriers and, since 1977, Telesat Canada as well. Its major function has been to set rates and settle long distance revenues among the member carriers on the basis of its own Revenue Settlement Plan (RSP). Characterized by a decision-making structure that requires a high degree of consensus, it plays a crucial although informal role in the process of making telecommunications policy and regulation in Canada. Since 1931, the federal and provincial governments have implicitly delegated to Telecom Canada and its member companies the responsibility to coordinate the national telecommunications system while Telecom Canada itself remains unregulated either by the federal or provincial governments.

While we believe that the concept of sectoral corporatism captures the overall character of national telecommunications policy-making in Canada, we also acknowledge that there are some gaps in the structure and that at least two important qualifications should be recognized. In the first place, there is the case of CNCP Telecommunications which is a competitor of the telephone companies that has had modest success and is excluded from membership in Telecom Canada. A mixed enterprise jointly owned by both a public and a privately-owned railway company and with a long history of involvement in the telegraph industry as well as a nationwide microwave network since the 1950s, CNCP Telecommunications has been sanctioned in recent years, by the federal government at least, as a real competitor with Telecom Canada in private line and other specialized markets and as a potential competitor in the long distance market. In the second place, the federal Department of Communications and the CRTC have demonstrated, since the late 1960s, a strong desire to engage themselves more actively in planning for the industry, rather than their traditional and more limited policing function, and these initiatives have posed

the spectre of increased conflict between the federal government and Telecom Canada and its member companies (Schultz and Alexandroff 1985:86-99). Despite these qualifications, however, we believe that the predominant pattern of decision-making in telecommunications is properly described as an example of sectoral corporatism.

THE UNCERTAIN ROLE OF TELECOM CANADA

The traditional source of continuity and order in the telephone system has been Telecom Canada. Telecom Canada, itself, has provided what amounts to a system of private sector decision-making for the industry, one whose decisions were largely adopted without change by the individual governments and regulators of each of the member telephone companies (telcos) and whose facilities have served as a central nervous system for the operation of Canadian telecommunications networks. Indeed, Telecom Canada is a good illustration of a sectoral corporatist structure both in the way that it operates internally and in the way that its activities mesh with those of its member companies as well as with the various governments and agencies that regulate those companies (Dalfen and Dunbar 1985:157ff; Boon 1985:74-76; Woodrow and Woodside 1986:147-149).

Telecom Canada is an unusual organization in that it is not legally incorporated, owns no property or buildings and is staffed by employees on loan from its member companies. It is organized around an extensive structure of committees on which each of the member companies is represented by its own management officials. This committee structure is hierarchically - ordered such that all committees report to a Board of Management. The Board is the governing body of Telecom Canada and appoints a full-time president who must work with the Board to coordinate and implement the decisions that have been taken. The decision-making approach is one based on consensus. This collegial approach to decision-making has been possible because the member companies are not competitors, being geographical monopolies, and because they share a number of common interests (Woodrow and Woodside 1986:106-109).

The role of Telecom Canada has been to coordinate and develop rate structures for the industry. Its particular concern has been with long distance usage that involves the facilities of more than one of the member companies. It is Telecom Canada's function to establish rates for these long distance services, which member companies then take to the appropriate regulatory bodies for approval, and then subsequently to allocate the revenues generated among the member companies whose facilities are involved. Since the overall structure of rates used by the telephone companies is riddled with cross-subsidies and since long distance revenues have been the dominant source of cross-subsidiza-

tion for local service usage, Telecom Canada decisions have played a crucial role in the governance of telecommunications in Canada.

Moreover, while the member companies are all regulated by their relevant governments, Telecom Canada itself is not directly regulated. Instead, Telecom Canada decisions are submitted to the various federal or provincial regulators and, in the past, have normally been automatically adopted. In this way, Telecom Canada has served as an important decision-making forum for the industry, coordinating and completing a system that might otherwise be rendered incoherent as a result of divided jurisdiction. Telecom Canada has successfully managed intercorporate and interjurisdictional conflicts where they have arisen and it has been able to do so largely because of the hegemony of an ideological consensus within the telephone industry, based upon the public utility emphasis on the value of service and on universality of access. In retrospect, it would be fair to say that Telecom Canada and its member companies, in conjunction with the various regulatory agencies and government departments, have provided for the governance of telecommunications in Canada; further, within this triad, it is Telecom Canada and its member companies that have been the dominant partners in the determination of long distance and even of local rates.

Recently, however, the structure of decision-making in telecommunications has been coming under considerable pressure. Technological changes and the resultant emergence of potential and real competitors to the telephone companies have raised the possibility of bypass and the need to bring the prices associated with services open to competition more in line with their costs, especially the costs of competitive alternatives. It has been alleged for a long time by the telephone companies that their long distance services provide a substantial cross-subsidy for their local service. Yet it is these very long distance services with their lure of high prices and low costs that are most subject to competitive or bypass pressures. There has been a recently unsuccessful bid by CNCP to offer a competitive discounted long distance service and, subsequently, moves to "rebalance" long distance and local service rates by the telephone companies in order to remove the incentive to bypass (CRTC 1985). Technological and economic factors suggest that long distance rates must and will come down. To the extent that long distance does cross-subsidize local service, the result of lower long distance rates will be higher local service rates. This is at the nub of the growing differences among Telecom Canada member companies. Those companies that give particular weight to the importance of retaining those cross-subsidies (and, thus, low local service rates) now find themselves increasingly at odds with those companies that more eagerly embrace the lowering of long distance rates. More specifically it is the prairie government-owned telcos, in particular the Manitoba Telephone System (MTS)

and Saskatchewan Telecommunications (Sasktel), that have been most concerned about any rebalancing of telephone company tariffs to eliminate such cross-subsidies and the federally-regulated companies, Bell Canada and B.C. Tel, which have been the most supportive. Given the relatively broad contribution toward social and economic development expected of MTS and Sasktel by their respective governments and regulators, any major reduction in long distance revenues would have serious implications for their capacity to pursue those goals.

Thus, Telecom Canada faces growing divisions within its ranks over how the long distance cross-subsidy issue should be resolved. These differences are serving to undermine the consensus that, historically, has characterized the industry. However, the problems for this corporatist structure in telecommunications go beyond these internal problems. The viability and legitimacy of this decision-making structure is also being challenged by the emergence of new interests. Three, in particular, deserve special reference (Woodrow and Woodside 1986:164-169). The first of these emergent interests is that of major business users. Long distance usage for all telephone companies is very highly concentrated among a small number of users and this enhances greatly the appeal to them of lower long distance rates, whether as a result of rebalancing, competition or bypass. Associations such as the Association of Competitive Telecommunications Suppliers (ACTS) and the Canadian Business Telecommunications Alliance (CBTA) have been formed to press governments and regulators to pay more attention to the needs of business users for lower long distance rates and increased competition.

A second emergent interest is that of the average residential consumer who faces the prospect of substantially higher local service costs if the long distance subsidy is phased out. The Consumers Association of Canada (CAC) and unions such as the Communications Workers of Canada (CWC) have all expressed strong concerns about the potential impact of much higher local service costs. The third emergent interest is reflected in the apparent desire, on the part of the federal government, to give serious consideration to opening up the telecommunications industry to more competition. While the CNCP Telecommunications bid to compete with the federally-regulated carriers in the provision of long distance services was denied in 1985, CNCP Telecommunications has acquired in recent years a degree of legitimacy in the telecommunications policy-making process that has the potential to change the existing pattern of policy-making for the industry (CRTC 1985). Moreover, the growth of interest in competition in telecommunications within the federal government has the potential to be a highly disruptive force in intergovernmental relations within the industry.

The result of these developments is to throw into question the capacity of Telecom Canada to continue to play its role in managing conflicts within the telecommunications sector. Not only are the common corporate interests that underlie Telecom Canada's effectiveness now beginning to diverge but new interests, that include aspects of class conflict, are emerging and they may be difficult to encapsulate within the existing structure. This pattern of change, involving an opening up of the policy process to new interests, is already reflected in the increased intervention by governments and their regulators in the process (Schultz and Alexandroff 1985:86-101). While Telecom Canada, as yet, does not openly acknowledge the pressures that it faces, recent experience with such issues as the attempted introduction of long distance competition leaves little doubt that they are present. As a consequence, the capacity of Telecom Canada to sustain an effective role in the governance of telecommunications in Canada is more open to question than in the past.

One possible initiative that might help to reassert and restore a greater degree of harmony within the industry would be to transform Telecom Canada from the corporatist decision-making institution that it presently is and, through a form of "investiture" fundamentally different from the divestiture recently undertaken in the United States, to re-structure it as a national long distance carrier along the lines of ATT Longlines (Woodrow and Woodside 1986:248). It would be federally regulated and the CRTC could impose and interject a form of equalization into payments made by the new long distance carrier for use of the facilities of the existing telephone companies. Ownership of the transformed Telecom Canada could be shared proportionately by the existing members of the organization. If something along this line of reasoning were attempted, it would ease a major source of tension within the existing industry and, with the "investiture" of Telecom Canada, a new industry structure would be formed to coordinate the industry more directly. Such a result might also reduce the need for the governments of Canada to resolve their jurisdictional and regulatory differences but it would also represent something of a retreat from sectoral corporatism.

