

The Spending Power in Federal Systems: A Comparative Study

Ronald L. Watts

**Institute of
Intergovernmental
Relations**

**Queen's University
Kingston, Ontario
Canada K7L 3N6**

Canadian Cataloguing in Publication Data

Watts, Ronald L.

The spending power in federal systems : a comparative study

Co-published by the School of Policy Studies.

Issued also in French under title: Étude comparative du pouvoir de dépenser dans d'autres régimes fédéraux.

Includes bibliographical references.

ISBN 0-88911-829-9

1. Government spending policy. 2. Government spending policy – Canada.
3. Intergovernmental fiscal relations. 4. Federal-provincial fiscal relations –
Canada. 5. Federal government. 6. Federal government – Canada.
7. Comparative government. I. Queen's University (Kingston, Ont.). Institute
of Intergovernmental Relations. II. Queen's University (Kingston, Ont.).
School of Policy Studies. III. Title.

HJ461.W37 1999 336.3'9 C99-930181-0

Contents

<i>Foreword</i>	v
<i>Acknowledgements</i>	ix
1. INTRODUCTION	1
1.1 The Canadian Context	1
1.2 Purpose, Scope and Terms of Reference of this Study	6
1.3 A Note on Terminology	8
2. THE SPENDING POWER IN OTHER FEDERAL SYSTEMS	9
2.1 The United States of America	9
2.2 Switzerland	13
2.3 Australia	18
2.4 Germany	24
2.5 Some Other Federations	29
2.6 The European Union	40
3. SOME COMPARATIVE OBSERVATIONS	47
3.1 The Federal Context.....	47
3.2 The Legal Basis of the Federal Spending Power	49
3.3 Links to Revenue-Raising Powers	51
3.4 Decisions on the Use of the Federal Spending Power	54
3.5 Nature and Extent of the Use of the Federal Spending Power	56
3.6 Alternatives to Federal Transfers to Provinces	58
4. CONCLUSIONS AND IMPLICATIONS FOR CANADA	63
NOTES	67
REFERENCES	75

Foreword

Canadian political debate in recent years has become increasingly focused on the concept of a social union. While this idea means different things to different people, many commentators would accept the notion that it includes the arrangements, political and administrative, between federal and provincial governments for the design and delivery of social programs. Central to that debate has been the desire of both orders of government to reach an agreement on the conditions under which Ottawa might continue to exercise its constitutional power to spend money on social programs in areas that are within the exclusive legislative competence of the provinces. While an arcane topic to most Canadians, resolving the controversy on the issue of the "federal spending power" has emerged as fundamental to the future conduct of federal-provincial relations and social policy-making in Canada. Given the debate in Canada about the political future of the country, the issue of the spending power inevitably spills over into efforts at achieving a stable political reconciliation between mainly French-speaking Quebec and the mainly English-speaking rest of Canada.

This volume provides additional context to the Canadian political debate by shedding light on how other federations handle these kinds of issues. Among the questions it poses are the following: Recognizing differences in political vocabulary from country to country, do other federations have central or federal government powers equivalent to the federal spending power in Canada? Is the power explicitly provided for in the constitution? Or does it derive from some other source? Where such power does exist, what are the limits, if any, on its use? And is there a role for the constituent units in the exercise of this power by the federal government?

The author is one of the world's leading scholars on comparative federalism. Ronald L. Watts is Principal Emeritus and Professor Emeritus, Queen's University and Fellow of the Institute of Intergovernmental Relations, Queen's University. The federations examined in depth by Professor Watts include the United States, Switzerland, Australia and Germany, as well as Canada. Briefer reference is also

made to Austria, Belgium, India, Malaysia and Spain. The European Union, more a confederation than a federation but with elements of both in its structure, is also treated. The result is a volume that will be of interest to practitioners and scholars in many countries even though it was motivated by Canadian developments.

A central finding of Professor Watts' research is that, under one name or other, all federations have a form of federal or central government "spending power." In most federations, however, there are extensive areas of concurrent legislative competence, *de jure*, including the United States, Australia, Germany, Austria, India, Malaysia and Spain. In the case of Switzerland, there is extensive *de facto* concurrency. That is, interdependence among governments, not disentanglement, is the norm. One result is that much of the federal government spending in these countries is in areas of concurrent legislative competence. Even when federal expenditure is in areas of exclusive legislative jurisdiction of the constituent units (provinces, states, lander, cantons, etc.), the exercise of this power, according to Professor Watts, appears to be less sensitive politically in other federations than is the case in Canada. The classical idea of "watertight compartments" between orders of government is simply not the norm in most federations. This is in spite of the fact that federal government transfers to the governments of constituent units are much more conditional in other federations than they are in Canada. In this regard, Watts characterizes the Canadian constitutional emphasis on areas of exclusive federal legislative competence and exclusive provincial legislative competence as unique.

In five of the federations examined, there is explicit constitutional recognition of a federal spending power (Australia, India, Malaysia, Spain and Germany). In other countries, the spending power effectively exists through the operation of other constitutional powers, judicial interpretation (as in Canada and the United States) or political dynamics (Belgium and Switzerland).

A second theme of the volume is the wide variation in the degree to which constituent units of the different federations play a role in federal decision-making and accordingly in the exercise of the federal spending power in areas of competence of these units. At one extreme is Germany, where the federal upper house is made up of members of delegates of Lander governments. Due to overlapping membership in cantonal and federal legislatures, the Swiss cantons also play a significant role. In Belgium and Spain, the party structures or political dynamics ensure that, in practice, the federal government does not normally act unilaterally. Even where the constitution appears to contemplate unilateral action, as in the United States and Australia, there are institutional features (weak party discipline in the U.S. and collaborative institutions in Australia) that serve to curb the autonomy of the federal government. In this regard, that is, the role of the provinces, Watts observes that "Canada does not match some other federations." At the same time, he observes that the provisions under which Canadian provinces can opt out

of shared-cost federal-provincial programs and receive financial compensation from the federal government is also unique.

Perhaps the main message to emerge from this volume, however, is that valid comparisons among federations require a consideration of many factors simultaneously. For those who are familiar with Watts' extensive work, it will come as no surprise that his approach is multidimensional, providing a careful and systematic analysis that enables the reader to understand similarities and differences among federations in this important area.

The Institute of Intergovernmental Relations has extensive research programs in the areas of comparative federalism and the social union. This volume is a major contribution to both programs.

Harvey Lazar
Director

Acknowledgements

I wish to acknowledge and thank John McLean for his extensive research in the preparation of this study. This study has been assisted by a number of consultants in other federations who have provided updated and previously unavailable data and who also offered their comments and suggested revisions on a draft text as it applied to their particular federations. In this respect I especially thank Professor John Kincaid, Robert B. and Helen S. Meyner Professor of Government and Public Service and Director of the Meyner Center for the Study of State and Local Government, Lafayette College, Easton, PA, USA; Dr. Hansjoerg Bloechli, University of Basel, Switzerland; Ms. Jutta Kramer, Deutsches Institut für Föderalismusforschung, Hannover, Germany; Professor Brigid Laffan, Jean Monnet Professor of European Politics and Ricki Schon, Department of Politics, University College, Dublin, Ireland. I also thank Professor Cliff Walsh, Director of the South Australian Centre for Economic Studies, Adelaide, Australia for extensive material on Australian fiscal federation. He was host for the International Association of Centres for Federal Studies (IACFS) international workshop on "Fiscal Arrangements in Federal Countries" held in Adelaide, Australia, 25-27 March 1998, which provided much useful information on the arrangements in a variety of federations. I would also thank Douglas Brown for supplying some Australian information.

The research for this publication was supported by the Privy Council Office of the Government of Canada, and I am grateful for their assistance in providing information and comments on drafts. However, the views expressed are mine and do not necessarily represent those of the Government of Canada.

Finally, I would like to express my thanks to Patti Candido, Mary Kennedy and Lois Jordan for their assistance, in some cases under unexpectedly trying conditions arising from illness and other difficulties. I would like to acknowledge Mark Howes, Valerie Jarus and Marilyn Banting of the School of Policy Studies Publications Unit.

Ronald L. Watts
1999

Chapter 1

Introduction

1.1 THE CANADIAN CONTEXT

The federal spending power and its use has been an important and often controversial element in the operation of the Canadian federation. While ordinarily the "spending power" of governments may be taken to mean simply the spending they undertake on particular programs under the authority of legislation passed by their legislative bodies, constitutionally the term has come to have a specialized meaning in Canada. In this context it has come to refer to the power of Parliament to make payments to people, institutions or provincial governments for purposes on which Parliament does not necessarily have the power to legislate, for example, in areas of exclusive provincial legislative jurisdiction.

While the federal "spending power" in this sense is not explicitly specified in the *Constitution Act, 1867*, the Canadian constitution, as it has been interpreted by the courts, has been taken to give to the Parliament of Canada the power to spend from the Consolidated Revenue Fund on any object provided the legislation authorizing the expenditures does not amount to a regulatory scheme falling within provincial powers. The constitutional basis for this spending power has been taken to be derived from those sections of the *Constitution Act, 1867* which provide for the creation of a Consolidated Revenue Fund (section 102), for the Parliament of Canada to raise money by any mode of taxation (section 91(3)), for Parliament to legislate in relation to "public debt and property" (section 91(1A)), and for Parliament to appropriate funds (section 106).¹ Although debate over the spending power in Canada goes back to at least the 1940s, the widespread exercise of the federal spending power in areas related to provincial jurisdiction stemmed from the period following the Second World War when the federal government directed its excess revenues to financial support for a range of social policies and program standards in a number of areas within provincial jurisdiction. By the 1960s a considerable variety of cost-sharing programs based on conditional grants

had been established.² In practice considerable intergovernmental bargaining preceded the introduction of the major shared-cost programs, but ultimately the federal spending on these programs was usually the result of independent federal decisions.

While initially most other provinces acquiesced in this expanded federal influence, Quebec from the beginning was critical of the increased role of the federal government in areas of provincial jurisdiction. Indeed in 1956 the Duplessis government challenged the federal use of the spending power to provide grants directly to postsecondary institutions by refusing to allow these institutions to accept direct federal grants and demanded compensation in the form of tax points. In the early 1960s other provinces also began to object to the increased federal role in areas of exclusive provincial jurisdiction through the use of the federal spending power. As a result of these objections, in 1964 the provinces were, for a time, given the opportunity to "opt out" of programs financed through the federal spending power and were provided compensation through income tax abatement. However, only Quebec took advantage of this arrangement.

In 1969 the Trudeau federal government presented a proposal to a Federal-Provincial First Ministers' Conference which "tentatively advanced" certain principles: (i) the federal spending power should be formally entrenched in the constitution; (ii) Parliament should have an unrestricted power to make conditional grants to provincial governments for the purpose of supporting their programs and public services; and (iii) Parliament's power to initiate cost-shared programs involving conditional grants in areas of provincial jurisdiction should require both a broad national consensus (i.e., on a regional basis, along the lines of the Victoria amending formula) and per capita reimbursement of the people (not the government) of a province whose legislature decided not to participate.

A similar approach was developed as part of the "best efforts draft" that emerged during the government's 1978-79 constitutional discussions with provinces: the exercise of the federal spending power would have been made subject to a provincial consent mechanism (a majority of provinces with a majority of the population), with unconditional compensation for non-participating provinces (though there was no agreement on whether compensation was to be paid to non-participating provincial governments or directly to their residents).

In the meantime, in 1977, the federal government replaced its previous major cost-sharing programs for health insurance and postsecondary education with a new complex arrangement known as Established Programs Financing (EPF) in which federal contributions were no longer related to direct provincial expenditures and would escalate according to population and gross national product, and with each province receiving a combination of tax abatements and cash transfers. The generality of the conditions established for these transfers made them in effect "semi-conditional" rather than conditional in character.

Debate on the issue of limits upon the federal spending power continued in the 1980s, and in 1985 the Quebec Liberal Party identified placing boundaries on the application of the federal spending power (although the boundaries were not

specified) as one of its five conditions for support of the *Constitution Act, 1982* (to which the Quebec government had not agreed). It was suggested that the federal government should remove itself from the fields of education, labour market training and health with appropriate financial compensation for provinces taking full responsibility in these areas. Consequently, one of the key elements in the Meech Lake Accord, 1987, was the proposal of a new section 106A (to be inserted in the *Constitution Act, 1867*) which would have added conditions for reasonable compensation to provincial governments not participating in any new shared-cost program established by the federal government in areas of exclusive provincial jurisdiction.³ No provision was made, however, for a provincial consent mechanism.

Following the failure to ratify the Meech Lake Accord, in 1991 the federal proposals for constitutional review, *Shaping Canada's Future Together*, included proposals for entrenchment in the constitution of a provincial consent mechanism requiring assent of at least seven provinces representing 50 percent of the population for any new Canada-wide shared-cost programs and conditional transfers in areas of exclusive provincial jurisdiction and for reasonable compensation to non-participating provinces which established their own programs meeting the objectives of the new Canada-wide program.

After extensive public consultation and intergovernmental negotiations a revised version of these proposals was incorporated into section 25 of the 1992 Charlottetown Agreement. This section read:

A provision should be added to the Constitution stipulating that the Government of Canada must provide reasonable compensation to the government of a province that chooses not to participate in a new Canada-wide shared-cost program that is established by the federal government in an area of exclusive provincial jurisdiction, if that province carries on a program or initiative that is compatible with the national objectives.

A framework should be developed to guide the use of the federal spending power in all areas of exclusive provincial jurisdiction. Once developed, the framework could become a multilateral agreement that would receive constitutional protection. The framework should ensure that when the federal spending power is used in areas of exclusive provincial jurisdiction, it should:

- (a) contribute to the pursuit of national objectives;
- (b) reduce overlap and duplication;
- (c) not distort and should respect provincial priorities; and
- (d) ensure equality of treatment of the provinces, while recognizing their different needs and circumstances.

The Constitution should commit First Ministers to establishing such a framework at a future conference of First Ministers. Once it is established, First Ministers would assume a role in annually reviewing progress in meeting the objectives set out in the framework.

A provision should be added (Section 106A(3)) that would ensure that nothing in the section that limits the federal spending power affects the commitments of Parliament and the Government of Canada that are set out in Section 36 of the *Constitution Act, 1982*.

The failure of the Charlottetown Agreement as a whole to receive support in the October 1992 referendum left the issue of the future of the federal spending power unresolved.

Debate on the federal spending power has continued to the present. The context of the debate has, however, undergone some changes. Among these has been increasing criticism on the part of the richer provinces. The most controversial issues have related to the federal role in creating new shared-cost programs, subsequent unilateral changes and reductions in the financing arrangements of shared-cost programs in the late 1980s and 1990s, and the federal insistence on retaining certain conditions attached to its block transfers under the Canada Health and Social Transfer (CHST) introduced in the 1995 budget to replace the EPF arrangements and the Canada Assistance Plan (CAP).

A significant feature of the current debate about the federal spending power has been the focus on appropriate arrangements for a reformed and renewed Canadian social union. Since 1995 the provinces and territories have been seeking to develop proposals for a Canadian social union along more collaborative federal-provincial lines with some measure of provincial control that would in future limit the unilateral federal reductions of support for programs experienced in the past. On the other hand the current Parti Québécois government in Quebec would prefer, as long as Quebec remains a part of the Canadian federation, to replace what it describes as federal unilateralism in the federal exercise of its spending power by the right for Quebec to opt out with full financial compensation from an application of the federal spending power in areas of exclusive provincial jurisdictions, and to move to a fully disentangled relationship between federal and provincial activity in social matters with a minimal federal role. The Ministerial Council on Social Policy Reform and Renewal in its *Report to the Premiers* argued that renewed fiscal arrangements should be a first priority in attempts to restructure and renew the social union (1995, pp. 17-19), and in setting out criteria for clarifying federal-provincial roles and responsibilities in the social sector proposed that "the use of the federal spending power in areas of sole provincial/territorial or joint federal-provincial/territorial responsibility should not allow the federal government to unilaterally dictate program design" (p. 10). In April 1997 the same council, in its options paper *New Approaches to Canada's Social Union*, argued for a new approach to the use of the federal spending power (pp. 7-9) setting out a variety of alternatives for provincial and territorial consent for rules to guide compensation for opting-out provinces and territories, for the scope of programs to be included, and for guidelines for financial arrangements. Subsequently, the Calgary Declaration of 14 September 1997, in its seventh principle, acknowledged the interdependence of governments and called for more cooperation

between the different orders of government in their respective jurisdictions, pointing implicitly to the significance of federal spending power.

In the meantime, the federal government had made changes in its use and policies regarding its spending power. It had converted virtually all the traditional shared-cost programs in the social policy area and replaced them with the block CHST program which, with a few exceptions, is generally unconditional in character. It also made a major policy undertaking in the Speech from the Throne in 1996 that it would only create new shared-cost programs in areas of exclusive provincial jurisdiction with the agreement of a majority of the provinces and would permit provinces to opt out of such new shared-cost programs if they created equivalent programs. Apart from the CHST block-fund transfers, there were some current federal shared-cost programs that are relatively small and concentrated in a few areas such as official language, infrastructure, and justice and the law. Federal direct spending also continued to extend into various areas such as support for research, student loans, and scholarships which are related to areas of provincial jurisdiction. The latest federal initiative based in whole or at least in part on an exercise of the federal spending power was the controversial unilateral announcement of the new Millennium Scholarship Fund although at the time of its announcement the federal government declared that it would consult provincial governments and the postsecondary education community on the design and delivery of the scholarships.