PROBLEMS OF INTERCONNECTION AND THE CONTINUING FRAGMENTATION OF CANADA'S REGULATORY STRUCTURE

Interconnection, in terms which clearly oversimplify its technical features, refers to the ability of one provider of telecommunications goods and services to connect to and use the network operated by another provider. Typically, interconnection can occur in at least two ways: "system interconnection" where one alternative provider of a service such as private lines or even regular long-distance service seeks to use the public-switched network operated by the tel-

cos to connect with its customers; and, secondly, what is better referred to as "terminal attachment" where telephone customers seek to attach their own equipment to the network rather than use the equipment leased to them by the telco. System interconnection in Canada has traditionally been closely regulated so that the telco which operates as a territorial monopoly either within federal or provincial jurisdiction would not have to face competition from alternate providers. In 1979, however, the CRTC issued an important decision bearing upon system interconnection affecting telcos operating under federal jurisdiction whereby it allowed CNCP Telecommunications to offer competitive private line services subject to payment of an appropriate "contribution" to the telco for the use of its network (CRTC 1979). Terminal attachment has also been strictly regulated over the years in Canada and the general regulations governing the customer's use of his or her telephone served to prohibit the hooking up of any "foreign" product - i.e. non-telco provided product - to the telephone network. In 1980 through an interim decision and as later confirmed and expanded in 1982 and 1984, the CRTC ruled that the telcos operating within federal jurisdiction could no longer prohibit customers from attaching such "foreign" equipment to their telephone lines so long as all such equipment was certified as meeting Canadian standards and subject to customer liability for any damage which might be done to telco facilities (CRTC 1980, 1982, 1984). What the CRTC has allowed to occur in those three provinces which are under federal jurisdiction - Ontario, Quebec and British Columbia - has not necessarily been approved in the other seven provinces with their own provincial regulatory authorities and this has led to a patchwork of regulations and practices. This poses considerable difficulty for companies like CNCP Telecommunications which would like to provide services - and not just private line services but also eventually alternative long-distance services - in areas of provincial as well as in areas of federal jurisdiction.

With regard to "system interconnection" specifically, CNCP Telecommunications claims that it has become caught up in a "regulatory crisis" which makes it exceedingly difficult to operate beyond areas of federal jurisdiction (CNCP Telecommunications 1982:1). While it has been granted competitive access to the private line market in the three federally-regulated provinces, it claims to face practices on the part of Bell Canada or B.C. Tel which continue to unfairly limit its ability to compete. For example, the company points to the case of its Econovoice service which was introduced in 1982 and offered private line voice service at a discounted rate in Ontario, Quebec and British Columbia and to which Telecom Canada responded by cutting prices to a similar level - but only in those three provinces and not elsewhere in the country (CNCP Telecommunications 1982:8). More importantly, however, many of the provincial governments and regulatory authorities in the other seven provinces

- and particularly in the three prairie provinces where the telco is publicly-owned - have been resistant to, if not dead set against, granting CNCP Telecommunications the right to interconnect with the systems of their provincial telcos. System interconnection has also come to the fore with CNCP Telecommunications' recent proposal to provide long distance service in competition with Telecom Canada and the CRTC's 1985 decision rejecting that proposal was a major and seemingly unexpected set-back for the company.

The situation with regard to terminal attachment in Canada also reflects the basic fragmentation in Canadian telecommunications policy and regulation. Within areas of federal jurisdiction, the CRTC has dramatically liberalized terminal attachment rules since the early 1980s so that the customer is essentially free to buy his own equipment and attach it to the public-switched network without penalty or restriction. This has led to the creation of a new and very competitive "interconnect market" where the telcos and their subsidiaries must compete with a variety of other equipment and service suppliers. In the seven provincially-regulated jurisdictions, however, the rules for terminal attachment vary considerably. In some provinces like Prince Edward Island, liberalized terminal attachment has been recognized by the courts and, more reluctantly, by the telco and regulatory authorities as a "fact of life" (Schultz 1984:48-50). In other provinces, however, government and the regulatory authorities have been much more hesitant to recognize competition in the interconnect market and Saskatchewan even went so far, in 1980, as to prohibit the advertising - let alone the attachment - of customer-owned terminal equipment within the province, although this was later changed (Schultz 1984:53). Thus, terminal attachment procedures vary considerably from areas under federal and provincial jurisdiction and even among the relevant provinces themselves and demonstrate the fundamental fact of divided jurisdiction.

The interconnection issue has been raised not only before regulatory agencies but also before the courts. All along, CNCP Telecommunications has argued strenuously that the "national dimension" in Canadian telecommunications needs to be strengthened and that the CRTC should use the full scope of federal jurisdiction - which it argues remains untapped - to mandate system interconnection across the country (CNCP Telecommunications 1982:2). When it looked as if the company would be denied the right of interconnection with the Alberta Government Telephones network, CNCP Telecommunications sought a writ of mandamus whereby the CRTC would order the Alberta regulatory authority to grant interconnection under the federal government's latent responsibility for interprovincial telecommunications. When the Federal Court of Canada rendered its decision in 1985, it refused to grant such a writ - not because of any absence of federal jurisdiction but simply on grounds of "crown immunity" because of AGT's ownership by the provin-

cial government (Federal Court of Canada, Trial Division 1984). This case, which CNCP appealed on the "crown immunity" argument and which subsequently went in their favour, is crucial to future developments in that it seems to confirm the federal government's authority over the "national dimension" in Canadian telecommunications and opens up the possibility that the traditional fragmentation spawned by divided jurisdiction might in future be overcome (Federal Court of Canada, Appeals Division 1985).

The "Rube Goldberg" analogy then seems very much confirmed by the fragmented pattern of policy and practice with regard to system interconnection and terminal attachment. In effect, Canada has eight different governments and regulatory authorities setting policy practices, but somehow phone calls still seem to get made quite efficiently and more than enough different options for equipment and services seem to be available to telephone customers. However, others have suggested, there is a danger in becoming too fascinated merely by the "structural inelegance" of Canada's unique pattern of telecommunications policy and regulation and failing to appreciate the very serious and continuing implications which divided jurisdiction has for public policy (Schmidt and Corbin 1983:222). Governments at both levels - and especially the federal government - have become more actively involved in telecommunications policy-making in recent years, taking on more of a planning responsibility rather than just its traditional policy function, and these efforts are frequently hindered by the division of jurisdiction (Schultz and Alexandroff 1985:63-101). As well, broad intellectual movements such as deregulation and the introduction of increased competition are more likely to meet resistance from particular jurisdictions unwilling, for their own reasons, to follow the trend. Divided jurisdiction is a primary concern for private sector corporate structures which must adapt to and operate within this patchwork of policy and regulation. Finally, it means that many of the broader social questions related to telecommunications, such as universal service and cross-subsidization of local by long-distance cannot be confronted squarely as economic and social issues but take on a distinctly territorial dimension.

FEDERAL-PROVINCIAL RELATIONS AND CONTINUING ATTEMPTS AT JURISDICTIONAL AND REGULATORY REFORM

Federal-provincial relations in the telecommunications field has been marked over the past decade or more by a series of engagements between the federal and provincial governments - several highly conflictual but some of a more peaceful nature - but all of which have resulted in stalemate on matters of jurisdictional and regulatory reform. Attempts at constitutional change in the communications field date back to the early 1970s, when the federal government

first sought to establish the "national dimension" of Canadian telecommunications by proposing a series of measures including "a single federal regulatory agency" which became the CRTC, consultative mechanisms to allow all provincial governments greater input into federal decision-making, and specific arrangements to allow Ontario, Quebec and British Columbia to participate in CRTC proceedings, the purpose of which was designed to bring about a "harmonization" of federal and provincial roles and responsibilities in the field. The provincial response to this federal initiative took the form of a common front position which argued instead for "a realignment of roles and responsibilities" which would, at the request of the particular provincial governments concerned, give them regulatory control over all "carriers having their facilities within the boundaries of a province," except for CNCP Telecommunications, Telesat Canada and Telelobe where federal jurisdiction was tacitly acknowledged, as well as jurisdiction over all aspects of cable distribution systems with the exception of federal broadcasting services. By the latter part of 1975, the issue of jurisdictional reform had bogged down, with both levels of government holding firm to their opposing positions, and in subsequent years attention shifted primarily to the matter of cable delegation where progress seemed, at the time, to be possible (Woodrow, Woodside, Wiseman and Black 1980:3- 28).

By 1978 and 1979, however, there was heightened interest in telecommunications policy and regulation as a result of the CRTC's landmark decision on system interconnection, the federal government's ill-fated attempts to pass comprehensive national telecommunications legislation, the spadework being undertaken by a federal-provincial task force established to examine competition and industry structure, and the Clyne Commissions's attention to the implications for Canadian sovereignty. Most importantly, however, communications emerged as one of a series of matters considered during the constitutional reform exercise which began in 1980 (Schultz 1982:66-72). The position taken by the federal government at that time was territorial in nature, asserting that there was a "national dimension to telecommunications as well as a local one" and that "what goes on within a province should be provincial and what is interprovincial or international should be federal". Specifically, exclusive federal jurisdiction would include national telecommunications and satellite carriers (CNCP Telecommunications, Telesat and Telelobe), inter-provincial and international rates and services, and technical standards and interconnection of systems while exclusive provincial jurisdiction would extend to the intra-provincial operations of all telecommunications carriers (including Bell Canada, B.C. Tel and certain smaller carriers) as well as local cable systems except for "national program" service and non-Canadian service. The provincial governments' position was more varied but equally inflexible and their "best efforts draft" continued to assert exclusive jurisdiction over all

telecommunications works situated within a province as well as over cable distribution systems (except for broadcast networks), while acknowledging only concurrent jurisdiction with the federal government over interprovincial carriers with provincial paramountcy and over the space segment of communications satellites with federal paramountcy. As is well known, the constitutional reform episode in the communications field came to no conclusion during the early 1980s and, more recently, interest has shifted to possible extra-constitutional change.

Progress has also been slow in the consideration of extra-constitutional changes that would allow for the development of common principles in the handling of issues evolving from the emergence of competition in telecommunications. In March 1978, a Federal-Provincial Working Group on Competition/Industry Structure was established to consider how competitive telecommunications services could best be provided in a manner consistent with the public interest. Although no concrete political decisions were taken when it first reported in October, 1979, the Working Group was authorized to continue its efforts and did help to establish some common ground among communications ministers and officials on such issues as the impact of competition on universality, the potential for cross-subsidization of competitive services by monopoly services, what boundaries to establish between competitive and monopoly services, and the consequences of decisions taken in one jurisdiction on policy being developed in another jurisdiction (Federal-Provincial Working Group on Competition and Industry Structure 1979 and 1981). At the same time, a second Working Group on Joint Regulatory Mechanisms was also established and reported back in May 1982 after the collapse of constitutional negotiations over communications. This Working Group proposed a number of alternative approaches to rationalizing the regulatory process, in particular proposing that some statutory basis be given to an actual inter-jurisdictional regulatory board and/or that some degree of coordination might be achieved through the use of committees of regulatory staff from across the country (Federal-Provincial Working Group on Joint Regulatory Mechanisms 1982). Yet another initiative came from the CRTC itself which finally gained acceptance as a member of the Canadian Association of Members of Public Utility Tribunals (CAMPUT) in 1984, the purpose of its membership being to promote greater inter-regulatory cooperation (Kane 1984).

The most recent Federal-Provincial Conference of Ministers of Communications held in February of 1986 - after a four year hiatus - is interesting as much for what was not discussed as for what was discussed. What was not discussed in any serious way was jurisdictional reform where the positions of the two levels of government remain well apart and where both the federal and provincial governments seem willing for the moment to put this issue on the back-

burner. What was discussed most prominently were the substantive issues associated with rapid technological change and increased competition in the Canadian telecommunications sector. In essence, the federal government wants provincial government acquiescence in moving towards long distance competition and the associated implications for local service pricing and universal access. Not surprisingly, provinces like Ontario, Quebec and British Columbia - where the provincial government doesn't regulate the major telephone rates within the province and therefore does not have to take the criticism for any disruptions - were generally supportive of the federal government's position. Some of the other provincial governments, like New Brunswick, were considerably more cautious about the implications of such a move while still others like Manitoba and Saskatchewan were much more concerned about maintaining low local service rates. Finally, the meeting itself was infused with a renewed emphasis on "consultation" and "collaboration" which may prove conducive to real change on the federal-provincial front (Federal-Provincial-Territorial Conference of Ministers Responsible for Communications 1986). Even more recent indications are that governments at the two levels are indeed moving towards consensus and the prospects look good for federal-provincial agreements on "roles and responsibilities" and on "interconnection" in the near future.

Thus, federal-provincial relations in the telecommunications field over the past decade or so has been very much involved with "coping" behavior. Attempts at jurisdictional reform, as these developed during the late 1970s and early 1980s, focussed on efforts to establish and then entrench a revised division of powers between the federal and provincial governments in the overall communications field. In the absence of explicit constitutional change, the focus then shifted to the exploration of extra-constitutional reforms such as possible joint federal-provincial regulatory arrangements and to litigation - most evident in the CNCP/AGT case discussed earlier. It is of interest, in particular, that major industry players like CNCP Telecommunications have taken it upon themselves to become involved to a greater extent in the process of moving towards jurisdictional and regulatory reform. As well, the federal and provincial governments have decided to get back together again but this time with an emphasis on substantive and procedural telecommunications problems rather than jurisdictional wrangles, although it is too early to see how successful these attempts will prove to be. Clearly, the "territorial imperative" remains strong at both the federal and provincial levels in that both the federal and provincial governments continue to seek their own "exclusive rights over telecommunications" and to see the division of powers in this area in terms of "sovereign parcels of territory" rather than a "sharing of functions" (Schultz 1982). In this circumstance, neither level of government has, in the past, had much incentive

to accept compromise solutions short of meeting their minimum objectives and continued stalemate has been the result. Nevertheless, better relations between the federal and provincial governments at the political and bureaucratic level, combined with the impetus provided by the recent court decisions, may create the conditions within which that stalemate can be broken (Woodrow and Woodside 1986:232-249).

CONCLUDING COMMENTS

In this paper, we have focussed on the problem of divided jurisdiction and its impact on policy-making and regulation in Canadian telecommunications. We have described the complex pattern of divided jurisdiction, public-private sector relations, and regulatory control that has characterized Canadian telecommunications policy and regulation over the years. Our analysis makes three broad points. First, Canadian telecommunications policy and regulation has been characterized by sectoral corporatism in that the industry itself has created, in Telecom Canada, an organization that participated in and coordinated the making of national and provincial telecommunications policy. Telecom Canada fits the mold of a sectoral corporatist structure both with respect to its internal organization and operation and in terms of its role in the governance of the telecommunications industry. While Canada is, for the most part, a polity characterized by pluralistic structures in policy-making, this has not been the case in telecommunications policy. This corporatist institutional arrangement has been workable because the telcos themselves shared a common outlook on the industry, its problems and its prospects and governments at both the federal and provincial levels have shown themselves willing to defer to its managerial capabilities.

Second, the basic pattern of sectoral corporatism in Canadian telecommunications has been persistent but incomplete in several regards. In particular, CNCP Telecommunications has been effectively excluded from the industry/government consensus and, in recent years, has taken aggressive action through the courts in pressing for stronger national policy and regulation and before regulatory authorities for the right to compete directly with Telecom Canada in areas like long-distance telephone service. As well, recent years have seen a new vitality in federal-provincial relations in the telecommunications field and governments at both levels show signs of breaking the impasse over jurisdictional reform. Both of these developments reflect a certain incompleteness and increasing strain in the prevailing pattern of sectoral corporatism.

Third, we have argued that the community of interest that was shared by the member telephone companies of Telecom Canada is under pressure and may be breaking down. Technological change and increased competition are creating

new opportunities and dangers for the industry and its users and the issues associated with telecommunications policy can no longer be so easily contained and resolved within the traditional policy-making structures. Not only are the interests of the telephone companies diverging but new interests, especially those of business users, now claim fuller recognition and satisfaction. The result of these emergent changes is to undermine the continued viability of Telecom Canada and it is unclear what future one can expect for this corporatist institution.

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Provincial-Municipal Relations in the Federal Republic of Germany

Herbert Uppendahl

Close observers of the Canadian constitutional landscape were not taken by surprise when they realized that the 1982 Charter of Rights and Freedoms failed to recognize Canadian municipalities as a third order of government. There had hardly been any indication of the willingness of provincial leaders to raise the constitutional rank of local authorities during the series of talks that had paved the way for the new charter. Municipal leaders, however, felt that a great opportunity to change their subordinate position had been missed (Magnusson 1985: 582). They then thought—and they still tend to think—that Canadian municipalities should not only be granted law-making powers in defined areas, but also fiscal autonomy, i.e., "access to the financial resources appropriate to the carrying out of their governmental responsibilities", thus asking for the right to levy local taxes and claiming a due share of the provincial income tax. In addition, they take the line that municipalities should be entitled to "determine their own charters" (Federation of Canadian Municipalities 1980: 126). The main pieces of argument in favour of these claims are, of course, that although the traditional, legal view does not concede to municipalities any powers of their own but rather confines them to their role as "creatures of the provinces" (Canadian Comprehensive Auditing Foundation 1984: 18; Bird and Slack 1984: 5), Canadian municipalities are involved to at least some extent in a variety of important expenditure responsibilities "such as education, transportation, planning, protection of persons and property, health and social assistance, housing, industry and tourism, and recreation and culture" (Bird and Slack, 1984: 7). Therefore, it is, indeed, hard to see why they should not be granted the constitutional rank they are claiming. This, however, is but my private view, tinged with and, therefore, reflecting German experience. The principle of local autonomy can be traced back not only to the German cities of the middle ages, but also to the very hearts of the Weimar constitution and the West German

Basic Law, which authorizes local authorities "to handle all matters of the local community on their own responsibility" (Nassmacher and Nassmacher 1979; Rudzio 1983: 315-35; Nassmacher and Norton 1984: 107ff; Roters 1984: 379 ff).