On 4 February 1999, the federal government and nine of the provinces, but not including Quebec, signed a Framework for Improving the Social Union for Canadians. This is intended to commence a new era of federal-provincial cooperation, collaboration and information-sharing in creating and financing social programs. In return for tacit recognition by the nine provinces of a federal role in the formation of social policy across Canada, the federal government pledged that no new Canada-wide initiatives for intergovernmental transfers, whether block-funded or cost-shared, in health care, postsecondary education, social assistance and social services would be proceeded with without the agreement of a majority of provinces. In relation to such programs, provinces and territories will be free to determine program details to meet the agreed objectives and accountability regime. Furthermore, if a province or territory already has a program it would still receive its full share of funding. In addition the federal government has agreed not to introduce Canada-wide direct transfers to individuals or organizations relating to these areas without three months notice and without a chance for provincial governments to help develop policy. The federal and nine provincial governments also agreed to referee differences on funding issues through a dispute resolution mechanism.

Thus, under this agreement, in return for recognizing a federal role in social policy through the use of its spending power in areas of exclusive provincial legislative jurisdiction, the provincial governments have been given a greater say in the designing of programs funded by the federal government. The agreement does not provide for the right sought by the provinces to opt out of such programs and

receive full financial compensation. It was for this reason that Quebec did not sign the agreement. A factor contributing to the agreement was the indication that the federal government in its 1999 budget would restore some substantial funding for health, an offer made possible by the federal government's budgetary surplus position.

1.2 PURPOSE, SCOPE AND TERMS OF REFERENCE OF THIS STUDY

Given the importance in current federal-provincial discussions of the issue of the appropriate arrangements for managing the federal spending power in areas of exclusive provincial jurisdiction, an examination of arrangements and experience in other federal systems may be of help in assessing renewed or revised arrangements for Canada. A particular feature of the debate in Canada has been the position taken by some intervenors that the federal spending power in areas of exclusive provincial legislative jurisdiction is largely or wholly illegitimate and contrary to at least the spirit of the federal principles of the constitution. Such arguments have usually been advanced with little or no reference to the arrangements and experience in other federations. One aspect this study will examine, therefore, is the extent to which the use by federal governments of their spending power in areas of provincial or state jurisdiction has been regarded as illegitimate, or whether such spending power has been accepted as necessary either with or without limitations upon its use.

The central purpose of this study is to review key issues associated with the federal spending power in selected other federal systems and the European Union.

The basic notion of a federation as involving the combination of shared-rule for some purposes and regional self-rule for others within a single political system, so that neither is subordinate to the other, has been applied in different ways to fit different circumstances. Thus the basic architecture of different federations, including the confederal-federal hybrid represented by the European Union, has varied in many ways: in the character of the federative institutions and the degree of input of the constituent units to federal policy-making, in the scope of the allocation of the legislative and executive responsibilities, in the use of joint versus exclusive jurisdictions, in arrangements for administering laws and programs, in the allocation of taxing powers and resources, in the balance between revenues and expenditure responsibilities between the two orders of government, in procedures for resolving conflicts and facilitating collaboration between interdependent governments, and in procedures for formal and informal adaptation and change. The issue of the arrangements for and use of the federal spending power inevitably varies significantly according to these different contexts. This study therefore attempts to set the spending power in each regime within its general context. While discussion of the broader context of the federal system as a whole cannot be exhaustive, the study attempts to draw out the main qualitative features of the different arrangements in each federation and their significance.

For each federal system four sets of issues are addressed: (i) the legal basis of the federal spending power, (ii) the link to revenue-raising powers, (iii) decision-making processes relating to the use of the federal spending power, and (iv) the nature and extent of the use of the federal spending power.

The questions considered in this study include:

1. *Legal basis of the federal spending power.* Does the jurisdiction distinguish between the law-making power and the spending power of the federal (and other) governments? Are jurisdictions typically concurrent or joint (with paramountcy?) or exclusive? What is the legal basis of the spending power, for example, a constitutional provision versus jurisprudence, in relation to different types of jurisdiction, most particularly the federal spending power in areas of exclusive provincial or state jurisdiction? Are there legal limits or interdictions on the objects on which the federal authority can spend?
2. *Link to revenue-raising powers.* Does the jurisdiction distinguish between the revenue-raising powers of the two orders of government? What is the balance of direct revenue raising between the two orders of government? What is the size and direction of transfers? Is the regime characterized by an imbalance of revenue-raising capacity and jurisdictional authority between the two orders of government? Is the regime characterized by an imbalance of revenue-raising capacity among the constituent units? Have these factors affected the dynamic of its development?
3. *Decisions on the use of the federal spending power.* Are uses of the federal spending power that touch areas of provincial or state law-making power subject to special decision-making procedures? Do provinces or states have an explicit role? When a decision is made, do dissenting provinces or states have the right to opt out and if so on what terms? Does any of the foregoing depend on whether the spending power is used in areas of joint or exclusive provincial or state jurisdiction? Has the federal government accepted any principles of a non-legal type to guide its use of the spending power?
4. *Nature and extent of use of the spending power.* Does the federal government make extensive use of its spending power in areas outside its law-making power: directly or through shared-cost or other conditional programs or transfers to the provinces or states? What is the nature of the conditions attached to central government transfers or shared-cost programs with the provinces or states in their areas of exclusive jurisdiction? Do they differ from the conditions attached to federal government transfers or shared-cost programs in areas of joint jurisdiction?

Among the federations that are examined in depth in terms of the federal spending power are the United States of America, Switzerland, Australia and Germany.

In addition, insofar as it has been possible to obtain data that is relevant, briefer references are also made to some other federations, notably Austria, Belgium, India, Malaysia and Spain. The European Union, which is a hybrid combining some of the elements of a confederation and some of a federation, is also examined.

1.3 A NOTE ON TERMINOLOGY

The terminology used to describe the federal spending power in areas of provincial legislative jurisdiction and the various forms of intergovernmental financial transfers varies from federation to federation. To Canadians reading about practices in other federations this can contribute to confusion. For example, in the United States "specific-purpose grants" are usually referred to as "categorical grants," and "cost-sharing" is more often referred to as "matching grants," with the proportions of matching required varying according to the specific program. All of these fall under the more general rubric of "conditional grants," that is, grants to which the federal government attaches conditions about the standards to be embodied in the programs and in many, but not necessarily all cases, establishes the degree of matching state contributions that are required. In this respect, the Canadian EPF, CAP, and CHST transfers are conditional grants. However, by comparison with conditional transfers in other federations, which usually involve detailed program conditions, the framework conditions for the EPF and CHST transfers have been much more general, to the point where they might appropriately be referred to as "semi-conditional" transfers. Indeed, compared to the conditional grants in other federations the conditions required by the CHST in Canada are so general that these transfers come close to unconditional ones. Another example is that while "equalization" transfers in Canada are unconditional in form, in some other federations (most notably the United States and Switzerland) most equalization is achieved through a variety of conditional grant schemes to which equalization factors are applied, in addition to other criteria in the calculations for allocating these to specific states or cantons.

For the sake of clarity for Canadian readers, the terminology in this report has been converted as far as possible to the Canadian equivalents, but readers should be aware that the terms may have different nuances in other federations.

It should also be noted that federal spending for programs and services in areas of provincial legislative jurisdiction may take one of two forms: direct federal spending in the form of transfers to individuals or organizations, and transfers to provincial governments (and in some federations to local governments) to assist them with expenditures in their areas of legislative jurisdiction. As far as possible these two forms have been distinguished, but in the course of gathering information, it has turned out that the accounting arrangements in some federations simply do not make it possible to draw out this precise distinction in all cases.

Chapter 2

The Spending Power in Other Federal Systems

2.1 THE UNITED STATES OF AMERICA

The federal context. The United States became the first modern federation in 1789 following the failure of the previous confederal form of government established in 1781. Originally comprised of 13 states, it has evolved into a federation of 50 states. It survived a devastating Civil War (1861-1865) during the first century of its existence, but as the longest-standing federation in the world, it is an important reference point in any comparative study of federations.

In comparative terms the United States federation is moderately non-centralized.⁴ The major feature of the distribution of powers, which is symmetrical for all 50 states, is the arrangement whereby the U.S. Constitution lists delegated subject matters under federal authority — most of which are concurrent but with federal paramountcy and a few of which are made exclusively federal by prohibiting the states from legislating on them — and leaves the unspecified residual matters to the states. While originally a more decentralized federation than Canada, the broad interpretation by the federal courts of federal powers (including “implied powers”) and the use by the federal government of its spending power have resulted in a federation that is now considerably more centralized and coercive in practice than the Canadian federation (Kincaid 1993).

The federal institutions are based on the principle of the separation of powers between executive, legislature and judiciary, with presidential-congressional-judicial institutions involving a system of checks and balances. Congress includes a Senate in which the states are equally represented, but since 1912 its members have been directly elected and therefore represent state electorates rather than state governments or legislatures in federal deliberations. The lack of party discipline resulting, in part, from the separation of powers has generally given prominence to local and state views in congressional deliberations. Furthermore, the large number of states and the separation of powers within both orders of

government has led to a diffused and relatively uncoordinated set of intergovernmental relationships.

Although the federal government does not need the cooperation of the states to carry out its policies in those areas in which it has legislative jurisdiction, in practice it has chosen, for a variety of reasons, to use state and local governments as administrative agents, sometimes leaving them considerable latitude of operation. For this, it has relied almost entirely on conditional grants. This has given to relations between governments in the American federation a highly interdependent character, characterized by Morton Grodzins as "marble-cake" federalism (Grodzins 1966).

Legal basis of the federal spending power. In general terms, the United States Constitution does not explicitly distinguish between the law-making and spending powers of the federal and state governments. While areas of federal exclusive legislative jurisdiction are identified and states are assigned exclusively the unspecified residual area of legislative authority (see the Tenth Amendment), there is a large area of concurrent jurisdiction with potential federal paramountcy and actual federal supremacy when the Congress legislates to occupy all or part of an area. Consequently, there is extensive overlapping in the jurisdictions of the two orders of government. In these areas, there is extensive federal funding relating to matters within the legislative competence (although not necessarily exclusive competence) of the states.

The Constitution of the United States of America also invests the federal government with a very broad discretionary revenue-raising and spending power: "The Congress of the United States shall have the Power to levy and collect Taxes ... and provide for ... the general Welfare of the United States."⁵ Furthermore, a broad interpretation of these powers applying to both areas of concurrent and exclusive state jurisdiction has been judicially upheld.⁶ Thus, there are no legal limits or interdictions on the objects on which the federal government may spend its own-source revenues.

Because the U.S. Constitution does not contain a list of powers specifically reserved to the states and there is only the provision of the Tenth Amendment that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people," neither the Constitution nor judicial rulings have been taken to prohibit federal spending (either by transfers to subnational governments or by direct transfers to individuals or organizations) in areas of exclusive subnational jurisdiction.

Link to revenue-raising powers. As noted above, the revenue-raising powers of the federal government under the Constitution are very broad, though not unlimited. Consequently, federal government revenues (before intergovernmental transfers) as a percentage of total (federal-state-local) government revenues represented 64.7 percent in 1986. A decade later they constituted 65.8 percent in

1996 and still represented the largest portion of total government revenues. This was substantially greater than in Canada where the comparable figures were 48.4 percent in 1986 and 47.7 percent in 1993 (see Table 2, p. 52 in this volume).

As a result, financial transfers, almost invariably in the form of conditional grants from the federal government to the states and to local governments, have come to represent a significant portion of state and local revenue. Intergovernmental transfers as a percentage of all state government revenue represented 20.5 percent in 1986 and 29.6 percent in 1994. While lower than in most other federations they are higher than in Canada where the comparable figures for intergovernmental transfers as a percentage of provincial revenue were 20.1 percent in 1986 and 19.8 percent in 1993 (see Table 4, p. 53 in this volume).

Three objectives have contributed to the extensive use of federal transfers to state governments. First, a major aim of these grants has been the desire of Congress to encourage the states to pursue national policies. A second objective has been to encourage the states to modernize and develop more effective policy. A third has been to help the states to participate in redistributive and welfare programs and a desire to preserve the ability of the states to mount these. Among the reasons contributing to the vertical imbalance in direct revenues is that the federal government dominates the income tax field. The states can levy income taxes and many do, but at relatively low levels. Federal occupancy of most of the income tax field and the ability to undertake substantial deficit financing at the federal level (a practice from which the states are generally precluded) have left the federal government with overwhelming fiscal supremacy. With no federal abatements and no Canadian-style tax-sharing arrangements, the balance of revenue-raising is more centralized than in Canada.

There are also fiscal disparities among the states in their revenue-raising capacities. The range in capacity measured by the U.S. Advisory Commission on Intergovernmental Relations' Representative Tax System was 141 (Nevada) to 71 (Mississippi) in 1994 (Tannenwald and Cowan 1997). Thus, the highest state had two times the fiscal capacity of the lowest. The comparable range in Canada for the pre-equalization fiscal capacities of the provinces in 1996-97 was not dissimilar, ranging from 143.4 (Alberta) to 64.8 (Newfoundland).⁷

Unlike most other federations, however, there have been no generalized schemes in the United States for vertical transfers or for equalization programs. The practice instead has been for Congress to authorize a large variety of "grant-in-aid" schemes, which totalled 633 programs in 1995, usually taking the form of matching grants or conditional grants directed at specific programs, with the conditions spelled out in considerable detail.

Unlike some other federations, there are no constitutionally specified portions of federal taxes dedicated to federal transfers to state governments. A few federal taxes (principally, the federal motor fuels and excise tax and airport taxes) are earmarked by federal statute for transfers to state and local governments for

transportation. Federal tax funds transferred from the statutory Highway Trust Fund constituted about 15 percent of all transfers to state and local governments in 1986 and about 10.2 percent in 1996.

Decisions on the use of the federal spending power. Decisions about the use of the federal spending power in the United States have not required any special procedures, whether relating to areas of concurrent jurisdiction or areas of exclusive state jurisdiction.⁸ Ultimately, decisions about the use of the federal spending power have rested with Congress and the President.

By comparison with Canada, in the United States there has been a relative lack of coordination between the two orders of government in the design of programs involving the use of the federal spending power. This is perhaps understandable given the large number of states, the lack of any forum comparable to the First Ministers' Conferences and ministerial conferences in Canada, and the diffused policy-making within both orders of government due to the separation of powers within their institutions. There is no formal provision for the states to have an explicit role in decisions about the use of the federal spending power. In practice, therefore, state and local government representatives participate in lobbying Congress along with a variety of other lobby groups.⁹

While ultimately the acceptance of grants-in-aid approved by Congress is voluntary on the part of the states, there have been no provisions for opting-out with financial compensation. Consequently, in practice, opting-out of a large federal grant-in-aid program has not been a realistic political option for states, although states do opt out of or decline to apply for many smaller grants-in-aid, recognizing that in doing so they forego the associated funding.

Congress, in approving grant schemes to the states and local governments, has not considered itself bound by any non-legal principles guiding its use of the spending power. Nevertheless, considerable weight has been given to the principle of fiscal responsibility, that is, that the government that raises the money should determine how it is spent. Consequently, virtually all the transfers to states and local governments today take the form of conditional grants.¹⁰

Nature and extent of the use of the federal spending power. The federal government makes extensive use of its spending power in relation to areas of state jurisdiction. Given the large number of fields of concurrent jurisdiction (in all of which there is potential total or partial federal paramountcy), many of the conditional grant programs, while relating to areas of state legislative competence, do not necessarily relate to fields outside the federal law-making power. Nevertheless, the use of the federal spending power has not been restricted to these areas of concurrent jurisdiction and has also been extensive in areas of exclusive state jurisdiction. Because the latter have not required a special procedure of approval, they have not been differentiated in public accounts as a specific separate classification. Without extensive examination of each individual federal grant-in-aid, it

is not possible to identify what proportion of these transfers have applied to areas clearly within exclusive state law-making power.¹¹

What is clear is that, except for the partial exception of General Revenue Sharing (1972-86), all federal transfers have been conditional. These grants have taken a wide variety of forms. Four broad types can be distinguished: (i) project grants, which are given on a discretionary basis to qualifying applicants, (ii) formula grants with open-ended reimbursement of costs at a specified rate, (iii) formula grants related to particular projects, and (iv) formula grants in which a fixed total amount is distributed to recipients in accordance with a formula.¹² The majority of these grants have required some degree of non-federal matching. They can also be classified as categorical grants (618 in 1995) for specific, narrowly defined activities and block grants (15 in 1995) for broad functional areas that although conditional may be used with greater flexibility and discretion by recipients. By comparison with Canadian experience, the conditions and formulas specified have tended to be much more detailed.¹³ Some of the schemes have involved direct federal expenditure to individuals or non-governmental agencies, but a substantial number have been directed at the states and local governments as recipients.¹⁴

Many of the conditional grant schemes have attempted to build in elements of equalization, but unlike in most other federations, there is no overall scheme of unconditional transfers to states aimed at equalizing revenue capacities.¹⁵

The most notable characteristic of the use of the federal spending power in the United States has been the vast array of uncoordinated conditional grants to the states and local governments and also the unfunded mandates established through the unilateral decisions of Congress. This has led to the ascription of the label "coercive federalism" to U.S. federalism by a number of commentators (Kincaid 1993).

Finally, a point to note is that the federal government has increasingly used the federal income-tax system since the mid-1970s as an alternative policy tool to achieve redistribution.¹⁶

2.2 SWITZERLAND

The federal context. Switzerland converted its previously confederal structure into a federation in 1848, thereby becoming the second modern federation. Switzerland is a relatively small country of some seven million people now comprising 26 cantons (of which six are designated "half cantons"). Switzerland is noted for its linguistic diversity (with three official languages and a fourth "national" language) and two dominant faiths (Roman Catholic and Protestant); these represent territorial cleavages that cut across each other.