Let me at this stage make it quite clear that I am not going to argue in favour of a mere application of this German-style solution to the Canadian constitutional landscape. I am well aware that any such solution once lifted out of context—even though it might appear to be particularly applicable and/or politically desirable—may not produce results analogous to those in my country (Muniak 1985: 2). Moreover, one should keep in mind that even constitutional provisions designed to protect and promote local autonomy may prove to be unsatisfactory for achieving this goal, and there are always ways to override constitutional principles for those who do not care about them. A close look at the history of local government in West Germany easily reveals that there has always been a considerable amount of complaint as to the "crisis of local autonomy" and the somewhat "silent" abolition of this principle since the promulgation of the Basic Law.

On the other hand, however, being pledged to comparative research, I feel that countries should, and in actual fact, could learn from each other, provided they are really willing to avoid mistakes already committed by others, and provided that their political and administrative systems do not totally lack similarity. Looking at Canada and West Germany I believe that there is sufficient proof of their being similar to each other. Both countries fall under the heading of "developed democracies" (Rowat 1985: 189), and share the following characteristics: a high standard of living, a federal system of government with a fairly stable multi-party system, an extensive range of public services, and last but not least a highly developed and skilled bureaucracy to provide these services.

Presently both nations are also facing similar challenges such as high unemployment rates, ever growing demands for the provision of social and welfare services and severe budgetary restraints. It is precisely at the local level where these problems are most intensely and severely felt. Responsiveness of local leaders to the needs, wishes, and demands of their voters has become the essence of local democracy in both countries (Uppendahl 1981: 123-4). Politicians and administrators seem to find it increasingly difficult to be responsive under conditions of severe economic and budgetary restraints (Eissel 1983: 222ff). Local authorities in both countries will have to tackle the problems referred to above, and that is why they might, indeed, be prepared to learn from each other. Let me, therefore, try to outline the state of affairs in West Germany. For this purpose it is necessary to briefly present the federal framework of local government, to assess its constitutional position in the light of recent federal

courts' decisions, and to depict the present state of provincial-municipal relations.

There are important incongruencies between the North American and the West German concepts of federalism (Chandler 1986: 5-20). Whereas both regard a constitutional division of powers between the levels of government as essential, with autonomous rights of decision in certain areas on each level, and with each of the political authorities of the federation possessing the quality and apparatus of state within its sphere of jurisdiction, the West German concept is somewhat unique in that the Basic Law allocates to the provinces not only legislative but also executive responsibilities in most areas, including many in which legislative power rests exclusively with the federal Parliament. According to Article 30 of the Basic Law, "The exercise of state powers and the discharge of state functions rests with the provinces insofar as the Basic Law does not proscribe or permit other arrangements" (my translation).

Except for a limited number of fields specifically referred to in the Basic Law, such as defence, customs, post, railways, etc., the federal government has no administrative structure of its own below the departmental level (Uppendahl 1984: 22). This contrasts sharply with Canadian and the U.S. experience. According to Articles 83 seq. of the Basic Law the provinces are entitled to administer federal laws either as their own affairs—which leaves to them certain discretionary powers as to the most appropriate way to handle them—or as agents of the federal government. In both cases, however, the provinces usually delegate executive functions to their respective local authorities which are also required to implement provincial laws and regulations. A horizontal division of powers with the federal government and Parliament being primarily absorbed with the bulk of legislative work either exclusively or concurrently with the provinces, and the latter being responsible for the discharge of functions assigned to them under federal laws therefore, may be called the "secret" of the West German system of federal government (Uppendahl 1984: 22).

In terms of autonomy, however, it is not the provincial but rather the local level which suffers most from the constitutional arrangements described above. Municipalities are expected not only to handle their own affairs under Article

28 of the Basic Law but also to administer all the functions delegated to them by both the federal and the provincial level.¹ It is precisely because of this fusion of functions that citizens often tend to hold local authorities responsible for decisions taken and mistakes committed by superior levels of government, thus reducing the role of local government to that of a scapegoat. For those who still believe in the fundamental principles of accountability and responsibility, this must, indeed, seem rather odd.

Let me now turn to a close examination of what I have already referred to as the constitutional basis of the West German system of local self-government, i.e., to the principle of local government as laid down in the provisions of Article 28.2 of the Basic Law: Local authorities are (to be) given the right to handle all matters of the local community on their own responsibility within the framework of the general law (my translation).

It should be noted here that the majority of provincial constitutions as well as municipality orders echo this provision.² What, exactly, are "matters of the local community"? This phrase does not lead us any further towards a proper understanding of the concept in question. In a series of decisions, the Federal Constitutional Court and the Federal Administrative Court have, therefore, developed and put forward the "core domain doctrine" according to which article 28.2 guarantees to all local authorities a set of self-governing functions which must be neither taken away nor even touched by any (federal or provincial) law. The core domain doctrine assigns to local authorities the following rights:

- to handle their local affairs on their own
- to determine and to set up their internal administrative structures
- to determine their rules of procedure
- to employ their own personnel
- to handle their financial affairs.

1 The legal term for "delegated functions" varies slightly in West German provinces. See Jergen Makswit, *Finanzierung weisungsgebundener Aufgaben auf der Kommunalebene*, in: *DVB1* 1984, p. 1044, footnote 5. It should be noted here that the federal government is only entitled to delegate functions to the local level if there is sufficient proof that this is absolutely necessary for the unified implementation of a law.

2 See, for instance, Article 71 of the Baden-Wuerttemberg Constitution, Article 83 of the Bavarian Constitution, and Article 39 of the Schleswig-Holstein Constitution.

Yet it was only recently that a turning point in the history of local self-government was marked by the 1983 "Rastede" decision of the Federal Administrative Court. With this decision the court put an end to the traditional view of municipalities as primeval elements of a natural order, or, as Hegel put it, as elements of civil society.³ Consequently, local authorities must no longer be regarded as units entitled to enjoy rights and freedoms independent from the state, but must be seen and assessed as parts of the administrative structure of the modern state, notwithstanding their self-governing rights and functions (Hassel 1984: 145ff). The court once again stressed the core domain doctrine. Simultaneously, it ruled that this doctrine may only be applied to municipalities, thus putting an end to the growing suspicions that the principle of local autonomy might gradually be eroded and undermined by simply shifting the responsibility for the performance of certain functions up to the county (*Kreis*) level, and from there even further up to the province.

To understand the underlying rationale of this decision, it is necessary to realize that the term "local authorities" covers two tiers of local government, municipalities and counties. In addition, the term also applies to county boroughs which may be described as single tier authorities responsible for the delivery of all functions within their respective areas of jurisdiction. Municipalities, counties, and county boroughs are governed by democratically elected councils. Municipalities are generally responsible for functions such as:

- general administration such as personnel matters, statistics, election offices
- financial administration
- the administration of law, orders and public safety
- the administration of cultural affairs
- social and public health administration and
- the administration of building matters, economic affairs and public transit.

3 This view was put forward by the OVG Lueneburg in its decision on the Rastede case. For a brief discussion of this view see Georg-Christoph von Unruh, "Gemeinsamkeit und Unterschiede der verfassungsrechtlichen Stellung von kommunalen Selbstverwaltungstraegern," in: DVB1., 1980, pp. 903 seq. Hegel made no distinction between municipal and other corporations of civil society. See T.M. Knox (transl.), *Hegel's Philosophy of Right* (Oxford 1952) pp. 152-155, see also Warren Magnusson, "Bourgeois Theories of Local Government," *Political Studies*, XXXIV, 1986, p. 4.

The main duties of counties include:

- duties which by their very nature cannot be performed by just one municipality, for example, the construction of major roads and the disposal of waste
- supplementary functions such as the maintenance of hospitals which small municipalities cannot possibly afford
- equalizing duties within their boundaries and
- the supervision of the municipalities in their areas of jurisdiction.

It should be noted here, however, that the functions and duties of local authorities vary within the different provinces of the Federal Republic.

As has already been shown above, West German local authorities are also responsible for the discharge of a variety of functions under federal and provincial laws. Due to the lack of federal administrative units the Federal Republic has witnessed the development of a system of "vertical departmental companionship" of governmental tiers, often described as "executive federalism" (Kevenhoerster 1977; Atkinson and Coleman 1985). Furthermore, the ratio between self governing and delegated functions of local authorities has become increasingly menacing to the principle of local autonomy, with approximately three-quarters of the total workload of local authorities devoted to the performance of delegated functions (Hassel 1984: 185). There is also sufficient evidence that the reimbursements they receive in return for their discharging delegated functions is definitely inadequate.⁴ Cities like Kiel and Luebeck already had to cope with budgetary deficits up to DM 16 million and DM 20 million, respectively, in 1984. Admittedly, these figures cannot be exclusively interpreted in terms of delegated functions. There are other factors to be taken into consideration, such as tax base erosion, inflation, bureaucratic growth etc., but there is no denying the fact that local authorities will be forced to cut down their self-governing functions unless there is a significant readjustment of their main sources of income in the immediate future. Thus, it is only logical that they are claiming a higher share of the federal income tax and a higher share of the local business tax. There are also demands for the introduction of a *taxe professionnelle* after the French model (Eissel 1983: 225ff). However, there is little hope that these claims will be heard and fulfilled within the immediate

4 There are contradictory expert opinions on this problem some of which hold that unbalanced budgets of local authorities are due to inadequate spending habits on the side of local government.

future, for the federal and the provincial governments can and will argue that they need every penny to fulfill the constitutional demand for the "equalization of the conditions of life" throughout the Federal Republic.⁵

Let me now outline the history of intergovernmental relations in West Germany. The Basic Law, as enacted in 1949, provided a clear cut vertical division of powers between the federal and the provincial levels of government with policy-making responsibilities distributed to them by policy areas. Consequently, Article 106 of the Basic Law (in its original version) provided an equally clear cut division of taxes between both levels. The provinces were free to decide the amount of money they wanted to give to their respective local authorities.

In practice, however, this system was given up in the early fifties, and by 1956 it was replaced by a "joint system of federal-provincial taxation" (Rudzio 1983: 306). Local authorities were given the right to collect the income from local property taxes as well as from local business taxes, which helped them to strengthen their somewhat ailing financial autonomy. The following decade was marked by the establishment of a series of joint federal-provincial bodies, a process which significantly contributed to the gradual erosion of the division of powers (Rudzio 1983: 310). It was not until the late sixties that the constitutional principle of federalism itself came under fire when the then powerful editor of the weekly, *Die Zeit*, denounced it as "the holy cow of the state, unable to give milk, but always prepared to block up progress." The late sixties were, in fact, the heyday of anti-federalist feelings in the Federal Republic. Thus, section 18 of the 1967 Promotion of the Economic Growth and Stability Act required the establishment of an economic advisory council made up of federal, provincial, and local representatives, and the 1969 Federal-Provincial Budgeting Act called for the setting up of a finance planning council on a similar basis of representation. The Act also required the introduction of a unified system of federal, provincial, and local budgeting, thus streamlining the budgetary process of all levels of government for the sake of economic growth and stability. The road towards a "unitary federalist state" reached its peak when the federal government in agreement with the provincial governments decided to totally reconstruct the financial constitution. Under Article 91a, then inserted into the Basic Law, the federal and provincial governments are allowed to share policy formulation responsibilities with respect to:

- the setting up of new universities, including medical departments

5 This somewhat isocratic-egalitarian principle is contained in Article 106 of the Basic Law.

- the promotion of regional economic development
- the promotion of the agricultural structure and coast protection.

At the same time, Article 104a, IV was inserted into the Basic Law which provided that federal grants could be given to provincial and local authorities to tackle problems they had not yet been able to deal with. Subsequent legislation eventually opened the way for these grants to be applied to, for example, urban renewal program, new transportation schemes, hospital construction, and housing program (Reissert 1980: 161ff). Finally, a revision of Article 106.5 of the Basic Law provided a totally new basis for local government finance. Since then municipalities have to transfer 40 per cent of their income from the local business tax in exchange for a 14 per cent share of the federal income tax.

It should be noted, however, that taxes have never made up more than one-third of the annual local revenue, and this share even decreased during the seventies. It follows, logically, that German local authorities rely heavily on other financial resources such as fees, fines, contributions, borrowing, and intergovernmental grants from either the federal and/or the provincial government, both of which are to be administered by the province. Intergovernmental grants fall into one of the following categories: general grants with no specific obligation for the recipient(s) and specific grants administered through a number of specific grant program.⁶ It is primarily by means of specific grants that the federal and the provincial governments tend to exercise what has come to be known as a "dictatorship by the provision of supplies", although it must be said at this stage that there is some evidence which suggests that this instrument is gradually running out of favour due to budgetary and fiscal strains on both the federal and the provincial level. Majority academic opinion, however, was and still is that the 1969 reform laid the foundation for the erosion of local autonomy. The introduction of the specific grant system definitely increased the amount of state control over local government resources, a state of affairs which has adequately been described as "ruling by golden reins" (Rudzio 1983:332).

This view was also partly reflected in the 1977 Report of the Parliamentary Inquiry Commission on Constitutional Reform (*Beratungen und Empfehlungen zur Verfassungsreform. Schlussbericht der Enquete-Kommission Verfassungsreform des Deutschen Bundestages 1977*). The Commission maintained that there was a strong tendency on the part of the provinces and the federal government to control local authorities by means of grants on the one hand, and by integrating them into a unified system of planning on the other. The main

6 Special grants account for more than half the total of general and special grants.

forces responsible for this development are the rising public demands for an advanced level of infrastructural facilities to be provided by local authorities, and the constitutional demand for an equalization of the conditions of life.

Let me now briefly comment on the main events which marked the subsequent era of intergovernmental relations. This period may be characterized by its belief in the ideal of "the bigger, the better", and witnessed a series of massive local government reorganizations in the West German provinces with each province following its own path. Local authorities, it was argued, were simply too small in terms of area, population, and resources to cope with the increasingly difficult task of providing adequate services within their respective boundaries. This, in turn, was thought to be absolutely unbearable because of the constitutional demand for an equalization of the conditions of life. In order to illustrate the scope and the extent of the reorganization processes which took place in this period some statistical information is useful. The total number of regional authorities, i.e., administrative subunits appointed and administered by the provinces (with the exception of the city states) was reduced from 33 to 25, the number of counties from 425 to 235, the number of county boroughs from 139 to 92, and the number of municipalities from 24,278 to 8,504 (Rowat 1980; Thieme and Prillwitz 1981).

Critics have pointed out that the reorganization was a serious blow to the principle of local democracy in that it reduced the number of seats available on local councils from 237,304 to 145,646. It may be noted here, however, that participating in local politics in pre-reorganization times was often rather trivial because of the irrelevance of the majority of issues then at stake (Rudzio 1983: 332). This argument, of course, implies that the new authorities created by the provincial acts were given more functions and duties than their predecessors, which was, in fact, the case, for the reorganization of local government areas was followed by a reallocation of functions. The amount of data available on the reallocation of functions is, however, rather poor. Also we have to rely almost exclusively on data provided by the provinces. Thus, for instance, North-Rhine Westfalia claims to have devolved a total of 83 functions to the local level (Der Innenminister des Landes Nordrhein-Westfalen 1980). Figures like these do not give us any real clue as to whether or not the functions devolved from one level to another were really important. Experts believe that there was, indeed, a considerable shift of important functions to the local level. Net winners of the reorganization, at least in terms of power, were the densely populated metropolitan areas and their chief executives and/or mayors, respectively, some of whom have even managed to gain nationwide popularity since (Hesse 1983: 19).

There is no denying the fact, that, after all, public opinion has swung from supporting "bigger is better" idea to advocating "small is beautiful" ever since

the late seventies. That is why a great number of metropolitan authorities have already set up district councils in their respective areas (Schaefer 1982) while below the provincial level there is a growing concern for regional identity. These tendencies suggest that the road we are presently travelling leads us to decentralization rather than to centralization. This view is further supported by the fact that politicians and administrators favour decentralization as a means of fighting problems of governmental overload, while economists advocate decentralization and reprivatization in order to overcome fiscal and budgetary strains. Last but not least, citizen movements have encouraged a devolution of powers to the local level. There is no doubt that we are presently witnessing the emergence of a number of self-help groups and small social networks as well as a revitalization of the idea of neighbourhood government. Decentralization, then, has finally become a synonym for all that is to be wished for in these dark ages of the post-1984 era.

From the history of intergovernmental relations in West Germany, there are different patterns of interpretation available to explain what has happened and, maybe even of what is likely to happen:

- the centralist pattern of interpretation
- the decentralist pattern of interpretation
- the joint policies approach.