The constitution lists federal powers and assigns residual powers to the cantons, but makes some provision for federal action in the residual areas.¹⁷ While

under the constitution a significant proportion of powers is assigned to the federal government there is in practice a high degree of decentralization because the federal government is highly dependent upon the largely autonomous cantons for the administration of a large portion of its legislation. A significant feature of the Swiss federation is that only cantonal legislation and not federal legislation is subject to judicial review. The umpire for the federal exercise of its legislative authority is the device of the legislative referendum by which any federal legislation challenged by 50,000 citizens or eight cantons must be submitted to a popular vote in a referendum. This has induced the seeking of a maximum consensus within parliament for all federal legislation before enactment.

As in the United States the principle of the separation of powers has been applied to the federal institutions, but the actual institutions are quite different from those in the United States. The federal executive (the Federal Council) is a collegial body elected by the Swiss federal legislature for a fixed term and is composed of seven councillors among whom the presidency rotates annually. The federal legislature is bicameral and in the second chamber cantons each have two members and half cantons one. The electoral system based on proportional representation has produced a multiparty system, but the fixed-term executive has provided stability and the tradition has developed that it should encompass all four major political parties, thus representing an overwhelming majority within the federal legislature. A characteristic of the Swiss political processes has been the widespread use of referendums and initiatives. Another characteristic is that dual membership in the cantonal and federal legislatures is permitted so that in practice about one-fifth of the federal legislators (in each federal house) are concurrently members of cantonal legislatures and thus serve as a bridge between the two orders of government.

For two decades, from 1965 to the early 1980s, a major effort at comprehensive constitutional revision was mounted in Switzerland, but in spite of the work of two commissions and extensive federal-cantonal consultations the process in the end came to nought (Schuetz 1993). Currently, a more modest effort at constitutional revision is underway directed more at tidying up and clarifying the constitution than at fundamental amendments. One important change that has been under consideration, however, is the extension of judicial review to federal legislation as an addition to the current processes of judicial review which are limited to reviewing cantonal legislation.

Legal basis of the federal spending power. The Swiss constitution does not distinguish between the law-making power and the spending power of the federal and other governments. The law-making power and the spending power are usually contained in the same article of the constitution. There is almost no law-making power without a corresponding spending power and vice versa. Legally speaking, therefore, the constitution generally does not permit federal spending, either by transfers to cantons or communes or by direct transfers to individuals or

organizations, in areas of exclusive cantonal jurisdiction. Article 3 of the constitution guarantees to the cantons exclusive sovereignty except where powers are specifically assigned to the federal government and articles 8 to 42 set out the various federal legislative powers. Thus, it is only in these specified areas that the federal government has a constitutionally backed spending power. There are some minor exceptions, particularly in the realm of promotion of culture, where a federal spending power has been interpreted as implied by some of the more specific federal constitutional powers.¹⁸

While that is the legal position, practice has been somewhat different. The key factor has been that unlike other federations, in Switzerland judicial review does not apply to federal legislation. In practice, therefore, the only limitation upon the federal parliament and government exercising their legislative and spending power in areas beyond those specified in the constitution is the device of the legislative referendum by which any federal legislation challenged by 50,000 citizens or eight cantons must be submitted to a referendum. This has meant that where federal legislation and associated spending extending beyond the strict constitutional limitations has gone unchallenged by referendum, or when challenged has been supported by a simple majority in a national referendum, federal action has been able to extend into areas of constitutionally exclusive cantonal jurisdiction. The result is that while there is no formal constitutional definition of areas of concurrent jurisdiction there has developed extensive overlap in the activities of Swiss governments. Characteristically, "the sharing of the spending power between governments is, like almost everything else in Switzerland, almost always the result of a series of compromises and adjustments" (Bird 1986, p. 56). When the general dependence of the federal government upon the cantons and local governments for the administration of a significant portion of its legislation is added, the result has been that "there is almost no function of government in which all three levels of government do not participate" (*ibid.*; see Dafflon 1998, pp. 5-6, 9, 24-25, 27). Thus, although the political culture of resistance to centralization remains a potent force in Swiss politics, Swiss federalism is marked by a high degree of intergovernmental interdependence and interaction. One result of the growing intertwining of the expenditure functions of the different levels of government has been the inevitable development of a complex system of intergovernmental transfers.

Link to revenue-raising powers. The Swiss constitution does specify the revenue-raising powers of the two orders of government.¹⁹ Article 41 bis lists the exclusive taxing powers of the federal government, article 41 ter lists additional areas of federal taxation, and article 42 lists certain fees the federal government may levy.

The proportion of total federal-cantonal-local revenues (before transfers) raised by the federal government is less than in most other modern federations, totalling 48.1 percent in 1986 and 44.7 percent in 1995. This is less than in Canada where the comparable figures were 48.4 percent in 1986 and 47.7 percent in 1993 (see Table 2).

Nevertheless, transfers from the federal government to the cantons and to local governments have been considerable. Indeed, intergovernmental transfers as a percentage of cantonal revenue were 21.7 percent in 1986 and 18.9 percent in 1995, levels comparable to the Canadian figures of 20.1 percent in 1986 and 19.8 percent in 1993 (see Table 4).

This indicates that even though the revenue-raising powers are more decentralized than in other federations, there has remained a substantial vertical imbalance between the revenue-raising capacity and the jurisdictional authority of the levels of government within the Swiss federation.²⁰

The Swiss federation has also been characterized, as have been most federations, by considerable horizontal disparity in the revenue-raising capacity of the cantons. Indeed, an index of the financial capacity of Swiss cantons in 1996-97 prepared for calculation of the equalization element in transfers showed a range from 30 to 228, a ratio of 17.6.²¹ This is somewhat larger than in either Canada or the United States, but it is in part due to the existence of a number of very small rural cantons.

The existence of these vertical and horizontal imbalances has influenced the development of the complex Swiss system of intergovernmental transfers. In respect to the horizontal cantonal disparities a commitment to equalization was first introduced into the constitution in 1958. Since then the concept of "fiscal capacity" has increasingly played a key role both in the distribution of conditional grants and in tax sharing (see Bird 1986, pp. 59-62; Dafflon 1998, pp. 21-24). Nevertheless, although extensively applied to conditional transfer schemes, equalization has been less significant in its total scope than in such other federations as Germany, Australia and Canada. In this respect Switzerland has been somewhat closer to the pattern in the United States although the approach has been more systematic than in the latter.

Decisions on the use of the federal spending power. Decisions about the use of the federal spending power in areas of cantonal jurisdiction lie with the federal parliament. There is no differentiation of procedures relating to decisions to exercise the federal spending power in areas of shared or exclusive cantonal jurisdiction. While constitutionally cantons are not given a specific role in decisions about the exercise of the federal spending power there is a requirement of cantonal consultation in certain circumstances, and furthermore any federal law is potentially subject to challenge by referendum (as noted above). This has meant that in practice consultation of cantonal governments about the exercise of the federal spending power has been extensive and that the cantons appear to have had a strong influence on the exercise of the federal spending power. Furthermore, given that normally something like one-fifth of the members of each house of the Swiss parliament are concurrently members of cantonal legislatures, there is a strong cantonal voice in the deliberations within the Swiss parliament concerning the exercise of the federal spending power.

As in most federations other than Canada there has been no financial compensation for cantons opting out of a federal grant schemes. The decision whether to accept or refuse such transfers has in practice, therefore, not been a politically realistic option in Switzerland.

In terms of whether non-legal principles have been accepted by the federal government to guide the use of its spending power, since the 1958 constitutional amendment which introduced a commitment to equalization into the constitution, the major example has been the extensive application of equalizing criteria and calculations in most of the many conditional grant schemes and in tax sharing.

Nature and extent of the use of the federal spending power. Since the various tax-sharing and conditional grant schemes developed by the federal government do not specifically differentiate those that lie legally outside the realm of the federal law-making power, and since a significant portion is represented by transfers in support of cantonal administration of federal legislation, precise data on the extent to which fiscal transfers to the cantons relate to areas outside federal legislative power are difficult to obtain.

What is clear is that the extensive fiscal transfers from the federal government fall broadly into four categories: unconditional grants, reimbursements, conditional grants, and tax sharing (Bird 1986, pp. 56-59; Dafflon 1998, pp. 14, 22-24). Of these, by contrast to Canada, *unconditional grants* constitute only a minuscule component. *Conditional grants* or specific-purpose grants that apply to the purposes specified by the federal government are much the most important type of transfer. Furthermore, all conditional grants to the cantons are also matching grants. Although the conditions are usually quite detailed, nevertheless cantonal performance has usually been controlled in only a formal way. In addition, as already noted, most conditional grants are intended to have some equalizing effects and are based on an index of fiscal capacity. While there is no way of calculating directly the portion of these grants that is redistributive, some estimates place the redistributive component (aiming at equalization) at about 35 percent. *Reimbursements* from the federal government involve payments to cantons for delegated administration of some federal tasks. Like conditional grants there is an equalization element, with the federal reimbursement varying according to the "fiscal capacity" of the recipient canton. Another major element in intergovernmental transfers is *tax sharing*. The original rationale for these was the replacement of cantonal customs duties when they were abolished in 1848. More recently a further factor has been the administration of certain federal taxes, including the income tax, by the cantons on behalf of the federal government. Consequently, the federal government shares with the cantons specified percentages of seven taxes, by far the most important of which is 30 percent of the direct federal income tax (with 22.5 percent based on source and 7.5 percent shared according to fiscal capacity). These are in effect unconditional transfers. The relative importance of these different types of transfers can be gauged from the fact that in 1980, of the

total 28 percent of federal direct revenues that were transferred to the cantons, 9 percentage points were in the form of tax sharing, 7 percentage points were reimbursements, and 12 percentage points were conditional grants (Bird 1986, p. 59). In 1995, of the transfers not directly related to reimbursements for delegated administration, tax sharing provided 27 percent and conditional grants were 73 percent.

In Switzerland, the federal government does little in the way of direct transfers to individuals. In 1986, such direct transfers represented about 3.5 percent of all transfers.²² Of the federal transfers to subnational governments, a few have been made directly to municipalities, but the overwhelming majority have been to cantons (with the cantons in turn making transfers to municipalities).

While there have not been recent alterations to the revenue and expenditure responsibilities of each order of government to bring revenues and expenditures into closer balance, there is currently underway a consideration of fundamental reform to Swiss fiscal federalism which includes (among a wide range of issues) special attention to decreasing the number of joint tasks, introducing and increasing unconditional grants, and changing the transfer system from a cost-oriented one to a performance-oriented one.

2.3 AUSTRALIA

The federal context. Australia was established as a federation in 1901 and comprises six states (of which the two most populous, New South Wales and Victoria constitute 60 percent of the country's population) plus a capital territory, the northern territory and seven administered territories. As federations with adaptations of the British parliamentary form of government there are strong similarities between Australia and Canada. But where Canada has evolved into a highly decentralized federation, Australia has by comparison become highly centralized, at least in part because regional differences have been less significant and there is no equivalent to the role played by Quebec in Canada.

The founders of the Australian federation chose to follow the American rather than the Canadian model in the distribution of powers. The constitution enumerates a limited list of federal exclusive powers and a substantial list of concurrent powers (with federal paramountcy), and leaves unspecified residual powers to the state governments.²³ The allocation of executive authority normally follows that of legislative jurisdiction. In practice, the Australian federation has evolved into a relatively centralized federation, particularly with respect to financial arrangements.

While adopting a different form of distribution of jurisdiction from Canada, the Australian federation did follow the Canadian precedent of combining federal and parliamentary institutions with responsible Cabinet government operating at both federal and state levels. Nevertheless, Australia incorporated a relatively powerful, directly elected Senate with equal representation of the state electorates,

but the impact of the parliamentary system has made the Senate more of a "party house" than a "state house." As a parliamentary federation, Australia has, like Canada, developed extensively the institutions and processes of "executive federalism," although its financial predominance has given the federal government a dominant role in meetings with the states.

Legal basis of the federal spending power. As noted above, section 51 of the Australian constitution enumerates some 40 heads of power with respect to which the federal Parliament may make laws and has paramountcy in case of conflicts with state laws²⁴ and three matters over which it has exclusive powers.²⁵ The unspecified residual authority is left exclusively with the states.²⁶ Historically the courts have interpreted the enumerated exclusive federal and concurrent heads of power broadly. This has contributed both to the extensiveness of the areas of concurrent jurisdiction and to the progressive centralization of the Australian federation.

The constitution also clearly distinguishes between the federal law-making powers and spending powers. Section 96 provides specifically that the federal Parliament "may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit." Furthermore, jurisprudence has upheld a broad interpretation of this clear statement of the federal spending power.²⁷ Nevertheless, the extent of the federal spending power is still controversial.²⁸ As far as the use of the federal spending power for assistance to states, there would appear to be no legal limits or interdictions on the objects on which the federal authority may spend.

Link to revenue-raising powers. The constitution does distinguish to some extent explicitly and to some extent implicitly between the revenue-raising powers of the two orders of government. The federal government is given a general power over "taxation" in section 51 (ii) and this is only limited by a proviso that it cannot "discriminate between States or parts of States." The result has been that by contrast with Canada and indeed most other federations, in Australia the federal government has consistently exercised virtually exclusive authority over most of the major tax sources, including income tax, and hence control over most of the sources of state revenues, whether taxes or borrowing (Bird 1986, pp. 123-29). Furthermore, this arrangement has been confirmed by jurisprudence.²⁹ This overwhelming federal government dominance of the taxing powers has been the single most important feature of Australian fiscal federalism and has enabled the federal government to use its spending power extensively.

A consequent result has been that the balance between federal and state direct revenue raising has favoured the federal government much more than in Canada, the United States or Switzerland. For example, federal government revenues before intergovernmental transfers as a percentage of total (federal-state-local) government revenues were 74.4 percent in 1986 and 69.1 percent in 1996 (see Table 2). Consequently, the vertical imbalance between the revenue-raising capacity and jurisdictional authority of the two orders of government in Australia

has been very substantial. This is illustrated by the difference between federal government direct revenues (before intergovernmental transfers) as a percentage of total (federal-state-local) government revenues (74.4 percent in 1986 and 69.1 percent in 1996) and federal direct expenditures (after intergovernmental transfers) as a percentage of total (federal-state-local) expenditures (52.7 percent in 1986 and 53.0 percent in 1996) (see Tables 2 and 3.)

This has made necessary massive transfers from the federal government to the states in order to meet expenditure requirements of the states in performing their legislative and administrative responsibilities. The percentage of state revenues represented by federal transfers has been substantially higher than in most of the federations examined in this study, 54.4 percent in 1986 and 40.7 percent in 1996.³⁰

There are also horizontal imbalances in the revenue capacities of the different states, although these have been much less extreme than in Canada, the United States, and Switzerland (Bird 1986, pp. 121-22). For instance, in 1997 the disparity in per capita personal income between the wealthiest state, Victoria, and the poorest state, Queensland, was 104 to 91 with 100 representing the Australian average. This is somewhat less than the range of the pre-equalization fiscal capacities of the provinces of Canada in 1996-97 — from 143.4 (Alberta) to 64.8 (Newfoundland).³¹ Nevertheless, it was a secession movement arising from dissatisfaction in Western Australia leading in 1933 to a referendum majority in support of separation that provided a major impetus for the establishment of the Commonwealth Grants Commission at that time. This resulted in Australia becoming a pioneer among federations in the establishment of a formal system of equalization grants.

These vertical and horizontal imbalances have given federal-state financial arrangements a predominant role in the dynamic development of federal-state relations within Australia (Matthews 1981, pp. 4-5).

Decisions on the use of the federal spending power. In terms of constitutional requirements, the use of federal spending power whether in areas of concurrent jurisdiction or in areas of exclusive jurisdiction is not subject to special procedures and rests solely at the discretion of the federal Parliament. There is no differentiation in processes between the use of the federal spending power in areas of concurrent jurisdiction or exclusive state jurisdiction. Furthermore, since neither of the houses of Parliament contains direct representatives of the state governments or legislatures, approval by Parliament does not entail a role for state governments in the approval of the use of the federal spending power. Thus, ultimately the federal government has the capacity to set unilaterally and arbitrarily the use of its own spending power in areas of state legislative jurisdiction, and through the spending power authorized by section 96 the federal government can exert economic and financial control over the states by laying down any condition it wants to for transfers (Walsh 1997, pp. 18, 21; Lane 1994, pp. 34, 42).

However, constitutional requirements are one thing and conventional practice is another. The practice of executive federalism has taken strong root in the development of Australian federalism and there is a long tradition of vigorous intergovernmental negotiation in the Premiers' Conference (the Australian equivalent of the Canadian First Ministers' Conference), focused upon matters of federal-state financial arrangements and the federal use of its spending power. More recently this has been supplemented by the Council of Australian Governments (COAG) which since 1992 has provided a forum on issues not covered at the annual Premiers' Conference. COAG has been the umbrella for coordinated intergovernmental negotiation in certain areas of large federal spending (e.g., health and housing). But by contrast with several areas of economic regulation and the environment, there has been less progress on reform in the area of federal social program spending.

A striking feature of executive federalism in Australia is the adoption in several intergovernmental ministerial councils of decision rules. The earliest example was the Loan Council established in 1928 where each of the six states has one vote and the federal government has two votes plus a casting vote. This means that five states voting together or the federal government plus two states can carry the day. More recently, during the past decade, seven intergovernmental ministerial councils have adopted formal intergovernmental agreements specifying voting rules for decisions binding on all governments. These voting rules vary from a simple majority to a two-thirds majority or a combination of weighted votes, with effects similar to that in the Loan Council.

One intergovernmental council is expressly provided for in the constitution: the Loan Council, with federal and state representatives, has the task of coordinating public borrowing by the federal government and the states and has had from the beginning the specific form of qualified majority voting referred to above.³² The various intergovernmental meetings have been characterized by hard intergovernmental bargaining, but ultimately the federal government has tended to dominate these meetings because of its predominant revenue-raising position and a constitutionally sanctioned discretionary spending power in areas beyond its own legislative jurisdiction.

A feature not found in Canada has been the use in Australia by the federal government of the quasi-independent Commonwealth Grants Commission. Originally created by the federal government in 1933 to advise it on the allocation of special equalization grants to the claimant states, its role has now developed into that of assessing "per capita relativities" for determining the allocation of the entire pool of general revenue grants to the states (Galligan 1995, pp. 234-38). The commission, as an independent statutory body, undertakes extensive consultation and public hearings with all the relevant parties including state treasurers and officials. Furthermore it undertakes a major review of its methodology every five years. While the federal government has not always acted on all the

recommendations of the Commonwealth Grants Commission, the fact that it has generally acted on the commission's recommendations and the reputation that that commission has established for independent judgement have helped to give considerable weight to the recommendations. This has reduced what might have been a greater political concern if the federal government had acted solely on its own discretion in the equalization arrangements.

In terms of state discretion whether to accept grants, there are no provisions for "opting-out" with compensation. Given the magnitude of the vertical imbalance whereby states are generally dependent upon federal transfers for a substantial portion of their revenues (54.4 percent in 1986 and 40.7 percent in 1996), the exercise of discretion in receiving them is simply not politically realistic.

In acting on the advice of the Commonwealth Grants Commission, the federal government has in effect accepted non-legal principles to guide it in the use of its spending power. The carefully calculated recommendations of the Commonwealth Grants Commission for general revenue grants have been based on an analysis of the capacity of the states to raise taxes and provide standard services. Thus, the federal government has implicitly accepted the objectives of reducing both the vertical and horizontal revenue-expenditure imbalances in the exercise of the federal spending power.³³ Furthermore, since the Commonwealth Grants Commission in its calculations has attempted to equalize both revenues and expenditures, has equalized down as well as up to the federation average, and has made explicit allowance for cost differentials, the federal government by accepting the commissions' recommendations has also implicitly accepted these guidelines for its unconditional transfers.

Nature and extent of the use of the federal spending power. Given the magnitude of the federal transfers to the states it is clear that the Australian federal government has made extensive use of its spending power to assist the states. Since, however, such vast areas of federal and state legislative and executive activity fall within areas of constitutionally concurrent jurisdiction, it is difficult to identify precisely what proportion of these transfers relate to areas of exclusive jurisdiction lying outside the federal law-making power, although clearly some of it does so. Nevertheless, since a substantial portion of federal conditional grants have related to health, education, and housing — all of which are areas of state exclusive jurisdiction — clearly such grants have extended beyond areas of concurrent jurisdiction. Indeed, in 1994-95, education accounted for 39.3 percent of all conditional grants, health for 29.9 percent, and housing and community amenities for 6 percent (Craig 1997, p. 83).

Of the total federal transfers to the states, a very important component has been the *unconditional* general-revenue grants intended to reduce both the vertical and horizontal revenue-expenditure imbalances in the states. In 1996 these represented 47 percent of all federal transfers to the states (Walsh 1998, p. 9; see also Galligan 1995, p. 230).

The other 53 percent of federal transfers were comprised of *conditional* grants tied to functional purposes, mostly in social policy areas such as education, health, social security and welfare, housing and community amenities, and economic services including transportation. This shows how extensive the federal government presence is in areas of social policy that would otherwise come within the states' jurisdiction. Furthermore, in the past 20 years up to 1997-98, specific purpose payments have increased as a percentage of total federal payments to the states by around 7 percentage points (Government of Australia 1997, p. 39).

In all, there are currently some 68 formal specific-purpose transfer programs to the states.³⁴ The conditions imposed on individual specific-purpose payments vary considerably in both degree and form (*ibid.*, pp. 37-38). They may involve a requirement that payment be expended for a specific activity, with varying degrees of budgetary discretion available to the states according to conditions placed on payments, or may involve general policy requirements on states (e.g., that the states provide free public hospital treatment for Medicare patients as a condition of receiving hospital funding grants). The federal government can attach conditions to specific-purpose payments to reflect policy objectives in program areas often including requirements for certain levels of spending by the states. The conditions attached to specific-purpose payments can thus limit the ability of state governments to set their own spending priorities. Specific-purpose payments that are paid "through" the states account for around 40 percent of total specific-purpose payments. These specific-purpose payments have a minimal impact on state budgets as they are essentially federal government own-purpose outlays, with the states acting as the federal government's agent. Some specific-purpose payments also include conditions that influence state own-purpose outlays through the use of matching fund requirements.

In comparative terms the Australian conditional grants do not appear as heavily conditional as those in the United States, although in comparison to Canada they appear much more detailed than anything Canadians are used to. For the most part Australian commentators have reacted somewhat adversely to the impact of these conditional grants on state spending patterns, but there appears to be little that is unique by comparison with other federations excluding Canada.³⁵ Since these conditional grants represent over one-fifth of total state revenues they provide a significant federal influence upon state policies in the areas they support (see Table 6, p. 57 in this volume).

Given the constitutional ability of the federal government to make extensive use of specific-purpose payments including payments "through" the states (noted above) the incentive upon the federal government to make direct payments to individuals and organizations in areas within exclusive state jurisdiction and thus to bypass making transfers to the states has not been strong, although under section 96 of the constitution such federal direct payments clearly are not prohibited.³⁶

There has recently been considerable discussion in deliberations between the federal and state governments about the need to alter the allocation of taxing

powers in order to bring into closer balance the revenue and expenditure responsibilities of each order of government.³⁷ Some major adjustments, particularly related to the introduction of a Goods and Services Tax, are in the process of being implemented.

2.4 GERMANY

The federal context. The German federation established in 1949 owes a great deal to the earlier experience of the German Empire (1871-1918), the Weimar Republic (1919-34), the failure of the totalitarian centralization of the Third Reich (1934-45) and the postwar influence of the allied occupying forces. In 1949 the 11 Länder of West Germany became the Federal Republic of Germany. Subsequently, the reunification of Germany in 1990 provided for the accession of five new Länder so that the federation now consists of 16 Länder with a total population of over 80 million.³⁸ The population of the German federation is linguistically homogeneous, although there remains considerable economic disparity and difference in political cultures between the former West and East Germanies.

A notable characteristic of the German federation is the interlocking relationship of the federal and state governments. The federal government has a very broad range of exclusive, concurrent (with federal paramountcy) and framework legislative powers. The Länder, in turn, have a mandatory constitutional responsibility for applying and administering these laws. While the legislative powers of the federal government are extensive, a significant feature of the German federation is that the Länder are more directly involved in federal decision-making than the states or provinces in any other federation. This is achieved through the direct representation of Land first ministers and senior Cabinet ministers in the federal second chamber, the Bundesrat, which is comprised of the Ministers President and ministers serving as ex officio delegates of their Land governments with the representatives of each Land voting as a single block. The Bundesrat possesses an absolute veto on all federal legislation affecting the Länder. About 60 percent of federal legislation falls in this category due mainly to the fact that the Länder are responsible for administering the federal laws in areas of concurrent jurisdiction. Thus, the Bundesrat is a key institution in the interlocking federal-state relationship in the German federation and there is extensive joint decision-making.

Both the federal and the Land institutions are organized on the principle of parliamentary responsible Cabinets, but there is a formal head of state, the President of the Federal Republic, elected by an electoral college consisting of the Bundestag and an equal number of members elected by the legislatures of the Länder.

The German federation is of particular interest because of the closely interlocked legislative and administrative powers of the two orders of government and the unique way in which the Länder participate in federal decision-making through their representation in the Bundesrat which thus serves as a key institution in the

legislative, administrative and financial interdependence of the two orders of government.

The legal basis of the federal spending power. The German constitution distinguishes between the law-making and spending powers of the federal and state governments.³⁹

In the realm of legislative jurisdiction the constitution sets out a list of exclusive federal powers and an extensive list of concurrent jurisdictions where Länder may legislate but federal legislation has paramountcy. In addition, the constitution provides for federal powers to legislate "framework provisions" for certain subjects where detailed legislation is left to the Länder. There are also "joint task powers" for joint federal-Land undertakings.⁴⁰ In terms of legislative jurisdiction there is thus a heavy emphasis upon concurrent and shared jurisdiction with the federal government in a predominant position.

At the same time the constitution places a heavy emphasis upon the administration of much federal legislation (i.e., that made in areas of concurrent, framework, and joint legislative jurisdiction) being performed by the Länder under a constitutional mandate. Thus, while legislation is relatively centralized, administration of that legislation is highly decentralized. This clearly has implications for fiscal arrangements since correspondingly centralized revenue-raising has to be counterbalanced by decentralized expenditures.

The German constitution has a number of provisions relating specifically to the federal spending power. These are more explicit and more limited than the broad discretionary federal spending power in Australia and the United States. The federal government is permitted to spend money on certain areas of Länder responsibility. Section 91a explicitly enables the federal government to participate in the discharge of the responsibilities of the Länder "provided that such responsibilities are important to society as a whole and that federal participation is necessary for the improvement of living conditions." In addition, where a federal law imposes additional financial obligations upon Länder, the federal government is required to compensate them. The constitution has also enabled a federal law to establish the formula and criteria under which financially weak Länder qualify for equalization contributions from financially strong Länder and from the federal government. Article 104a(4) of the constitution enables the federal government to grant financial assistance to Länder in order (a) to avert disturbance of the overall economic equilibrium, (b) to equalize differences in economic capacity, or (c) to promote economic growth.

There are some legal limits or interdictions on the use of the federal spending power. Article 91a, which provides for cooperation between the federal government and the Länder in funding certain projects that are policy areas under Land jurisdiction, specifies that the joint tasks that are funded under this provision must be defined in detail by a federal statute. The statute then requires the consent of a majority in the Bundesrat (composed of state government delegates). Grants-in-aid under article 104a also require the consent of the Bundesrat.

Link to revenue-raising powers. A major feature of the revenue-raising arrangements in the German federation is the constitutional provision for the sharing of tax revenues. The constitution itself provides for 42.5 percent of income tax, 50 percent from corporation tax and 49.5 percent of turnover tax to be apportioned directly to the Länder.⁴¹ By 1980, constitutionally shared taxes accounted for 81 percent of the total tax revenues of all levels of government. These shared taxes accounted for 76 percent of the federal tax revenue, 87 percent of the state tax revenue and 84 percent of the local tax revenue (Bird 1986, pp. 91-95 at 91-92). The most important shared taxes were the income tax accounting for 52 percent of all shared revenues and the value-added tax accounting for another 32 percent. As Bird notes, "Revenue sharing in Germany thus dominates the tax system at all levels of government and constitutes by far the most important fiscal institution in modern German federalism (*ibid.*, p. 92).

For purposes of comparison with other federations the question arises whether the Land and local shares of the constitutionally required revenue-sharing should be classified as a form of unconditional transfer derived from federal taxes or simply as a constitutionally allocated "own source" of Land and local revenues. A good case can be made for either categorization. On the one hand, in Germany as in some other federations, such as India where the states receive constitutionally specified portions of certain taxes, the states do not control the level of those taxes, and therefore there is some limit on their autonomy. On the other hand, unlike those other federations where shares of certain taxes are specified, in Germany the federal approval of tax levels for shared taxes requires the concurrence of the states through the Bundesrat, and thus the levels are not determined by the federal government alone. In effect, tax levels for shared taxes are jointly determined. For purposes of comparability with other federations in Table 2 (later in the paper) the former classification has been used. This means that for 1986 and 1996 federal government revenues (before transfers) as a percentage of federal-state-local revenues would represent 64.5 percent in both years, a figure close to that in the United States and India in Table 2. On the other hand, if the alternative interpretation is adopted because the constitutionally specified revenue shares of the Länder go automatically to the Länder and the federal government exercises no unilateral discretion or control over the size or allocation of these shares, this has a significant bearing on any comparative classification (as in Table 2). Indeed, German legal scholars, therefore, usually treat these Land revenue shares as "own revenues" of the Länder rather than as transfers from the federal government. Under the latter approach to classification, federal government revenues (before transfers) would not include the constitutionally allocated Land and local government shares and therefore would represent substantially less of total federal-state-local government revenues, that is, 26.3 percent in 1986 and 24.3 percent in 1996. This proportion is the lowest among all the federations (but not the European Union) considered in this study.⁴²

In addition to the constitutionally specified revenue-sharing arrangements, there are intergovernmental transfers between the states and from the federal to the state governments. These are broadly of two types. The first is the unconditional equalization transfers. These consist of two elements: (i) an interstate revenue pool into which richer Länder pay in and poorer Länder draw out according to a specified formula, and (ii) federal supplementary payments to the poorer Länder based on a fixed percentage of the federally administered value-added tax.⁴³ The second category of transfers consists of the specific grants from the federal to the Land governments related to the joint tasks, reimbursement of delegated administrative responsibilities and conditional grants for specific programs.⁴⁴ In 1986 and 1996 the first category (unconditional equalization transfers) represented 42.1 and 35.5 percent respectively of all federal transfers to the Länder, and the second category (specific conditional transfers) 57.9 percent and 64.5 percent respectively.⁴⁵

Even after the inclusion in the federal and Land revenues of their respective shares of shared taxes, there still remains some vertical imbalance in the revenue and expenditure authority of each order of government, but the imbalance is somewhat less than in most other federations. Consequently, the percentage of state revenue coming from intergovernmental transfers, at 15.5 percent in 1986 and 18.3 percent in 1996, was the second lowest of all the federations considered in this study including Canada (see Table 4).

As in all federations there has been a disparity in revenue capacity among Länder, although prior to reunification in 1990 these were less serious than in most other federations (except Australia), ranging before equalization in a ratio of 2.28 between the wealthiest and the poorer Länder (Bird 1986, p. 96). The new eastern Länder added by reunification have sharpened the disparity, however, and special additional financial arrangements have proved necessary to assist them. The distribution of the turnover tax between the federal government and the Länder, as well as the horizontal distribution of the turnover tax was, therefore, changed. In addition, to assist the step-by-step integration of the five new Länder into the system of horizontal equalization, the supplemental grants were amended. These arrangements have placed some new stresses upon the fiscal arrangements within the German federation (Exler 1992).

Decisions on the use of the federal spending power. The overriding characteristic of decisions about the use of the federal spending power is that whether in areas of concurrent (or shared) jurisdiction or areas of exclusive Land jurisdiction, they require the consent of a majority in the Bundesrat and that in these matters the Bundesrat has an absolute veto. This means that the Länder have a major constitutionally entrenched role in the design and approval of schemes employing the federal spending power, whether related to areas of concurrent or exclusive Land jurisdiction, a role that is much stronger than in any other federation.

Approval is, however, by a majority in the Bundesrat.⁴⁶ There are no arrangements for Länder that are in a minority in the Bundesrat to "opt out" with compensation from programs involving the exercise of the federal spending that have been assented to by a majority in the Bundesrat.

As for the federal government's acceptance of non-legal principles to guide its use of its spending power, these have largely been the product of political negotiations required to obtain the assent of a majority in the Bundesrat.

While formal approval rests with the Bundesrat, the process of intergovernmental negotiation has been facilitated not only by its committees but also by the existence of an institutional forum for macroeconomic coordination, the Financial Planning Council.

The extensive interlocking federal-state relationships in the German federation and particularly the emphasis upon coordination through joint decision-making has led to the identification by some critics of a resulting reduction in opportunities for flexibility and variety, a problem which Scharpf has identified as the "joint decision trap" (Scharpf 1988).

Nature and extent of the use of the federal spending power. Given that the vertical imbalance in federal and state revenue and expenditure responsibilities has been less than in most federations, the employment of conditional grants to the states has been less than in most of the other federations. Furthermore, since interstate transfers are a major component of the equalization arrangements, the use of the federal spending power for equalization purposes has also been less than in most federations. Nevertheless, of federal transfers to Länder (not including constitutionally allocated revenue shares), 57.9 percent in 1986 and 64.5 in 1996 were in the form of conditional grants, usually related to the exercise of "joint responsibilities" (for 1996, see Table 5, p. 56 in this volume). These represented 8 percent and 9.8 percent of total Länder revenues in 1986 and 1996 respectively (for 1996, see Table 6, p. 57). Where conditional grants are made, the conditions usually relate to the task to be performed and standards of performance for those, and not to matching fund requirements.

On the other hand, it is worthy of note that while transfers to other levels of government (excluding constitutional allocation of revenue shares) accounted for less than in most other federations, a substantial portion of federal transfers has gone directly to individuals rather than being channelled through other levels of government (Bird 1986, p. 83). It should be noted, however, that given the extensive exclusive and concurrent legislative powers of the federal government in Germany, such transfers have all been made within the scope of federal legislative jurisdiction. It should be remembered at the same time that the Bundesrat has a suspensive veto over all federal legislation, and insofar as such legislation relates to areas of concurrent legislative jurisdiction the Bundesrat has an absolute veto.

The use of the taxation system as an alternative policy tool for redistribution has been considered in Germany, but the property (net worth) tax was ruled unconstitutional by the Constitutional Court and the government, therefore, did not introduce the new legislation.

To summarize, because of the substantial constitutional allocation of revenue shares, the German federal government has not had to resort to the use of its spending power to correct revenue-expenditure imbalances to the degree that has been necessary in most other federations. Nevertheless, while federal transfers to the *Länder* have formed a smaller portion of state revenues than in most federations, a significant proportion of these transfers has been conditional in character. Perhaps the most significant feature of the use of the federal spending power in Germany, however, is the extent to which its application to areas within the jurisdiction of the *Länder* requires not simply consultation with the *Länder* but their consent through approval by a majority in the Bundesrat. The Bundesrat has an absolute veto on any federal legislation affecting in any way the legislative or administrative responsibilities of the *Länder* including the financial arrangements affecting the *Länder* in the discharge of their functions. This provides the Bundesrat with strong negotiating leverage.