The centralist pattern of interpretation is often used to analyze the transition from a traditional to a modern society, or to shed light on the growth of government in modern society (Beer 1973: 53). Protagonists of this view hold that there is basically no efficient remedy against what they call the irresistible rise of centralized power (Goldsmith and Newton 1983). Ideas like these may be traced back to the writings of de Tocqueville, Wagner, or Popitz. There are also modern scholars of wide reputation who follow similar lines of thought (Galbraith 1967). State governments, it is often assumed, feel that it is their duty to promote public welfare. To achieve this goal they often apply unified designs of economic and fiscal policies. This tendency is further strengthened by the democratic call for equal conditions of life particularly in Western democracies. Times of economic recession also tend to strengthen the position of central and state governments in their attempts to take unto themselves preemptory powers in all relevant fields of public policy. Even if they don't entertain ideas of preemption they are, at least, always determined to override

local government powers and initiatives (Andrews and Pierson 1985: 90-99) thus leaving to this level functions that are often residual, i.e., designed only to keep the pressure off the federal and provincial levels.⁷

The centralist pattern of interpretation may be a helpful device to explain what happened during the three decades that followed the promulgation of the Basic Law. There is, in theory as well as in practice, an end to the irresistible power of centralization, when it is confronted by absolutely incompatible societal demands. In this case, the only solution possible is devolution or decentralization. Here, it becomes obvious, that centralization and decentralization may be treated as interdependent forces.

The future, of course, may well be reserved for the adherents of the decentralist interpretation as has already been shown above. Let us not forget, however, that the decentralist approach may turn out to be a poor device for the creation of the consensus that is not only desirable but also necessary for the survival of any social unit including the local level where we always find more people who dissent from any plan or solution than who agree with it. Also, following the argument of Hesse and Fuerst, it is particularly the local level which is highly affected by the conflicting forces of "production-oriented interests" on the one hand and "reproduction oriented interests" on the other (Hesse 1983: 36ff). Last but not least the question may be put as to whether the protagonists of decentralization are really heading for a full decentralization of decision-making powers, of the fiscal system and of all services provided by any level of government. I must confess my doubts as to the capability of the new social movements to overthrow the boundaries of institutional politics,⁸ and to set up entirely new and decentralized systems of government. Therefore, the pattern most appropriate to explain what has happened, and what is likely to happen, is the joint policy approach (Scharpf et al. 1976).

There is hardly any doubt that there has been a definite trend within the Federal Republic to fit local authorities, provincial authorities and federal departments into a streamlined system of planning, programing and budgeting. The underlying rationale of this process is that there is always a high amount of incongruency between those affected by a particular problem and the authority officially in charge of it. Thus, for instance, river and air pollution do

7 Andrews and Pierson (1985) suggest that there are four different approaches to the role of state governments which they call "state preemption, state override, local veto, and state procedural restraints".

8 Claus Offe (1985) "New Social Movements: Challenging the Boundaries of Institutional Politics," *Social Research*, Winter, pp. 817-869 provides a good survey of the new social movements, but I think that he rather overrates their importance.

not stop at local authority boundaries but are likely to spill over. Therefore, all levels of government as well as adjacent authorities are required to cooperate to solve problems of both, positive and negative spillovers. The joint policy approach not only takes into consideration spillover effects; it also sheds light on the fact that there is another side to the coin of the ever growing involvement of local authorities in regional, provincial, and federal matters, namely that the voice of local government is not only heard but also taken into consideration at the provincial and even the federal level. Given the multitude of countervailing forces within modern society hierarchical forms of decision-making are bound to fail unless subordinate levels of government are prepared to cooperate and to implement policies. There is also sufficient empirical evidence to support the view that the joint policy approach has contributed to the strengthening rather than weakening the position of local government. Under the Federal Planning Act local authorities are to be given a fair chance to participate in regional planning. Accordingly, provinces such as North-Rhine Westfalia and Baden-Wuerttemberg have set up regional planning councils on which local government interests are well represented (Benz and Henrich 1983). For the members of the Baden-Wuerttemberg regional planning councils are elected by the municipal councils, the county councils, and the county borough councils, respectively, and the majority of the members of the North-Rhine Westfalian regional planning councils are elected by county councils and county borough councils, with the chief executives of these authorities as ex officio advisory members. There are other, more informal ways open particularly for metropolitan leaders representing a multitude of voters to influence provincial policies along party lines.

Last but not least it should be pointed out that if it were not for the detailed and often highly sophisticated information on various subject matters provided by the local level, adequate decision-taking and, consequently, adequate policies would be impossible. This, in fact, is a power resource which local authorities have not yet made full use of in bargaining with superior authorities.

Given the constitutional division of powers and functions in the Federal Republic coexisting with the overriding principle of the equalization of the conditions of life, there is still no feasible alternative to the joint policy approach today and in the immediate future.

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An Evaluation of Urban Policy-Making In Canada: Theory and Case

Mark Sproule-Jones

INTRODUCTION

In 1981, a dominant coalition of governments in Canada, consisting of the Federal Government and nine of ten Provincial Governments, agreed to secure amendment of the Constitution of Canada from the British Parliament in Westminster.¹ The result was passage in 1982 of an amended Constitution Act, 1867 (previously called the British North America Act, 1867). The revised Constitution submitted future amendments to solely a domestic rather than domestic and British governmental process, and attached a "charter" of rights to the provisions of this written document. Both changes will make significant differences to the conduct of government in Canada, especially the provisions for judicial review of a uniform national "bill" of individual rights and freedoms.

However, the changes enacted in 1982 did not change some fundamental and more significant elements of the Constitution for urban policy-making. They did not alter the rules and conventions of Parliamentary Government, of the so-called "Westminster model", and they did not alter the Federal Structure and its existing divisions of jurisdiction between the Federal and Provincial Governments. As a result, the governmental processes in Canada remain executive-centred or dominated, whereby the elected leaders of majoritarian parties and their non-elected public servants (at both planes of government) comprise the core grouping of effective decision makers. (Sproule-Jones 1975, 1984). It is one of the purposes of this chapter to explore the effects of execu-

1 Research for this chapter was supported in part by the Social Sciences and Humanities Research Council of Canada.

tive-centred government on urban policies and policy-making. Particularly, the chapter will explore some of the more neglected aspects of executive-centred government in Canada, those surrounding the concepts of "Crown" property and public property, and trace their consequences for both public and private decision-making in urban areas.

One implication of this first purpose may be made at this time. It is frequently argued in public choice and public finance theory literature that state intervention is necessary to solve failures of the market associated with zero and under provision of public goods and positive externalities, and overprovision of negative externalities. This argument assumes that no structure of property rights exists which can, in theory, solve these kinds of market failures. It is an assumption of political rule, *Res Nullius*. However, *Res Nullius* may never have existed in Canada. Certainly, since earliest settlement times by Europeans, the Sovereigns of England and France claimed ownership of all property rights other than those expressly granted to subjects. When French Canada was ceded to England in 1763, the English Crown extended its prerogative throughout the Dominion. Currently, native Indians and other "indigenous peoples" are claiming property rights over lands that would take precedence over the Crown prerogatives exercised (in legal terms) by the "Crown-in-the-Right-of-Canada" or of the "Crown-in-the-right-of-Ontario" (or equivalent Province). What these Crown prerogative rights over property means is that the Cabinets at the Provincial or Federal levels of government have constitutional authority, since 1867, to regulate and coordinate independencies in the consumption and production of public goods and externalities. A form of *Res Communitis* has always existed in Canada, rather than *Res Nullius*, which means that any market failures are associated with inadequacies in the public property rights arrangements rather than the absence of property rights entirely. This conclusion is strengthened when we also consider the additional impact of legislative authority attached to the Provincial or Federal Parliaments which the Crown (read Cabinets) can also mobilize for the solution of market failures.

A second purpose of the chapter is theoretical. Recent theoretical work in law, economics and political science emphasizes how markets and hierarchies are best understood as coordinating mechanisms among individual persons. Both may have allocative or rationing features, but as coordinating mechanisms they can link the decision making of large numbers of individuals engaged in economic and non-economic pursuits. A third mode of coordination also exists—that of "provision systems" (Sproule-Jones 1981)—in which public and private organizations engage in interactions associated with jointness in the consumption and/or production of economic and non-economic "goods". In this paper we explore the coordinative features of all three modes, and we

develop a theory of the necessary institutional conditions for all three modes to create efficient outcomes. These institutional conditions highlight the critical importance of both private and public property rights in creating efficient outcomes for urban areas.

The chapter proceeds as follows. Part I develops a theory of coordination and of the necessary conditions for coordination to yield efficient outcomes for urban policies in Canada. Part II extends the analysis by examining how constitutional and institutional arrangements (especially property rights arrangements) work in practice rather than in *de jure* terms. In this Part, a case example is developed to illustrate some of the consequences of attenuated public and private property rights in the governance of an urban natural resource. The chapter ends with a brief conclusion.

PART I

URBAN POLICIES: INTERACTIONS AND COORDINATIONS

One of the prevailing characteristics of urban life is the intertwined nature of social and economic activities. An individual in an advanced Western country will typically spend his or her day absorbing information from media like television, radio or newspapers, consuming food and drink purchased from neighbourhood or further "flung" shops, travelling to and from work and other recreational or shopping sites, participating in a work force that may be of an industrial, service or entrepreneurial character, and interacting socially with co-workers, neighbours, relatives and other friends. All of these relationships, and others could be added, form the basis of urban policy-making from the citizen's point of view. If we conservatively estimate that an urban resident makes 1,000 decisions per day (most of which we make by habit and experience rather than the product of information search, analysis and resolution) and if we consider a city of 1 million persons, then we would view city life as a process of facilitating 1 billion decisions within a 24 hour period. Cities, in this perspective, are centres of massive energy production and consumption that are inherently difficult to simulate or model in view of all of these complexities and energy transfers.