2.5 SOME OTHER FEDERATIONS

The United States, Switzerland, Australia and Germany, considered in the preceding sections, are the longest-standing developed federations most frequently considered in comparative analyses relating to Canada. In all, however, there are some 23 federations in the contemporary world whose experience relating to the use of the federal spending power might be of interest (see Watts 1996, p. 10). The circumstances and structures of many of them, however, are so radically different from those of Canada that their relevance for the spending power issues under consideration in Canada is extremely limited, and so consideration in this report has been limited to five further federations — Austria, Belgium, India, Malaysia and Spain. These have been selected for brief analyses because of their significant features.

Austria

Austria has formally been a federal country since 1920, shortly after the demise of the Austro-Hungarian Empire. The federal system was suspended in 1933, but in 1955 with the signing of a treaty with all the occupying powers, Austria regained its status as a federal republic. Currently, with a population of eight million it comprises nine *Länder*.

Austria is largely culturally homogeneous. German is the official language, although special constitutional provision is made for the use of the Slovene and Croat languages in certain regions of the country.

Given a statist and hierarchal, traditional, political culture, the Austrian federation exhibits a highly centralized, legislative jurisdiction, but with the administration of much federal law extensively decentralized to the *Länder*. Among federations it is one of the most centralized with the *Länder* often serving mainly as "agents" and subordinates of the federal government, although they are assigned the residual legislative authority (see, for instance Pernthaler 1983; Bird 1986, pp. 97-103; Watts 1996, pp. 23, 39-50).

Federal government institutions are parliamentary in form, the Chancellor and Cabinet being responsible to the Nationalrat, although there is a directly elected federal president who performs the functions of head of state. The federal legislature is bicameral. The members of the second chamber (the Bundesrat) are indirectly elected by the assemblies of the *Länder* with representation fairly closely proportional to population except for a minimum guarantee of three representatives for each Land. The Austrian Bundesrat is unlike the German Bundesrat in which Land delegates vote on federal measures as instructed by their Land governments and hold a potent veto over a substantial segment of federal legislation. The Austrian Bundesrat has no significant constitutional power and generally represents party rather than Land interests.

In practice, there is no real constitutional limitation regarding matters upon which the federal government may spend. The constitution (article 10) does generally tie together powers of legislation and execution, but the scope of federal legislative authority is so sweeping that this sets no restrictive limit. Federal legislative authority embraces federal legislation executed by federal authorities (article 10), federal legislation executed by the *Länder* (article 11) and federal legislation prescribing the general framework for state organization and administration (article 12). As Bird has noted: "In short almost every important policy area lies within federal (Bund) jurisdiction. As one author has said, '*De jure* and *de facto*, Austrian *Länder* appear to have less autonomous policy making powers than their German counterparts' — not to mention Canadian provinces!" (Bird 1986, p. 99).

Although the Austrian federal government is extensively involved in administering many of its wide variety of functions, much federal legislation nevertheless is administered by Land agencies, as in Germany, and the *Länder* have to bear much of the cost of that administration (Pernthaler 1983, pp. 9-10). Since most of the major taxing powers are assigned to the federal government, this has meant that federal revenues (before transfers) as a percentage of total (federal-state-local) government revenues represented 71.6 percent in 1986 and 72.8 percent in 1995. Federal government expenditures after transfers constituted 70.5 percent in 1986 and 68.8 percent in 1995 of total federal-state-local government expenditures.⁴⁷ The transfers to the *Länder* and local governments to bring revenues and

expenditures into balance have mostly taken the form of assigned shares of federal taxes, usually on the basis of a percentage established for a five-year period by the federal government in the process of general negotiations on equalization. The result has been an elaborate process of tax sharing which in 1995 provided 43.6 percent of Land revenue.⁴⁸

As for the decision-making processes in the federal government's exercise of its federal spending power, in Austria (in contrast to Germany) the *Länder* appear to have had very little effective voice in shaping the provisions on revenue-sharing.⁴⁹ The *Länder* have only a limited revenue of their own, and unlike Germany very little influence on either the size and form of the tax shares or the fiscal transfers on which they subsist.

To summarize, the dominance of the federal government in Austria in both legislative and financial terms, and the lack of any significant formal or influential role of the *Länder* in policy-making means that issues concerning the legitimacy and extent of the use of the federal spending power have never really surfaced in Austria.

Belgium

By contrast to the highly centralized Austrian federation, the recent evolution of Belgium into a bi-national federation with radical decentralization in some fields would seem to make it an example of particular interest to Canadians.

Belgium was founded in 1830 as a unitary constitutional monarchy, but four stages of devolution — in 1970, 1980, 1988 and 1993 — culminated in the establishment in 1993 of a formal federation (Alen 1992; Alen and Ergec 1994; Alen and Peeters 1995). With a population of just over ten million people, it is composed of six constituent units. Three are regions territorially defined (the Flemish, Walloon and Brussels regions) with councils responsible largely for regional economic matters. Overlapping these are three communities (the Dutch-speaking, French-speaking and German-speaking communities) with their own councils responsible for cultural and educational matters. These regional and community councils became directly elected bodies for the first time after the 1993 constitution came into effect.

The main motivating force for the process of devolutionary federalization has been the political polarization of the two main linguistic groups, the Dutch-speaking (59 percent) and the French-speaking (41 percent) Belgians. The German-speaking minority constitutes less than 1 percent of the population. The centrifugal and bipolar character of Belgian politics has been accentuated by the greater prosperity of the Flemish region (reversing the nineteenth-century situation) and by the resentment of the Dutch-speaking majority at the political dominance that was traditionally exercised by the French-speaking Belgians within the unitary Belgian state. Thus, it has been Flemish nationalism that has been the main driving force behind the devolutionary federalization.

Because of the devolutionary character of the federalization process, the distribution of powers has generally taken the form of allocating increased specific powers to the regional and community councils, leaving the unspecified residual jurisdiction with the central government. Three features distinguish the Belgian distribution of powers. First, the progressive devolution has, in fact, produced a high degree of decentralization. Indeed, in the realm of international relations, the powers assigned to the Belgian communities and regions are greater than those in any other contemporary federation (Alen and Peeters forthcoming). The list of the competences of the communities and the regions entrenched in the 1993 constitution is very extensive, leaving the federal government limited to defence, justice, security, social security and monetary policy. In social policy, the exclusive role of the federal government over social security generally remains one of its few major roles, although a number of important aspects of social policy-making have been transferred to the communities or regions. Furthermore, there are signs that in the next round of post-election coalition negotiations, expected in 1999, the Flemish authorities will be pressing for further fiscal autonomy and additional devolution of powers over social security and justice. A second feature of the distribution of powers has been that, like Canada but unlike most other contemporary federations, the constitutional powers allocated to each order of government have been mainly in the form of exclusive powers (Alen and Peeters 1997). A factor contributing to this pattern in Belgium has been the polarization and distrust between the two major language groups. A third feature of the distribution of powers has been the development of a considerable measure of asymmetry among the constituent units. This is illustrated by the differences between regions and communities, the differing relationships between the regional and community councils in the Dutch-speaking and French-speaking areas, and the particular situation of Brussels as the federal capital located in the Flemish region but with a French-speaking majority.

The federal institutions of the Belgian federation are those of a constitutional monarchy with a Cabinet responsible to the Chamber of Deputies in a bicameral parliament. The most significant feature of the Belgian federal political processes, however, has been the fragmentation of political parties along linguistic lines with no major federal parties bridging the linguistic groups. Consequently, after each election there has been a laborious process of creating a new federal coalition government. This has usually been a complex multi-month process in which the negotiations include reaching agreement on new or additional arrangements for constitutional adjustment and devolution. Consequently, present indications are that there will be a further fifth stage of constitutional evolution in 1999 arising after the next elections, and that the maintenance of the fragile bipolar, centrifugal and asymmetrical Belgian federation will depend upon what sort of consensus is reached at that time. It should be noted that one factor that has contributed to the acceptance of radical devolution and weakening of the federal government within Belgium has been its membership within the wider European

Union, which provides a wider economic framework and safety-net within which the Belgian regions and communities expect to continue to be linked no matter how weak the Belgian federal government becomes.

Turning specifically to the issue of the federal spending power in the Belgian federation, a point to emphasize is that the financial relations within the federation are still undergoing a process of evolution from those that existed prior to Belgium formally becoming a federation in 1993. The 1993 constitution did not spell out the financial arrangements; it merely provided that the plans for financing the communities and regions would be fixed by a special federal law supported by a majority of each linguistic group in each federal House and with the total affirmative votes representing at least two-thirds of the total votes expressed.⁵⁰ Thus, in a purely technical sense it is the federal parliament exercising its spending power that determines the financing of the regions and communities. But in terms of political reality, the fragmented and regional character of the political parties, and the constitutional requirements of special majorities relating to such legislation, mean that the opportunity for any discretionary use of the federal spending power relating to funding regional and community governments is extremely limited. In effect, the consent of the regional parties representing the different linguistic groups is required.

Because of the evolutionary and transitional character of the funding arrangements, it has proved difficult to obtain reliable figures on the relationship between revenues and expenditures in the different orders of government that would be comparable to those obtained for the other federations. Regrettably, therefore, it has not been possible to include comparative figures for Belgium in the tables below. Nevertheless, some general indications are possible. For the fiscal year 1992, it would appear that in terms of expenditure 56 percent could be attributed to the federal government and 44 percent to the community and regional councils.⁵¹ The continued prominence of the federal government financially is largely attributable both to the derivation from the earlier unitary framework and to the relatively recent adoption (after 1993) of regional and community councils as directly elected bodies. Given the clear indications that the forthcoming negotiations following the next federal elections will focus on increasing the fiscal autonomy of the regions and on further devolution of responsibility for social security, it may be expected that the revenue and expenditure balances will continue to undergo considerable change.

India

India became independent in 1947 and the new constitution establishing the Federal Union of India came into effect in 1950. Given the vast, populous and variegated nature of India and the concerns with the threat of insecurity and disintegration, the Constituent Assembly had concluded that the soundest framework would be "a Federation with a strong Centre."⁵²

India is a diverse multilingual society. Hindi, the official language, is spoken by no more than 40 percent of the population (mostly in the north) and there are 18 recognized official languages. Between 1956 and 1966, the states were reorganized largely on an ethno-linguistic regional basis and in one case (Punjab) on a religio-linguistic basis. Today, the federation comprises 25 states, 7 union territories, one federacy and one associated state, with a total population of over 950 million people.

While the founders sought to create a centralized federation, the ethno-linguistic basis of many of the states and the powerful forces of regionalism within the Indian subcontinent have meant, in practice, that India is a federation that is only partially centralized and contains powerful states. The constitution provides for three exhaustive lists of legislative powers — exclusive federal powers, exclusive state powers and concurrent powers (with federal paramountcy) — and for residual powers assigned to the Union Parliament. There is a degree of asymmetry among the states, not only in relation to Jammu and Kashmir but also in relation to the smaller states established in the northeast tribal areas. Formally, the Union government possesses very substantial powers, especially powers of intervention and preemption which have not infrequently been resorted to, but the Union government now functions within an ethno-political and multiparty context that requires that its extensive powers be used for the most part to preserve federalism in form and spirit.

The institutions of the Union and state governments are parliamentary in form with responsible Cabinet government at both levels. The head of state is a president elected by an electoral college consisting of the elected members of both houses of parliament and the state legislatures. The formal heads of the states, the governors, are, like the lieutenant-governors in Canada, appointed by the federal government.

By contrast with Austria and Belgium, there is a considerable literature on Union-state financial relations in India.⁵³ As to the spending power of governments, the Indian constitution provides a specific spending power for both orders of government that extends beyond their law-making powers.⁵⁴ In addition, a further constitutional provision enables Parliament to make grants-in-aid of the revenues of such states as determined by Parliament to be in need of assistance (article 275). The one constitutional qualification to the exercise of these powers is that such grants may be made only after considering the recommendations of the Finance Commission (article 275 (2)).

In devising the financial arrangements, the Indian constitution-makers were heavily influenced by the Australian model. Consequently, the major taxing powers were assigned to the Union government, although expenditure responsibilities were more decentralized. Thus, in 1994, while federal government revenues (before transfers) represented 64.6 percent of total federal-state-local revenues, federal government expenditures (after transfers) represented considerably less, 54.8 percent of total federal-state-local expenditures, and intergovernmental transfers

constituted a substantial percentage, 39.4 percent, of state revenues (see Tables 2, 3 and 4). Transfers have taken the form of both revenue-sharing and grants-in-aid. The constitution specifies that portions of certain Union taxes must be shared with the states, but in certain cases leaves the specification of those portions up to the Union Parliament acting on the advice of the Finance Commission (see, e.g., articles 268, 269, 270). Currently, shared revenue accounts for about 55 percent of the transfers from the Union government to the states (Hemming *et al.* 1997, p. 532). A further 7 percent of transfers consists of grants-in-aid recommended by the Finance Commission to close residual deficits in the state governments' non-plan revenue accounts (see below). These gap-filling grants have in most cases been determined by projecting historical trends in revenue and expenditure, although the Ninth Finance Commission (1990-95) introduced a controversial normative element into its approach, taking account of the special needs of each state (*ibid.*).

The balance of transfers is largely made up of grants decided by the Planning Commission, which approves state development programs as a condition for development grants to be paid by the Union government. The Planning Commission, created in 1950, used to plan comprehensively all development expenditures by the states, and the grants given for specific projects were clearly conditional grants. More recently, a substantial portion of plan grants has tended to be in the form of grants determined by the "Gadgil" formula thus making these grants less conditional in character.⁵⁵ Nevertheless, a substantial portion of plan grants still take the form of specific-purpose grants determined at the discretion of the Planning Commission, and in these instances a significant share of state spending is in effect dictated by the Union government (*ibid.*, p. 533).

The decision-making processes with regard to the exercise of the federal spending power relating to transfers to the states have been dominated by two important commissions, the Finance Commission and the Planning Commission. For some 62 percent of all transfers, including revenue-sharing and grants-in-aid, the Finance Commission, established under article 280 of the constitution, is the key body. Finance Commissions are appointed every five years to recommend how the proceeds of taxes should be shared between the Union government and the states and how these, and grants-in-aid, should be shared among the states. The recommendations of the ten Finance Commissions so far have shown a significant development in the principles they have employed, and, as with the Commonwealth Grants Commission in Australia, their recommendations have generally been accepted by the Union government, thus ensuring confidence in a relatively impartial process relating to the adjustment of non-plan Union-State financial relations (Vijapur 1998, pp. 3-6).

The other element in the decision-making processes relating to the exercise of the federal spending power has been the role of the Planning Commission in relation to transfers directed at development planning. Appointed by the Union government, it was originally conceived as an advisory body of specialists working

as a staff agency to aid and advise the Union government, but over the years it has established itself as an influential body. It recommends the plan grants which are of a discretionary nature and it has generally been viewed as a creature of the Union government — more deferential to it than to the demands and problems of the states (*ibid.*, p. 7). The plan grants made under authority of the discretionary federal spending power authorized by article 282 of the constitution make up over one-third of all the transfers to the states and thus provide a major Union influence on state-spending patterns. Furthermore, since the Planning Commission also recommends plan loans to the states and these represent some 70 percent of the total plan funds distributed (compared to grants constituting 30 percent), this has led to some charges that the funding of plans has played a major part in undermining the financial autonomy of the states.

Malaysia

The Malaysian federation currently comprises 13 states — 11 on the Malay peninsula and two more autonomous states on the island of Borneo — with an overall population of some 19 million. A significant feature of Malaysia is the diversity of its population in terms of race, ethnicity, language, religion, and social customs. The population is approximately 59 percent Malay and other indigenous peoples, 32 percent Chinese and 9 percent Indian. Malays are in a majority in most of the peninsular states, but there are strong concentrations of Chinese in the west coast states, and other indigenous peoples, composed of a variety of linguistic groups, form the majority in the two Borneo states. The federal system has therefore been an important factor in maintaining the delicate communal balance within the federation.

As in India, the Malaysian federation is characterized by a high degree of centralization. Like India, there are three exhaustive lists of powers (exclusive federal, exclusive state and concurrent with federal paramountcy), but the residual powers are assigned to the state governments. A particularly distinguishing feature is the considerable degree of asymmetry in the legislative, executive and financial autonomy ascribed to the constituent units. The 11 peninsular states which were the original states of the Federation of Malaya stand in a symmetrical relationship to the federal government, but the two Borneo states, Sabah and Sarawak, have been allocated greater autonomy as a means of safeguarding their special "non-Malayan" interests.

Like India, Malaysia has incorporated the institutions of Cabinet government responsible to the legislature within both orders of government. It has, however, its own unique form of rotating monarchy, under which the head of state of the federation, the *Yang di-Pertuan Agong*, is elected for a five-year term from among the hereditary rulers of nine of the Malay states.

As in the Indian federation, the Malaysian constitution expressly empowers federal spending in any area of state legislative jurisdiction.⁵⁶

More than in any of the other federations considered in this study, the major sources of revenue are concentrated in the federal government. Indeed, in 1996 federal government revenues (before transfers) as a percentage of total (federal-state-local) government revenues constituted 89.9 percent (see Tables 2 and 3). At the same time, direct federal government expenditures (after transfers) as a percentage of the total (federal-state-local) government expenditures were also the highest. Thus, in revenue and expenditure terms the Malaysian federation is a very centralized one indeed. Even for the relatively limited proportion of expenditure for which the Malaysian states have been responsible, the states were dependent upon intergovernmental transfers for 29.5 percent of their revenue in 1986, although by 1996 this degree of dependence upon federal funding had fallen to 17.9 percent (see Table 4). One of the biggest issues concerning fiscal relations within Malaysia has been the degree of horizontal imbalance. There is a considerable variation in the ability of the states to raise their own revenues, ranging from 49 percent to 93 percent of total state revenues (Wilson 1996, p. 2, Table 1).

As to decision-making processes for the federal exercise of its spending power in relation to areas of state jurisdiction, the structure and size of federal-state grants is primarily at the federal discretion. The constitution does provide for a consultative process through the National Finance Council (article 108, 109(5)). This Council must meet annually and also must be summoned at the request of at least three or more states. The Council consists of the prime minister or his representative, and one representative appointed by the government of each state. The Council is in practice an important forum for the discussion of all matters of federal-state finance and must be consulted prior to the making of grants by the federal government to the states (article 108 (4)(a)). But while the federal government is required to consult the Finance Council, the decisions of the Council are not binding on the federal government. Although not insignificant, the Council's purely advisory character weakens its influence upon federal decisions in the exercise of the federal spending power (Wilson 1996, p. 4). The degree to which the federal government has exercised its ultimately discretionary use of its spending power is illustrated by the fact that in 1992, for instance, 67.9 percent of all federal grants to the states were conditional.

Spain

In 1978, after some 40 years of totalitarian centralization under the dictatorship of General Franco, Spain adopted a new constitution establishing a system of parliamentary democracy. As part of the post-Franco democratization and as a means of balancing powerful regional interests fostered by renewed Basque and Catalan nationalism, Spain has also been pursuing a process of regionalization. Indeed, this has progressed to the point where, although in name Spain is not a federation, it has virtually all the major characteristics of one. Spain currently provides for 17 "Autonomous Communities" in a country of nearly 40 million people.

A characteristic feature of the Spanish devolutionary process since 1978 has been the granting to each region its own degree of autonomy tailored to its particular situation and based upon a particular set of compromises negotiated between the regional leadership and the national government. Subsequent actions of the Madrid government have been working toward a more uniform distribution of jurisdiction, the intention being that although the different regions are currently proceeding to greater autonomy at different speeds, ultimately the situation of the different Autonomous Communities will be less asymmetrical. Nevertheless, both in terms of legislative and executive jurisdiction and financial arrangements, there is currently considerable asymmetry among the Autonomous Communities.

While the Spanish constitution does not explicitly define itself as federal, it does provide for lists of powers that are exclusive to either the central government or the Autonomous Communities; and the 17 Autonomous Communities, although in differing degrees, possess constitutional authority for a considerable degree of self-rule. The central government is a parliamentary monarchy with the Council of Ministers responsible to that lower house of the Cortes, Spain's bicameral central legislature. The Senate, the second chamber of the Cortes, composed mostly of directly elected senators, serves as a representative body for the regions of Spain.

The Spanish constitution empowers the central government to make grants to the Autonomous Communities for any purpose defined by the central government.⁵⁷ Thus, an unlimited central spending power even in areas coming under the jurisdiction of the Autonomous Communities is firmly embedded in the constitution.

A number of constitutional provisions relate to the allocation of financial resources among governments. Article 133 gives the central government power of taxation but also makes provision for the Autonomous Communities and the local governments to raise taxes. Article 150(2) enables the central government to delegate powers to the Autonomous Communities but requires that in such cases the law "shall contain the pertinent transfer of financial means." Article 157 enables Autonomous Communities to obtain revenues that are wholly or partially assigned to them by statute, and article 158 expressly provides that an allocation shall be made to an Autonomous Community "in proportion to the volume of State services and State activities for which they have assumed responsibility and to guarantee to provide a minimum level of basic public services throughout Spanish territory." While ultimately the determination of the level of transfers rests with the central government, the constitution sets out a process for the establishment of an Autonomous Community which involves the negotiation and adoption of a "statute of autonomy defining the jurisdiction and resources to be available to the Autonomous Community." The provision of resources has usually involved three types of transfers: (i) ceded taxes, (ii) specific grants, project grants and "other revenues," and (iii) tax sharing (the major source of revenue for the Autonomous Communities).

In November 1986, an agreement was made with 15 of the 17 Autonomous Communities for the adoption of a new common formula. Under this, the assignment of funds was no longer related directly to the level of responsibilities assumed and was based instead on criteria including population, size, personal income, fiscal effort in terms of central income tax revenue, number of provinces within the Autonomous Community and (in the case of the island communities) the distance to the state capital. The choice of variables and the weight given to their coefficients has been described as arbitrary, and a number of considerations induced the central government to alter the formula in ways that ensured that no Autonomous Community would get less with the new formula (Solé-Vilanova 1990). Thus, the departure from the effective cost of devolved services was more formal than real, but at least formally, tax sharing on the basis of "need" was replaced by simple revenue-sharing.

The overall devolutionary trend is illustrated by the fact that, while in 1986 central government revenues (before transfers) as a percentage of total central-state-local revenues represented 87.9 percent and federal expenditures (after transfers) as a percentage of total central-state-local expenditures constituted 79.4 percent, by 1994 the corresponding figures had declined to 84 percent and 68.5 percent, respectively (see Tables 2 and 3 for comparisons). The dependence of the Autonomous Communities upon intergovernmental transfers (of the three types referred to above) is illustrated by the fact that in 1994 intergovernmental transfers constituted 77.6 percent of the total revenues of the Autonomous Communities.

While these figures give a general picture of the pattern of revenues, expenditures and transfers within the Spanish political system, they mask significant differences amongst the different types of Autonomous Communities, each type having a different set of fiscal relations with the central government. Fiscal relations are in fact characterized by a significant degree of asymmetry. Broadly speaking, among the 17 Autonomous Communities there are four basic types of Autonomous Communities. The first type, represented by two Autonomous Territories, Basque and Navarra, have a "special regime" of financing and they represent exceptional cases. The next category relates to Autonomous Communities with a high level of autonomy (i.e., including responsibility for health and education). In this category are Andalusia, the Canary Islands, Catalonia, Galicia and Valencia. In this group, transfers in 1987 represented 76.9 percent of their revenue, of which 25.3 percent was in the form of conditional transfers and 49.7 percent in the form of unconditional transfers (Solé-Vilanova 1990, p. 337, Table 20.1). The third category consists of four multi-provincial Autonomous Communities with substantially lower levels of responsibility. In this category, taken together, transfers represented 71.7 percent of their income by contrast with the second group, conditional transfers constituted a much higher proportion, 36.5 percent, and unconditional transfers much less at 35.2 percent (*ibid.*). Finally, in the fourth category are six uni-provincial Autonomous Communities with low levels of responsibility. For these as a group, transfers represented 72.8 percent of

their revenue, with 27.1 percent in the form of conditional transfers and 45.7 percent in the form of unconditional transfers (*ibid*). Clearly the asymmetry in the jurisdiction of the Spanish Autonomous Communities is reflected in the different patterns of financial arrangements and the proportions in which their transfers have taken the form of conditional or unconditional transfers. While the objective of the national government has been to work towards more uniform arrangements at least in form, it would appear that, for the time being, under the pressure of the varied conditions in the different Autonomous Communities, considerable asymmetry is likely to remain in the financial arrangements in Spain.

2.6 THE EUROPEAN UNION

The confederal context. The previous political systems considered in this study are all, like Canada, federations.⁵⁸ The European Union (EU) is fundamentally different, however. Since Maastricht, it has been a hybrid political system which is basically a confederation but with some features of a federation. In major respects it remains confederal in character. Unlike federations, the European Union has no federal government with its own electoral and fiscal base (Leslie 1996, pp. 14-25). The Union's legislative process involves a sharing of power between the Commission, the Council of Ministers (composed of delegates from the member states) and the European Parliament. The European Parliament, however, while having some significant co-decision powers, lacks the full legislative powers of a federal parliament. Furthermore, the European Union is still dependent on the member states in the realm of policy implementation and the application of Community law. It is also dependent upon negotiations among the member states to finance its activities (*ibid.*, pp. 20-21).

Over time a number of features typical of federations have been added to the EU, the clearest examples being the introduction of weighted voting and qualified majorities in the Council of Ministers, the co-decision role of the European Parliament on some matters, the role of the Commission in formulating policy roles for consideration and the role of the European Court of Justice in ensuring the compliance of national laws in the member states with EU law. Indeed, some supporters see the current EU structures as a further step along the path to a European federation.

Nevertheless, despite the features that are typical of federations, the European Union remains fundamentally confederal in form and in this respect contrasts with the other federations considered in this study, and Canada. The significance of this contrast in relation to the spending power of the EU is illustrated by the fact that between 1994 and 1998, EU expenditure as a percentage of EU GDP has ranged between 1.2 and 1.25 percent, whereas in all the federations considered in this study, federal expenditure as a percentage of GDP is in no case lower than about ten times that figure (see Table 1, p. 48 in this volume).

The financial system of the European Union does not conform to a traditional federal system. The finances of the Union have evolved in an incremental and contested manner since the establishment of the European Coal and Steel Community in 1952. The financial constitution of the system was established by the foundation treaties (Paris 1951 and Rome 1957), developed by two budgetary treaties (1970 and 1975) and further modified by the *Single European Act* (1986), the Treaty on European Union (1992) and the Treaty of Amsterdam (1997). The rules governing the budget are found in the treaties, the financial regulations and interinstitutional agreements within the Budgetary Authority (the Council of Ministers and the European Parliament). The EU budget has developed as a mechanism for financing agreed policies of collective interest to the member states, beginning with the common agricultural policy in 1962 and a social fund in the same year to finance vocational training. In 1975 the EU agreed to establish a small Regional Fund to finance the lesser developed areas in the Union. This was followed by spending programs in research and development (1982), the environment (1986), cultural programs (1988) and many programs for overseas development and external aid. The major shift in the EU budget came in 1988 with agreement to the Delors I package which established a multi-annual spending program for the Union up to 1992. This was followed by Delors II in 1992 which runs to 1999. The member states are now beginning to negotiate the terms of the next financial perspective which will run from 2000 to 2005.

The legal basis of the EU spending power. As Peter Leslie has pointed out, the distribution of powers, that is competences, within the European Union differs both in form and scope from that of the other federations considered in this study (Leslie 1996, p. 4). In some respects the scope of the competences of the European Union are as great as those of the federal parliaments in those federations and Canada, and indeed were expanded by the Maastricht Treaty. But where the powers vested in the two orders of government in those federations are solidly entrenched in their constitutions as areas of jurisdiction and are available for use by the governments possessing jurisdiction, the competences of the European Union represent subject areas where joint action may be undertaken, provided that the states collectively want it. Furthermore, the areas of competence are stated broadly in terms of common objectives rather than precise jurisdiction. This provides considerable room, provided the member states are agreed, to expand their scope and application. In the EU most or all major EU decisions are made by the member states represented in the Council, albeit on the basis of proposals by the Commission. Thus, unlike the federal governments in federations, the EU legislative institutions collectively do not constitute a separate repository of exclusive jurisdiction independent of the member states, but rather constitute an attempt to embed the national interests in the Union by pooling and sharing powers. Consequently, the issue of competence relates primarily to the *degree* of EU involvement. Following the Treaty on European Union, subsidiarity became a principle to be

taken into account in deliberations determining the amount of EU involvement in various areas.

The Union's constitution (treaties) does distinguish between law-making power (decision rules regarding how laws are made and in what areas of public policy) and the spending power of the EU. The bulk of the EU revenues are supplied by member states on the basis of multi-year agreements approved in the basically confederal Council of Ministers. Once these agreements have been approved by the member states participating in the Council, the Commission administers these EU revenues as "own revenues" and has some discretion in their application, but always within the framework approved by the Council. Thus, basically the spending power of the European Union is derived not from any independent legal or constitutional jurisdiction, but from the agreement of the participating states concerning the areas in which they agree upon expenditures for EU purposes. In this sense the situation is the inverse of that in the federations considered elsewhere in this study. In the federations the issue is whether and how federal governments should use their "own" resources to provide assistance to provinces or states in their exercise of provincial or state jurisdiction. In the deliberations within the EU institutions the issue is the extent to which member states agree to pool or share their resources for EU purposes.

Link to revenue-raising powers. The provisions specifying the revenue-raising powers of the European Union are set forth in article 201 of the European Treaty. Article 201 does not explicitly identify what the revenue sources should be, but rather establishes the process by which the Council will determine the sources of revenue.

Currently there are four basic sources of EU revenues: (i) customs duties levied on products imported from outside the EU (19.8 percent of EU revenues); (ii) agricultural levies and contributions (3.4 percent of EU revenues); (iii) value-added tax, representing the transfer to the EU of a fixed percentage (1.4 percent in 1994) of VAT receipts in the member states (53.8 percent of EU revenues); GDP-related income based on payment by member states of a certain percentage of their GDP to the EU budget (22.4 percent of the EU revenues) (Nugent 1994, p. 343).

In 1986 total EU revenue amounted to 35174.1 million ECU and in 1996 to 82046.3 million ECU. These represented 0.91 and 1.21 percent, respectively, of the total revenue of governments within the EU (see Table 2).

EU budget expenditures are divided into two different classes of expenditures: "compulsory" expenditures and "non-compulsory" expenditures (*ibid.*, p. 344; Molle 1994, p. 72). Compulsory expenditures are expenses that result from commitments of the EU towards third parties (farmers enjoying guaranteed prices, developing countries with which the EU has cooperation agreements in force, etc.) or expenditures that arise from treaty obligations or acts adopted on the basis of the treaties. Non-compulsory expenditures are expenditures that do not arise out of treaty obligations or EU commitments to third parties.

Five items make up almost all of the EU budget. As the description below indicates, the dominant expenditure is in agriculture and fishery, accounting for more than half of the budget expenditure (the figures mentioned are for the 1993 budget):

1. Agriculture and fishery (53 percent of expenditures).
2. Structural operations (32 percent of expenditures). Many of these expenditures consist of "structural funds" from the European Regional Development Fund that go towards stimulating investment and promoting innovative economic activities. The funds are also used to help particular regions address the problems of industrial decline and underdeveloped economic infrastructures.
3. Internal expenses (5 percent of expenses). The programs in major policy areas such as energy, manufacturing, transport and research fall into this category.
4. External expenses (5 percent of expenses). Expenditure for foreign aid.
5. Running costs (5 percent of expenses). The costs of staffing, offices, travel, etc.

Total EU expenditure in 1986 was 36052 million ECU and in 1996 was 86637 million ECU representing 2.1 percent of the total public expenditure within the EU in 1986 and an estimated 2.5 percent in 1996.⁵⁹

In relation to vertical imbalances in the revenues and expenditures of the EU and of the member states, the major transfers to correct such imbalances are from the member states to the EU as determined by the member state delegates on the EU Council.

There are, however, as noted above, some transfers in the opposite direction from the EU to selected member states to assist in reducing disparities in their capacity for economic development. These come from the European Regional Development Fund and mainly supplement similar efforts within the member states. Although significant, these transfers are nevertheless very small in relation to the national budgets of the recipient member states.

Decisions on the use of the EU spending power. Article 203 of the treaty provides the basic framework for the budget process, this has been fleshed out and adapted over time in response to pressures, necessities, and conveniences (Nugent 1994, p. 344). The Commission establishes a draft budget, which is submitted to the Council of Ministers (composed of one representative minister from each member state). After the Council acting on a qualified majority has accepted or amended the Commission's preliminary draft budget it is then considered by the European Parliament, which may propose modifications to "compulsory" expenditures and amend "non-compulsory" expenditures. The Council then receives this draft and by a qualified majority may adopt or reject the amendments and modifications proposed by the Parliament. After a final round of negotiations between the Council

and Parliament, the Council ultimately decides on compulsory expenditures and the Parliament on non-compulsory expenditures. Transfers have been decided in two processes. First, the multi-annual financial perspective (e.g., 1992-99) has decided the pool of money for the structural fund spending for the period and established a key for its distribution by region. All beneficiaries then had to prepare plans for how they would use the money and supply matching finance. This was then followed by a Commission decision on the Community Support Framework and periodic reviews by the Commission regarding the implementation of the Community Support Framework.

The key feature of the decision-making processes is that the member states have a very substantial influence in determining budget expenditures and revenue-raising in what is essentially an interactive process among the EU institutions (Commission, Council and Parliament) and national and regional governments. Nevertheless, there do appear to have been some cases where the EU collectivity has by a qualified majority made decisions to spend by means of regional development infrastructure grants in areas within the competence of member states and has attached to these conditions that have led to contention within some of the recipient member states. A notable example has been Greece.

Nature and extent of the use of the EU spending power. Since the European Union's overall budget accounts for little more than 2 percent of the EU's GDP, the European Union's budgetary power is small compared to that of its member states and compared to the federal governments in the other federations studied.⁶⁰

Within that small budget, a large part of the 37 percent (1996) allocated to "structural operations expenditures" goes towards the European Regional Development Fund grants directed to targeted areas within the European Union to address problems of "economic backwardness" and industrial decline. Since 1988 transfers have become significant for what are defined as Objective One regions, i.e., regions with per capita incomes less than 75 percent of the European Union average. These have been Ireland (no longer after 1999), parts of Spain, Portugal and Greece, and very small parts of other member states. The 1994 Commission report on the structural funds estimated that transfers from the Structural Funds and the Cohesion Fund would represent 6.1 percent of GNP in Portugal, 7.1 percent in Greece, 3.8 percent in Ireland, and 4 percent in Objective One parts of Spain during the programming period 1994-99. Ireland, followed by Portugal, Greece, and then Spain received the highest per capita transfers. The structural funds are not designed to provide a system of continual fiscal transfers to tackle permanent problems of revenue capacity as is the case with equalization schemes in many federations. They are merely designed to help the poorer states and regions to catch up. The European Union is characterized by a divergence of economic performance and level between its rich and poor regions. In 1991, the ten most prosperous regions had an average per capita income 4.5 times that of the ten least prosperous regions. All attempts to develop a permanent equalization transfer

mechanism such as in some of the federations have failed, but since the 1970s the Union has been enhancing its capacity to develop its poorer regions through transfers focusing on basic infrastructure, "know how" gaps, investment deficits and problems of high unemployment.