We may nevertheless take a step toward unravelling those complexities by developing a new tradition of scholarship that draws upon the economics of property rights (e.g., Alchian and Demsetz 1973) and the political science of constitutions (e.g., Sproule-Jones, 1981, 1983). This new tradition will emphasize that there are three major patterns of interactions and coordinations, namely markets, hierarchies and what we call "provision systems". These three patterns will be briefly described and then evaluated and assessed.

The first pattern is that of markets. Markets exist to coordinate economic decisions between and among both producers of goods and services and consumers of these goods and services. Many markets are characterized by prices that clear supplies in the light of demands for goods and services. Other markets display prices that do not clear goods and services because of regulations and other entitlements of legal persons. A further set of markets constitute "an underground economy" in which the media of exchange are either bartered goods and services or are non-taxed revenue and expenditure flows. There is increasing public policy concern in Canada, that the latter two sets of markets are growing at the expense of the first set, but because of inherent difficulties in measuring the magnitude of these markets the concern often takes on a metaphysical and ideological cast.

A second form of coordination is the hierarchical organization, although it is not the only alternative coordinating device to markets (Williamson 1975; c.f., Lindblom 1977). It can be an effective form of coordinating interactions, including those of an economic character, but it is subject especially to limitations of size. Large sized hierarchies may only be effective where they organize service deliveries or production that are easily measurable, are capital (rather than labour) intensive and involve relatively little face-to-face interaction with customers and clients (Bish 1983). Some hierarchies may also not have the well developed rules that we associate with the Weberian model, and hence internal coordination may rely largely on shared norms or clan loyalties. Nonetheless there is a strong tradition in Canada to view hierarchies as especially effective models of coordination for governments, and at the city level to amalgamate local governments and special purpose districts into large hierarchies (Feldman 1974).

A third form of coordination may be called a "provision system" (Sproule-Jones 1981: 1983). This is a name used to characterize the coordination of individual and corporate persons that may jointly produce and/or consume goods and services.² We understand from empirical work on constitutional and institutional arrangements that an extensive network of contractual arrangements, interorganizational committees, referral systems, informal and formal agreements occur between persons (especially organizations) within provision systems. We also know that this form of coordination takes place in a regular and planned way, and can extend across levels of governments, the private sector, and the voluntary "not-for-profit" sector of organized groups and individuals. Provision systems include phenomena like "co-production", in which citizens

2 Jointness in production and/or consumption are, in varying degrees, characteristics of all public goods, common pools and externalities.

interact with organizations to jointly produce goods and services that could not be delivered without such participation. (An example is education whereby the engagement of students is a necessary concomitant of service delivery). Provision systems also include associations and interorganizational networks for resource allocation and stability that is a topic of concern among neo-corporatist scholars in Western Europe (Olson 1986).

Whatever, the form that coordination may take, the fact that most interactions within an urban area are coordinated in patterned and ordered ways drives us to ask two interrelated questions. First, what are the conditions that allow interactions and coordinations of persons to take place? Second, can we distinguish between interactions and coordinations that would be labelled superior and those that could be labelled inferior? The next section of the paper suggests answers to these questions.

MORE ON COORDINATION

When persons engage in coordinations through markets, hierarchies and provision systems, we must assume that they do so because their perceptions of the advantages of coordination outweigh their perceptions of the disadvantages. The term "perceptions" is included because persons in similar contexts are capable of differently interpreting advantages and disadvantages, and they are also differentially capable of making errors and learning from these errors in decision situations. Moreover, we must also assume that persons in similar contexts will bring to bear different assessments of the advantages and disadvantages because of their own preferences and concerns. Financial concerns will enter with these assessments, but we need not assume they are exclusive concerns. Given the advantages and disadvantages of coordination for different persons, then, we may state that persons will engage in a coordinative interaction up to the point at which their expected marginal value (advantages) of co-ordination equals their expected marginal costs (disadvantages).

This simple decision rule can not be operationalized in the real world without three institutional considerations, however. The world is replete with examples of market failures, the pathologies of hierarchies (public and private) and the breakdown of intergovernmental and interorganizational decision making, regardless of the good intentions of persons engaged in such fora. We will now specify the three institutional considerations, but preface each consideration with discussion and examples from the coordination arrangements of markets, hierarchies and provision systems.

In the first place, the only guarantee that persons will follow the decision rule (they will interact to the point at which where expected marginal value equals their expected marginal costs) is if they themselves do the calculations

of advantages and disadvantages. If other persons do the calculations for any one person, then there is a probability of less than 1.0 that the calculations will be accurate over the long run. On the basis of a balance of probabilities, persons are more likely to understand their own perceptions and assessments of advantages and disadvantages over a sequence of decisions than are other persons. In making this assertion, we need not rely on moral precepts like natural rights or entitlements, but merely on the empirical conclusions of behavioural psychology. The assertion also leaves open the possibility that, on occasions, persons may wish to delegate decisions to others acting in a fiduciary role; the proxy may have greater expertise or opportunity to scan the advantages and disadvantages of particular decisions and a person may wish to benefit from this expertise of a "principal agent". We thus admit of the place of delegated and representative decision making in the interests of individual persons.

The first institutional consideration, therefore, is to ensure that persons who wish to be a party to an interaction or who are affected by an interaction have standing to be so involved. It is at this stage that the terminology of rights intrudes. Courts are traditional means for ensuring that persons have standing (or have no standing) in market, hierarchical and provision system interactions. And courts use the terminology of rights, duties, liabilities and so on to characterize the status of parties to an interaction as well as the limits to which they can pursue their interest. Another way of framing this institutional consideration is to state that persons must possess clearly defined, transferable and enforceable "property rights" to be a party to an interaction or coordination.

A second condition that creates an incentive for persons to follow the decision rule—to pursue the expected marginal value of coordination until it equals the expected marginal costs of coordination—must now be elaborated. The term costs has well defined and operational meaning in accountancy and bookkeeping. It refers to monetary expenditures actually incurred or committed. In market, hierarchical and provision system coordinations, it has a wider meaning. It also refers to transaction costs, costs in terms of time, energy or decision-making, which are integral parts of all interactive coordinations. It may be possible to put a price or a "shadow price" on these transaction costs, but often transaction costs have no readily measurable dollar attribution.

Given the nature of transaction costs, some of which are not directly signalled by prices, and given the probability that the transaction costs will not always fall symmetrically on different persons, it is difficult to specify the full set of institutional considerations necessary to facilitate effective coordination among all rights holders. However, in order to ensure that coordination among all rights holders does actually take place, it is possible to suggest the institutional criterion that transaction costs for any rights holder be such that they not limit entry into coordination arrangements (Sproule-Jones and Richards 1984).

Another way of stating this institutional consideration is that transaction costs not be prohibitive for any rights holder.

A third and final incentive for persons to follow the efficient decision rule for coordination is the condition that the liabilities associated with property rights are fully specified. This condition is really a subcondition of the first institutional principle, but is worth highlighting on its own because it is a critical element of many liberal-democratic theories. When persons exercise their own rights they can infringe on the rights of others; the fundamental issue is when and under what conditions are they liable for such infringements (Sproule-Jones 1982).

Thus there are three institutional arrangements that facilitate efficient coordination in markets, hierarchies and provision systems. The arrangements create incentives for persons to engage in interacting to the point at which their expected marginal benefits or interactions approximates their expected marginal costs of these interactions. We must note again that interactions/coordinations can occur without persons following the decision rule; institutional arrangements can create "misplaced" incentive systems. However, the three institutional arrangements constitute a necessary, if not sufficient, set of preconditions for efficient policy making in urban areas. The proof that the institutional arrangements in question create an efficient incentive structure need not be made in this chapter. The arrangements are the postulated assumptions in the famous "Coase Theorem", in which Coase demonstrated that there were optimum market solutions for the market failures (Coase 1960). We have provided a rationale for the assumptions and extended the analysis across non-market modes of coordination, namely hierarchies and provision systems.

The presence or absence of the three institutional arrangements in any society will depend on the constitutional arrangements of that society. Constitutional arrangements will determine the allocation of property rights and the processes under which they are defined, exercised and enforced. We must briefly summarize the constitutional arrangements within Canada before we examine a complex empirical manifestation of urban policies in order to clarify the nature of constitutions, institutions and policy-making in this country.

CONSTITUTIONAL ARRANGEMENTS

There are four major components of the constitutional arrangements in Canada that are critical for our understanding of the operation of institutional arrangements (like property rights) and in turn the nature of urban policy-making (Sproule-Jones 1975). First, Canada possesses a written Constitution Act, 1867 (formerly called the British North American Act, 1867) which establishes *inter alia* the legislative authority of the Federal and Provincial Governments, a

charter of individual rights and freedoms, and amendment processes for changes in the document.