Most of the regions receiving EU assistance already receive aid from their own governments, and the EU expenditures in these regions are intended only to complement such pre-existing government aid. In essence, the EU's expenditures in these regions are complementary to that of the member states and are not intended to establish an independent program or policy (Molle 1994, pp. 434-37). As an effort to redistribute resources within the EU, the scope and significance of these transfers is much less than that of the equalization efforts in the federations considered elsewhere in this study. This is perhaps not surprising given the small size of the EU budget and the confederal processes of decision-making that temper efforts at redistribution. Nevertheless, the character of these transfers does help generate solidarity towards the EU in the less wealthy regions.

The implementation of EU expenditure differs from program to program. Expenditure from the common agricultural expenditure may flow directly to individual farmers but is channelled via national agencies. Other agricultural expenditure flows to support intervention relating to farm produce, which may be organized by public or private bodies. Structural fund expenditure is channelled to public and private agencies in the member states or at a regional level depending on the national management of this expenditure. Expenditure in areas of culture, media, education and training flows directly to the beneficiary agencies and not through member governments. In 1986, 61 percent of total EU expenditure was spent on the guarantee section of the common agricultural policy (compulsory expenditure arising from the treaties), 16 percent went to structural funds (in the form of conditional grants), 2 percent to research (in the form of conditional grants), 3 percent to external action, and the remaining expenditure went on administration. In 1996, 47 percent went to agriculture, 37 percent to structural operations, 6 percent to both internal action (research, culture/the environment) and external policy, and the remaining 10 percent to reserves and administration.

All EU expenditure is in the form of conditional grants for projects or programs that meet the eligibility criteria established in EU law. There are no unconditional grants, nor are there provisions for automatic fiscal transfers. Almost all programs require matching national or regional public expenditure or private expenditure.

A high level of conditionality attaches to all EU expenditure. All financed programs and projects must meet pre-established criteria in EU legislation according to a selection process that differs from area to area. Expenditure under the structural funds is negotiated on the basis of national or regional plans submitted by the member states to the Commission, which then prepares a Community Support Framework (CSF). The CSF establishes the amount of money available to the member state or region under each heading of the program (infrastructure, human

resource development, etc.). There is a requirement for a matching national expenditure (public and sometimes private) for all programs. The matching finance ranges from 50 percent to 25 percent depending on the program and the status of the beneficiary, the poorer the region the less matching financing required. Agricultural expenditure for price and income support is automatic, however, and does not require national matching finance, but rural development programs do. Research grants to universities and research centres are 100 percent grants.

The exercise of the EU's spending power has been shaped by the small size of its expenditure relative to public expenditure in the member states. The EU is designed so that the traditional areas of public expenditure, such as health, welfare and education, remain national. The EU use of its spending power mainly aims to offset the consequences of market integration by subsidies to farmers, which represent the guarantee section of the common agriculture policy (47 percent of the EU expenditure in 1996) and by helping the poorer regions to catch up with the core of Europe (37 percent of EU expenditure in 1996). The objective of the latter has been catch-up rather than the permanent subsidization of Europe's poorer regions. The budget has also been designed to cushion some social groups such as the farming community, a legacy of the original foundation bargain in the creation of the European Community. Other uses of the EU spending power are designed to complement market integration by expenditure on research and development, environmental policy and promotion of transnationalism.

Chapter 3

Some Comparative Observations

3.1 THE FEDERAL CONTEXT

The first point that emerges from the preceding analysis very clearly is the fundamental difference between the federations as a group and the predominantly confederal European Union. Both the form and scope of the allocation of competences and the basis of decision-making are very different in the European Union. In each of the federations the federal government is assigned specific constitutional functions, and the federal governments have their own direct electoral and fiscal relationships to the citizens of the federation. In the European Union the EU competence is defined more in terms of objectives, and the scope of EU policy is to a considerable extent determined by the Council, a confederal body composed of delegates of the member state governments. Two resulting features of the European Union are particularly noteworthy in relation to this study. The percentage of EU expenditures in relation to EU GDP is of the order of 1.25 percent, whereas, as Table 1 indicates, in the federations federal government expenditures as a percentage of GDP are a totally different order of magnitude. The range among federations in 1996 was from 11.7 percent in Switzerland to 19.4 percent in the United States.

The magnitude of central expenditure is clearly substantially less in the European Union than in the federations. Second, since the powers of the EU are less precisely defined and their scope and financing depends upon approval by delegates of the member states, the issue of EU spending in areas of exclusive member-state jurisdiction has arisen only occasionally as a significant issue of contention. It has been the extensive regulatory activities of the EU rather than its use of its spending power that has been particularly contentious.

The second general point of note is that among the federations there are significant variations in the form and scope of the distribution of legislative jurisdiction. By contrast to Canada, in the United States, Australia, Germany,

TABLE 1: Federal Government Expenditure (after transfers to subnational governments) as a Percent of GDP

	1986	1996
U.S.	20.8	19.4
Germany	15.3	18.8
Canada	19.4 ^a	18.4 ^b
Australia	20.0	18.1
Switzerland	10.6	11.7
European Union	1.0	1.2

Notes: ^afigures are for 1985.

^bfigures are for 1995.

Source: Data provided by the Australian Bureau of Statistics; Treff and Perry (1997); data submitted by consultants (see acknowledgements).

Austria, India, Malaysia and Spain there are very extensive areas of concurrent jurisdiction. Even in Switzerland, where the constitution defines federal and cantonal powers more specifically, over time all three orders of government have come to play some role in most areas of policy-making. Furthermore, in Germany and Switzerland the constitution has mandated state or cantonal administration of a considerable portion of federal legislation. These arrangements in other federations recognize the inevitable interdependence between the different orders of government within a federal system. The large areas of concurrent constitutional jurisdiction in other federations also means that while there is a substantial degree of federal spending in areas of state legislative competence, much of the federal transfers relate to areas of concurrent jurisdiction and, therefore, are not in areas outside federal legislative competence. Some federal transfers in each of these federations do relate to areas of exclusive state jurisdiction, but these have not been strictly differentiated nor as frequently challenged as in Canada. Canada, because of the constitutional emphasis upon the exclusive jurisdiction of each order of government, represents a relatively unique example among federations. In this emphasis in the constitution upon areas of exclusive federal and provincial jurisdiction, the Canadian situation is to all intents and purposes *sui generis*.⁶¹ It is true that in many cases the original 1867 distribution of powers is in circumstances 130 years later not always explicit about jurisdiction in certain aspects of health and social assistance and services. For example, such areas as health promotion, pharmaceuticals regulation and income support through tax systems are not explicitly covered by sections 91 and 92. Nevertheless, because the aspects of health, education and social programs that fall constitutionally under exclusive provincial jurisdiction are relatively broad, the extensive federal transfers in these

areas (particularly when conditions have been attached) have been frequently challenged as intrusions into provincial sovereignty.

Among the federations, there are also variations in the degree to which the constituent units have been provided with a role in federal decision-making generally and hence in relation to the federal exercise of its spending power in areas of state or provincial legislative jurisdiction. The German federation has clearly gone the furthest in this respect. The highly interlocking legislative and administrative interrelationships established within that federation have required the establishment of a wide range of federal-state joint decision-making bodies. Among these, the Bundesrat as a federal second chamber composed of delegates of the state governments, serves as the centrepiece. Without such a formal set of inter-governmental institutions, the Swiss federation achieves a considerable degree of cantonal participation in federal decision-making through permitting dual membership in federal and cantonal legislatures and through its tradition of extensive cantonal consultation. At the same time, the lack of judicial review of federal legislation and the operation of the legislative referendum has enabled the expansion of federal action where there has been sufficient popular support. In the United States, Australia, Austria, Belgium, India, Malaysia, Spain and Canada, on the other hand, the state or provincial governments are not directly represented within the federal legislature. Their respective federal governments and legislatures are consequently in a position ultimately to decide unilaterally on the exercise of federal spending affecting the states or provinces. In the case of Belgium this is to some extent moderated by the bipolar multiparty system which requires agreement between parties in the different regions and communities for approval of legislation governing financial arrangements. It should also be noted that in Australia and Canada parliamentary institutions and the resulting predominance of the executive within both orders of government have led to strong traditions of "executive federalism" involving negotiations, particularly on financial relationships. In the United States, state governments would seem to have a weaker influence upon decisions concerning the exercise of the federal spending power than in any of the other federations. The bargaining occurs within Congress rather than by intergovernmental negotiations. The form of Congress itself and the resulting weakness of party discipline does provide considerable opportunity, however, for the expression of state and local views within congressional deliberations. In addition, the equality of the representation of state electorates within the Senate provides a stronger voice for the smaller states than within the Canadian Parliament.

3.2 THE LEGAL BASIS OF THE FEDERAL SPENDING POWER

It is strikingly clear that in one form or other, all the federations considered in this study recognize as constitutionally and legally legitimate a federal spending power

in areas of exclusive state or provincial jurisdiction. Thus, the recognition of a federal spending power in areas of exclusive provincial jurisdiction is by no means unusual, and in fact fits the norm among federations. The constitutions of five of the federations reviewed recognize such a power explicitly: Australia, India, Malaysia and Spain without limitations, and Germany with some not very restrictive qualifications. In the case of Austria the sweeping breadth of federal exclusive and concurrent legislative jurisdiction in effect provides the federal government with a spending power on virtually all matters. In the case of the United States and Canada judicial interpretation of the constitution has led to the recognition of a broad federal spending power in areas of exclusive state or provincial jurisdiction. Switzerland and Belgium represent special cases. In Switzerland, the federal spending power in formal legal terms is limited to its legislative powers, but the absence of judicial review in relation to federal legislative powers has led in practice to an extensive exercise of the spending power in a way that has resulted in its involvement in almost all levels of policy-making. In Belgium there is no legal barrier to the exercise of the federal spending power but the requirements for the process of approval provide some limitations on its use.

This raises two points for comment. First, it has not infrequently been suggested in Canada that the power of a federal government to spend in areas of exclusive provincial legislative jurisdiction runs counter to the federal principle of divided sovereignty and is therefore illegitimate. This argument has been usually based upon a classical definition of a federation as a political system founded upon the division of jurisdiction between two orders of government into watertight compartments.⁶² In most federations, however, it has long been recognized, and particularly so in the second half of the twentieth century, that overlaps and interdependence between the orders of government within a federation are unavoidable, and that therefore a variety of devices, including a federal spending power in areas of exclusive state or provincial legislative jurisdiction, are required for federations to operate effectively (see, e.g., Birch 1955; Grodzins 1966; and Watts 1966). Indeed, it has been argued that if the essential feature of federations is that neither order of government should be constitutionally subordinate to the other, an alternative to mutual independence of jurisdiction is mutual interdependence. One of the difficulties with attempting to achieve a permanent watertight division of legislative jurisdiction and revenue resources in a federal constitution is that over time the costs of expenditure for different responsibilities and the significance of different tax sources (such as income and consumption taxes) change in ways that cannot be foreseen, thus leading to the development of imbalances and the need for adjustments. An alternative to seeking mutual independence is to aim for mutual interdependence in which the two orders of government interact on a genuinely collaborative basis. Such an objective has important implications, however, for it requires the acceptance of genuinely collaborative decision-making processes for the exercise of the federal spending power in areas of concurrent and exclusive state or provincial legislative competence.

A second point is that in most contemporary federations other than Canada and Belgium, there is constitutional provision for extensive areas of concurrent legislative jurisdiction and many of the major areas related to social policy and programs have come within these areas. Thus, in those federations, a large portion of the exercise of the federal spending power relating to social programs has been in areas of state legislative competence, but not necessarily exclusive state competence. By contrast, the degree to which in Canada it has been necessary to exercise the federal spending in areas of *exclusive* provincial legislative power in order to facilitate federal-provincial collaboration in the area of social policy and programs has arisen from the distinctive form of the distribution of powers in the Canadian constitution with its emphasis upon the exclusive jurisdiction of each order of government. At the same time it should be noted that one of the difficulties in efforts to achieve a watertight division of legislative jurisdiction in any federal constitution is that new policy areas regularly emerge that do not fall neatly into the listing of exclusive powers based on policy concerns at the particular point in history when the constitution was written. For instance, in the case of Canada, fields such as "communications," "the environment," and "social policy" were unrecognized at the time the constitution was enacted in 1867.⁶³ Consequently, different aspects of such fields, including regulation and legislation and the federal and provincial uses of their spending powers relating to them, have had to be based upon how these new policy areas fit into an incomplete and dated list of powers. The result is that in practice federal and provincial governments have *de facto* shared some important policy fields, including responsibility for different aspects of social policy. Inevitably these federal and provincial aspects are interrelated. The consequence has been a *de facto* situation somewhat approximating the concurrency existing in other federations, made necessary to a large degree because of the impact of contemporary realities. This points to the need for intergovernmental collaboration in these areas.

3.3 LINKS TO REVENUE-RAISING POWERS

All the federations considered in this study have been marked by both vertical (federal-provincial/state) and horizontal (interprovincial/state) imbalances in the revenue capacity and expenditure responsibilities of each order of government.

Tables 2 and 3 illustrate in comparative terms the level of revenues and expenditures of the federal governments as a proportion of total governmental revenues and expenditures in a number of federations. These tables give some indication of the relative degrees of centralization and decentralization in these federations, and the two tables taken together indicate the extent of the imbalances between revenue allocations and expenditure responsibilities. Among the federations considered in this report the largest vertical imbalances occur in Spain and Australia and the lowest in Germany. In all these federations substantial transfers have been

needed to reduce these vertical and horizontal imbalances (see Table 4). The only alternative would have been to expand significantly the taxing powers of the states or reduce their expenditures. These transfers have generally flowed from the federal government to the provinces or states, except that in the case of Germany, the effort to reduce horizontal imbalances has also included an element of interstate transfers. Where equalization among constituent units to reduce horizontal imbalances among provinces or states has been one objective of federal transfers, the form of equalization has varied from the efforts in the Australian, Indian, German and Canadian federations to provide systematic formal schemes of unconditional equalization transfers to the efforts in Switzerland and the United States (in a less coordinated way) to apply elements of equalization to a wide variety of conditional grants to the cantons and states.

TABLE 2: Federal Government Revenues (before transfers) as a Percentage of Total (federal-state-local) Government Revenues

	1986	1996
Malaysia	87.2	89.9
Spain	87.9	84.0 ^c
Austria	71.6	72.8 ^d
Australia	74.4	69.1
United States	64.7	65.8
India	68.2	64.6 ^c
Germany	64.5 (26.3)	64.5 (24.3) ^a
Canada	48.4	47.7 ^b
Switzerland	48.1	44.7 ^b
European Union	0.9	1.2

Notes: ^aThe bracket figures treat constitutionally specified portions of federal taxes as "own revenues" of the Länder rather than as federal revenues. See earlier text on revenue-raising powers in Germany for further details.

^bThese figures are for 1993.

^cThese figures are for 1994.

^dThese figures are for 1995.

Source: *Government Finances Statistics Yearbook* and data submitted by consultants (see acknowledgements).

TABLE 3: Federal Government Expenditures (after transfers) as a Percentage of Total (federal-state-local) Government Expenditures

	1986	1996
Malaysia	82.4	85.6
Austria	70.5	68.8 ^c
Spain	79.4	68.5 ^b
United States	56.0	61.2
India	47.3	54.8 ^b
Australia	52.7	53.0
Germany	35.7	41.2
Canada	41.4	40.6 ^a
Switzerland	35.0	36.7 ^c
European Union	2.1	2.5

Notes: ^aThese figures are for 1993.

^bThese figures are for 1994.

^cThese figures are for 1995.

Source: *Government Finance Statistics Yearbook* and data submitted by consultants (see acknowledgements).

TABLE 4: Intergovernmental Transfers as a Percentage of Provincial or State Revenue

	1986	1996
Spain	77.4	77.6 ^b
Austria	31.9	43.6 ^c
Australia	54.4	40.7
India	44.0	39.4 ^b
United States	20.5	29.6 ^b
Canada	20.1	19.8 ^a
Switzerland	21.7	18.9 ^c
Germany	15.5	18.3
Malaysia	29.5	17.9

Notes: ^aThese figures are for 1993.

^bThese figures are for 1994.

^cThese figures are for 1995.

Source: *Government Finance Statistics Yearbook* and data submitted by consultants (see acknowledgements).

3.4 DECISIONS ON THE USE OF THE FEDERAL SPENDING POWER

The European Union and the federations of Germany and Switzerland clearly involve the governments of their constituent units to a much greater extent than Canada or the other federations in the process of designing and approving federal spending in areas of constituent unit jurisdiction (both concurrent and exclusive). Indeed the virtually confederal structure of the European Union means that the member states are involved in the design and approval of the framework for all community spending. Nevertheless, because these processes include the requirement of qualified majorities, the resulting decisions have on occasion been considered invasive by some individual member states who did not vote for the decision. Of the federations, Germany goes furthest in giving constituent units a role in designing and approving federal spending in areas of concurrent jurisdiction or exclusive Land jurisdiction. The Bundesrat, the federal second chamber consisting of state government delegates, must by majority vote approve any legislation and spending affecting the interests of the Länder. While the Swiss constitutional provisions do not go that far, the provision for concurrent membership in cantonal and federal legislatures means that a significant proportion of federal legislators are able to represent cantonal interests directly in federal decision-making. In addition, the constitutional provisions permitting any eight cantons to invoke the legislative referendum in relation to federal legislation and the strong tradition of federal consultation of cantons before taking action have meant that cantonal governments are regularly consulted on a wide range of matters, including the federal exercise of the spending power in areas of cantonal legislative competence. Set against this, as noted above, is the absence of judicial review of federal legislation which makes public opinion through the legislation referendum the ultimate arbiter regulating the federal use of its spending power. The examples of Belgium and Spain also provide in practice a regional influence on the exercise of the federal spending power. In the former, the requirement of special majorities in the processes for approving federal financial arrangements ensures a strong leverage for the regional political parties and in the latter, the negotiations for the particular arrangements applying to each Autonomous Community have affected the different financial arrangements.