In the second place, the Courts grant legislative supremacy to the Federal and Provincial Governments, subject to the common law doctrines of *ultra vires* (including its application to the written Constitution Act) and natural justice (except when a statute discloses a contrary intention). It is not yet fully clear as to the primacy of the charter clauses in the Constitution Act and those granting legislative supremacy. At the present time, one assumes that the *de jure* legislative powers of both levels of government remain extremely large. And because of the discipline exercised by majoritarian political parties at both levels of government, one assumes that the *de facto* powers of the Federal and Provincial Cabinets also remain large.³

Third, the Crown retains prerogative powers, including prerogative proprietary powers. The Crown only exercises these powers on the advice of the governments at the appropriate level of government. However, for purposes of our analysis, public proprietary rights can be created or modified by statute or are simply attached to the powers of the Provincial and Federal Governments.

Finally, private property rights are the product both of custom and the codification of these customs by the courts. Private property rights can be extinguished by statute and they are not constitutionally guaranteed in Canada. The courts will carefully scrutinize legislation, however, that appears to "take" private property rights without compensation.

These four components of the Canadian constitutional arrangements are *de jure* components that do not reveal the practice of private and public persons as they interact and coordinate their decision making in any urban area. We now develop a short case study to reveal the operation of these constitutional arrangements, how they affect property rights, and how urban policies are constructed in Canada. We will also use our three institutional criteria to evaluate and criticize the practice of urban "governance".

PART II

THE SETTING AND THE SITE

The setting for the analysis and evaluation of the nature of urban governance in Canada is that of Hamilton Harbour, which is the only naturally protected harbour on Western Lake Ontario. The waters of the Harbour measure some

3 It should be noted that minority governments are occasional features of national and provincial politics.

forty square kilometres and are accessible to Lake Ontario by a man made ship canal built in 1823. The Harbour watershed is home for 500,000 people and drains an area of 900 square kilometres.

The site is valuable for intense scrutiny because the Harbour is used for a variety of purposes, each use is governed and regulated by a complex network of laws and organizations, and the uses themselves require coordination and mutual accomodation. In other words, we have markets, hierarchies and provision systems operating together to coordinate interactions among and between uses. The major uses are those of commercial shipping, waste disposal and recreation (especially recreational boating).⁴

THE LEGAL FRAMEWORK

Legal rights and liabilities to use the waters of Hamilton Harbour for any of the three major uses are based on a complex amalgam of common law, constitutional law, statutes of the Federal and Provincial Governments, and by-laws of the City of Hamilton. The laws are particular to each single use, and the law courts have determined priorities among laws and thus among uses when conflicts between uses emerge.

In general terms, most proprietary and legislative rights for commercial shipping do not rest with vessel owners but with an "independent" public corporation, Hamilton Harbour Commissioners. This body received its legislative powers from the Federal Government on incorporation in 1912, and most proprietary powers from the City of Hamilton in 1948.

Again most legislative powers over waste disposal rest with the Province of Ontario through parts of Section 91 of The Constitution Act, 1867. The Province has also extinguished proprietary powers of land owners (including the Harbour Commission which owns the bed of the Harbour) to restrict waste disposal. Those users of the waters, like fishermen or recreationists, that require relatively unpolluted waters, must rely on the fiduciary regulatory powers of public agencies, especially the Ontario Ministry of the Environment.

Finally, pleasure boaters possess limited property rights to use and enjoy the waters of the Bay. They are subject to the ownership rights of riparians for access to the waters and are subject to the ownership and regulatory powers of the Harbour Commissioners for use of the waters themselves.

In a relatively unknown part of the Canadian Constitutional arrangements, the courts have used the common law doctrine of "navigable servitude" to

4 Data for this and subsequent sections are drawn from Sproule-Jones 1985a, 1985b, 1986.

establish priorities among uses. This doctrine grants first priority to that of shipping, which is largely compatible with water quality and waste disposal. Also, the Hamilton Harbour Commissioners have granted priority to commercial shipping over pleasure boating in their official plan. For our purposes, it is interesting to note that the doctrine of "navigable servitude" stems from the Magna Carta of medieval England, when the barons agreed to remove their fishing weirs from the River Thames to allow unobstructed navigation for the navy of King John (Moore and Moors 1903). This medieval doctrine is the primary constitutional principle for allocating water uses in Hamilton Harbour.

The courts have not established a general doctrine to resolve the incompatibilities between water quality and waste disposal, on the one hand, and recreational and environmental uses of the Bay on the other hand. We do know, however, that there has been a major decline in the multiplicity and diversity of fish species, aquatic plants and invertebrate species. Some of the larger resident fish species display indications of toxic water quality conditions, such as lip papillomas (Sproule-Jones 1985B). Moreover, swimming, sports fishing and commercial fishing are now banned in the Harbour for public health reasons. In effect, the network of laws and regulations for the uses of waste disposal and recreation have, in historical terms, granted priority to that of waste disposal.

A CASE EXAMPLE

Pleasure boaters thus possess highly attenuated property rights to use the waters of Hamilton Harbour and to secure access to these waters. In addition, these agencies, like the Harbour Commissioners, that possess ostensible proprietary and legislative powers over pleasure boating, find these powers are in practice highly attenuated because they have no authority over waste disposal and water quality of the Harbour. Our theory would suggest that there are substantial opportunity costs associated with such a misplaced property rights system.

In Table 13.1, we provide a summary of our calculations of the economic losses associated with the misplaced property rights system. We compare the actual expenditure, income and employment effects of pleasure boating in the Harbour with those levels that should exist were watershed residents willing to use the Harbour rather than alternative sites.⁵

5 The methodology for the calculations is found in Sproule-Jones 1986.

Table 13.1
Comparative Performance Indicators

<i>Indicators</i>	<i>Expected Performance</i>	<i>Actual Performance</i>	<i>Deficit¹</i>
Direct Expenditure	\$ 7,945,742.70	\$ 3,033,585.60	\$ 4,912,157.10
Total Economic Output	18,593,307.00	7,098,590.30	11,494,717.70
Income Generated	23,241,633.00	8,873,237.90	14,368,395.10
Direct Employment	748.4	285.1	462.7
Indirect Employment	1,324.7	505.7	819.0
Total Employment	2,073.1	791.4	1,281.7

Notes

1. Expected Performance minus Actual Performance.

We find that the opportunity costs associated with current boating and sailing facilities, access and usage in the Harbour varies from almost \$5 million of direct expenditures to \$14 of lost watershed income. Over 450 person years of direct employment is foregone, and almost 1300 person years would be generated in the watershed from enhanced motor boating and sailing. In other calculations, we estimate that a potential recreational industry with \$14 million in direct expenditures alone is available for capture by appropriate Harbour facilities, access and pleasurable conditions for boating.

In the light of these figures, it is possible to conclude that the governance system—as embodied in our three property rights criteria—is seriously inadequate. It is likely that such inadequacies exist outside Hamilton Harbour and in more instances than that of pleasure boating. The constitutional arrangements for urban policy-making in Canada have created incentives for the construction of misplaced property rights systems by governments at all levels.

CONCLUSION

Urban policy-making in Canada is complex, diverse and involves large numbers of persons. It involves market processes, organizational or hierarchical processes, and interorganizational processes. Governments at all levels in Canada are involved in all three processes not least in the statutory modification of common law property rights.

It is useful, however, to emphasize that government involvement includes public property rights as well as the private property rights that have been developed, modified and enforced by common law, statute law and constitu-

tional law. Public property rights often stem from the Crown prerogative rights as well as the ownership rights enacted under the legislative authority of either level of government.

It may be asserted that the governance system embodied in the structure of public property and private property rights is a neglected aspect of Canadian Federalism. Indeed, it is possible to examine these rights and to develop from them principles for evaluating the operation of markets, hierarchies and provision systems. We established three principles and then applied these to a case of urban policy-making—the multiple use of an urban harbour and the opportunities foregone for recreational boating as one of the uses.

It may be suggested that there are two "challenges to federalism" implied by the analysis. The first challenge is to ensure that all three levels of government recognize that there are alternative ways to coordinate the complex, diverse and large numbers of interactions characteristic of urban policy-making. When alternatives are posed, comparisons of alternatives are possible, and selections among alternatives may be made. Coordination is possible through markets, hierarchies and provision systems, and the presumption that governmental hierarchies are the sole mode of coordination can be rejected as dogma. This does mean, however, that care must be taken in establishing coordination on sound institutional evaluative criteria.

The second challenge is more particular. Public property rights are a strong, well rooted feature of Canadian Federalism. Like private property rights, they too can be evaluated and appraised in terms of their advantages and disadvantages. The challenge to federalism is to sustain a continuing public debate on those principles for evaluating property rights and to adopt modes of organization best suited for their implementation. This may well presage more fundamental changes in the constitutional order for Canada.

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