In the United States, Australia, Austria, India and Malaysia the involvement of state governments in decisions about federal spending in areas of state legislative competence is more limited. In none of these are state governments directly represented in the federal legislature, and in all of them ultimately the federal legislature is in a position to act unilaterally. In that respect the situation in these federations is not radically different from that in Canada. However, there are differences in the degree of influence states can bring to bear upon the designing of federal programs and spending in areas of state legislative competence. In the United States the diffusion of power within federal institutions and the consequent weakness of party discipline has meant that state and local interests have

had some influence through the lobbying processes affecting federal decision-making. Furthermore, the equality of state representation in the elected Senate has added to the influence of the smaller states. The latter feature also applies to the Australian elected Senate where states are equally represented, but in other respects the situation in Australia is more like that in Canada. In both Australia and Canada, the combining of federal and parliamentary institutions and the resulting characteristic executive predominance within both orders of government has produced intergovernmental relations characterized by "executive federalism" (Watts 1989). Moreover, in Australia and Canada, executive federalism has focused particularly on issues of federal-state and federal-provincial financial arrangements. Australia has gone further in formalizing the collaborative institutions of executive federalism, as in the case of the Loan Council and the use of quasi-independent commissions (e.g., the Commonwealth Grants Commission) to legitimize federal government decisions.⁶⁴ In Australia and Canada, intergovernmental meetings and negotiations have played an important part in intergovernmental financial deliberations, although the ultimate constitutional power to make decisions about the federal spending power in areas of state or provincial legislative competence has remained with the federal government. In one particular respect, the influence of the individual provinces or states in Canada and Australia, with ten provinces and six states respectively, has been enhanced by their relatively small number compared to those federations with more constituent units, such as the United States where there are 50 states.

While the degree of provincial approval or involvement in decisions about the exercise of the federal spending power has varied among federations, clearly in this respect Canada does not match some other federations.

One feature that is unique to Canada is the proposals that have been advanced from time to time to permit provinces to opt out of federally assisted programs with compensation. Such proposals intended to safeguard provincial autonomy in areas of their exclusive jurisdiction find no counterpart in any other federation.

Considerable attention has been given in Canada recently to the ACCESS proposals of Tom Courchene for a new framework for social policy and programs (Institute of Intergovernmental Relations 1997). The full ACCESS model which he has proposed would in effect apply a decision-making process in the delivery of health, social services and education involving interprovincial agreement strongly akin to the confederal character of decision-making generally within the European Union. While there are some instances of interstate arrangements in the United States, sometimes referred to as "federalism without Washington," and of intercantonal agreements in Switzerland, sometimes referred to as "federalism without Bern," collaborative federal-state or federal-cantonal programs are much more common in both federations. In this respect what Tom Courchene has described as the interim ACCESS model rather than the full ACCESS model would come closer to practice in some other federations. Leaving aside the very different processes of the EU, in none of the federations has it yet been found practical

for federal-provincial collaboration to be superseded by a purely confederal process of interprovincial decision-making.

3.5 NATURE AND EXTENT OF THE USE OF THE FEDERAL SPENDING POWER

The analysis of the individual federal systems indicates that there has been extensive use of the federal spending power in areas of provincial legislative jurisdiction in all the federations, although less so in the basically confederal European Union. At the same time we have noted that in federations other than Canada, the extensive constitutional designation of areas of concurrent jurisdiction and more limited designation of areas of exclusive provincial legislative jurisdiction, has meant that much of the federal spending in areas of provincial legislative competence has applied to areas of concurrency rather than to areas of exclusive provincial jurisdiction.⁶⁵

The general extent of federal transfers as a percentage of provincial revenues in a number of federations is set out in Table 4; this gives some indication of their

TABLE 5: Conditional Transfers as a Percentage of Federal Transfers

	1996
U.S.	100.0
EU	100.0
Switzerland	73.1 ^b
Malaysia	67.9
Germany	64.5
Australia	53.0
India	38.0
Spain	23.5 ^a
Canada ^c	4.3

Notes: Comparable data for Austria and Belgium are not available.

^aThe Autonomous Communities with "high level" policy responsibilities were used for this figure.

^bFigures are for 1995.

^cCHST transfers which accounted for 39.3 percent of the total federal transfers to the provinces in 1996, could be described as semi-conditional in nature, but they have either no conditions for certain aspects or such general conditions compared to conditional transfers in other federations that they are more appropriately classified here as unconditional.

financial dependency. It ranged in 1996 from 77.6 percent in Spain to 17.9 percent in Malaysia. Among federations more similar to Canada it ranged from 40.7 percent in Australia to 18.3 percent in Germany.

The degree of provincial dependency is affected even more by the degree to which these federal transfers are conditional and how constraining those conditions are. Table 5 sets out conditional grants as a percentage of federal transfers in the various federations and Table 6 conditional grants as a percentage of total provincial or state revenue. As Table 6 indicates, Canadian provinces, in comparison to the constituent units of all other federations, are less dependent upon conditional transfers.

Comparisons of the degree to which conditions attached to federal funding are constraining upon provinces are difficult to make because of the qualitative and even subjective nature of the assessment of such constraints. Within a federation, the character and conditionality of transfers may vary according to program. Some transfers may be entirely unconditional as are the equalization transfers in Canada. Others may involve quite intrusive terms and conditions, as in the case of the former Canada Assistance Plan. Still others may be regarded as semi-conditional because they involve general principles and objectives, such as the five principles of the *Canada Health Act* and the social assistance mobility condition under the Canada Health and Social Transfer (CHST).

TABLE 6: Conditional Grants as a Percentage of Total Subnational Government Revenue

	1996
U.S.	29.6
Australia	21.6
Spain	18.2
India	15.0
Switzerland	12.3
Malaysia	12.2
Germany	9.8
Canada ^a	0.9

Notes: Comparable data were not available for all countries in the same year. Therefore these figures are approximate measures. Comparable data for Austria and Belgium are not available.

^aAlthough CHST payments are at most semi-conditional in nature because they have either no conditions for certain aspects or very general conditions, they are treated here as unconditional. If, nevertheless, they were to be classified as conditional transfers, the figure for Canada in this table would be 15.8 percent.

Nevertheless, it is clear from a review of the transfers in the federations considered in this study that there are significant variations among federations, not only in the proportions of unconditional and conditional transfers, but also in the degree and details of the conditions attached to specific conditional transfers. Among the federations the United States has attached probably the most detailed conditions to virtually all grants-in-aid for state and local programs on the grounds that this is desirable to ensure accountability to the federal taxpayer. In Australia, while over half of all the federal transfers to the states take the form of conditional specific-purpose grants, the conditions have tended to be less heavily conditional than in the United States. On the other hand, there are no grants in Canada with detailed conditions comparable to even those in Australia (Bird 1986, p. 111). Broadly, the specific-purpose grants in Australia would appear to be similar in degree of conditionality to those in such other federations as Switzerland and Germany.

It is abundantly clear from Tables 5 and 6 and from an examination of the various specific federal grants to constituent units in other federations that Canada has placed more emphasis on the need to avoid undermining the autonomy of its provinces. This is explainable since much of the use of the federal spending power in areas of state legislative jurisdiction in other federations relates to the large areas of concurrent jurisdiction, whereas in Canada uses of the spending power have related largely to areas of exclusive provincial jurisdiction. The end of the detailed cost-sharing under the Canada Assistance Plan and the advent of the CHST has meant that in Canada all but a very small portion of transfers to provinces now fall into the categories of fully unconditional or at most semi-conditional transfers.⁶⁶ Thus, Canadian provinces enjoy more freedom from conditionality of federal transfers than the constituent units in any other contemporary federation. This would be reinforced by the federal commitment in the 1996 Speech from the Throne to allow provinces to opt out of new shared-cost programs and to receive compensation if they maintain comparable programs — a provision not found in any other federation.

3.6 ALTERNATIVES TO FEDERAL TRANSFERS TO PROVINCES

As noted in the introduction, an alternative to transfers to provinces as a use of the federal spending power in areas of provincial legislative jurisdiction is direct federal transfers to individuals and organizations. Direct transfers to individuals and organizations do represent an important alternative approach and are significant in a number of federations. Because of the variation in how these are accounted for in different federations, it has been difficult to obtain reliable comparative figures, particularly on the extent to which direct transfers to individuals or non-governmental organizations are in realms of exclusive provincial jurisdiction. Nevertheless Table 7 gives some indication of the extent to which federal transfers

TABLE 7: Direct Non-Government Transfers and Transfers to Subnational Governments as a Percentage of Total Spending

		1986	1996
Australia	• To individuals ^a	33.8	46.8
	• To governments	30.0	25.0
Germany	• To individuals ^a	16.5	12.3
	• To governments	12.0	14.4
Switzerland ^b		32.1	26.2 ^b
	• To individuals ^a		
	• To governments		
U.S.	• To individuals ^a	43.6	51.8
	• To governments	11.3	14.8 ^c
Canada	• To individuals ^a	28.1	21.2
	• To governments	18.3	16.3

Notes: ^aThis includes transfers to individuals that "pass through" other orders of government.

^bThis is a distinction that is hard to make in Switzerland. Many transfers that go to the cantons are then redistributed to individuals. These numbers represent total transfers.

^cThis number is for 1995.

Source: Data provided by the Australian Bureau Of Statistics; Treff and Perry (1997); Canada Tax Foundation (various years); and data submitted by consultants (see acknowledgments).

have gone directly to individuals or organizations or to subnational governments. Table 8 differentiates the kind of subnational governments receiving transfers.

Also worthy of note is that an alternative form of financial adjustment to federal governments' use of their spending power in areas of provincial jurisdiction (either in the form of transfers to provincial governments or direct transfers to individuals and organizations) is through alterations to the system of taxation. This may take one of two forms. One is the reallocation of taxing powers so that the revenue capacities of each order of government balances more closely with its expenditure responsibilities. Examples are the arrangements for tax sharing and the adjustments made to them in both Germany and Switzerland.⁶⁷ Rearrangement of taxing powers is also currently under active consideration in Australia and further reforms to the federal-cantonal fiscal arrangements are currently under serious consideration in Switzerland. Proposals advanced in Canada from time to

TABLE 8 : Direct Transfers to Subnational and Local Governments as a Percentage of Federal Expenditure

		1986	1996
Australia	• to states	29.9	24.9
	• to local	0.1	0.2
Germany	• to Lander	12.0	14.4
	• to local	3.6	0.1
Switzerland	• to cantons	32.0	26.8 ^a
	• to local	0.2	0.08 ^a
U.S.	• to states	8.6	11.4
	• to local	1.9	1.4
Canada	• to provinces	17.9	17.6 ^a
	• to local	0.4	0.8 ^a

Notes: ^aThese figures are for 1995.

Source: Data provided by the Australian Bureau Of Statistics; Treff and Perry (1997); Canada Tax Foundation (various years); and data submitted by consultants (see acknowledgments).

time for the transfer to the provinces of equalized tax points would come into this category of adjustment. Such alterations could have important implications, however, for tax harmonization and for the coordination of tax collection. Alterations to the arrangement of federal and provincial tax fields also have important implications for horizontal balance since in the absence of enhanced or modified equalizing mechanisms, they may vary significantly the tax yields in different provinces.

A second way of using the taxation system as an alternative to the federal spending power is through the creative use by the federal government of the taxation system as a federal policy tool for redistribution. A relevant recent Canadian example is the Child Tax Benefit announced in the 1997 federal budget as a major component of a federal-provincial National Child Benefit System.⁶⁸ Information on such approaches in other federations in a form enabling comparison has been difficult to obtain. In the United States, the federal government has increasingly used the federal income tax system since the mid-1970s as an alternative policy tool to achieve redistribution. The Earned Income Tax Credit enacted in 1975 and

considerably expanded by the *Tax Reform Act* of 1986 and then further increased in 1990 and 1993 is a leading example. The EITC lifted about 2.4 million children out of poverty in 1996 and now lifts more children out of poverty than any other single government social-welfare program. The U.S. federal income tax itself is progressively redistributive and various deductions, exemptions and credits have a redistributive effect. At the same time it must be said that homeowners' mortgage interest and property taxes can be said to constitute regressive redistribution and the federal Social Security and Medicare tax, which is the largest single tax bite for most Americans, is a flat regressive tax. There have been some similar efforts to use the taxation system as an alternative policy tool to achieve redistribution in Germany, but the property (net worth) tax was ruled unconstitutional by the Constitutional Court in 1996, checking that effort. Examples in Switzerland and Australia of efforts by their federal governments to use the taxation system as an alternative to the spending power to achieve redistribution have been more difficult to find.

Given the Canadian federal government's recent commitment under the agreement upon a Framework to Improve the Social Union for Canadians, 4 February 1999, not to proceed with the exercise of its spending power to establish new shared-cost or block-funded initiatives for health care, social assistance and services and postsecondary education unless there is support from a majority of provincial governments, there may be a greater reliance upon direct transfers to individuals and organizations and the creative use of the income tax system as a policy tool for achieving redistribution objectives. But even in the case of direct transfers to individuals the federal government has now agreed to give advance notice and to consult provincial governments.

Chapter 4

Conclusions and Implications for Canada

From the examination of the federal spending power in other federal systems some broad conclusions may be drawn.

First, there is an enormous range of variations in financial arrangements not only between a confederal system such as the European Union and the federations but also among the federations themselves. Indeed, the significant differences between Canada and the other federations — in terms of the relative scope of areas identified in the constitution as under exclusive provincial jurisdiction as opposed to concurrent jurisdiction, in terms of degrees of decentralization and emphasis on provincial autonomy, and in the lack of provincial government representation in federal institutions — to some extent limit comparability. The debate over the spending power in Canada is therefore virtually *sui generis* and considerable caution needs to be exercised in applying to Canada the experience of other federations.

Second, three general (if cautious) lessons can nevertheless be drawn from a comparative analysis of the federal spending power in areas of provincial legislative competence in other federations.

First, all federations, and even the confederal European Union, have been marked by considerable overlap and interdependence, especially in the area of social policy and programs. While complete disentanglement and independent jurisdiction of different orders of government may have a seductive appeal as a way of ensuring the federal principle that neither order of government should be subordinate to the other, in practice it has proved simply impossible to divide functions in federations into watertight compartments, particularly in the realm of revenues and expenditures. This has made necessary in virtually all contemporary federations an acceptance of interdependence and interpenetration of the functions of different levels of government, but with quite different approaches to collaboration between federal and provincial/state governments. For Canada this suggests that trying to confine the activities of the federal and provincial governments to separate,

watertight compartments would in the long run be self-defeating, but also that processes involving genuine intergovernmental partnership in areas of overlap, including certain uses of the federal spending power, would be helpful.

Second, since interdependence between orders of government in federations is unavoidable, some federations have made provision for provinces/states to have a role in designing and approving federal spending in areas of their legislative jurisdiction. As we have noted in the study, the degree to which this has been achieved in the different federal systems varies widely. A partnership for constituent governments in decision-making is clearly the case constitutionally not only in the European Union but in the German federation. Indeed, the German experience of closely interlocking federal-state collaborative joint decision-making provides a cautionary note that, carried to excess, this can itself lead to undesirable rigidities and inflexibility characterized by critics as "the joint-decision trap."⁶⁹ The constitutional structures and political culture in Switzerland generally also assure the cantons an influential role in the design and ultimate approval of federal spending.

In some other federations, the states play a significant though limited role in the negotiation of federal spending in areas of state jurisdiction. For example, in the United States and Australia there is no formal constitutional or other provision for state approval of the design of federal spending programs. At most, the institutional character of Congress provides channels for the representation of state interests (but not necessarily those of state governments) in Congressional decisions. In Australia, the formal structures of "executive federalism" in such bodies as the Premiers' Conference, the Council of Australian Governments and the Loan Council are a regular feature in the shaping of federal-state financial relations. Ultimately, however, in both these federations the general tendency of the federal government in matters relating to the federal spending power has been quite heavy handed.

In some of the more centralized federations such as Austria, India, Malaysia, and Spain the role of the federal government in the design and implementation of its spending power in areas of state jurisdiction has been dominant, although even in India and Malaysia the role of the constitutionally established Finance Commission in the former, and of constitutionally authorized intergovernmental councils in the latter, have provided channels for the states to have some influence on decisions.

By comparison, in the past the role of the Canadian provinces in policy-making relating to the exercise of the federal spending power has been less than in some federations but more than in others. In terms of constitutional provisions, Canada's provincial governments have no representation at the federal level through a second chamber, as they do in Germany and, to a lesser extent, Switzerland. In practice, however, the highly developed processes of executive federalism in Canada have led to a greater degree of consensual intergovernmental decision-making than in many other federations, especially in relation to shared-cost and direct transfer programs. The Agreement on a Framework to Improve the Social

Union for Canadians, signed 4 February 1999, while recognizing the role of the federal government through using its spending power in relation to social policy in Canada, will enhance the role of the provinces in the design of federal programs and funding arrangements in this area and provide for a more collaborative approach.

It must be noted that those other federations that have provided for a greater role for their provinces/states at the federal level have also been characterized by a more detailed or intrusive approach to setting terms and conditions than has been the case in Canada. Indeed, as the federal government has reduced its transfers to the provinces in the face of fiscal pressures, it similarly has reduced the level of conditionality attached to such transfers. Furthermore, as noted in this study, no provision has been made in any other federation for "opting-out" of national programs.

Finally, among federations Canada clearly stands out in the recognition of provincial autonomy through the generally relatively low degree of conditionality of most federal transfers to the provinces (as illustrated by Tables 5 and 6 above). This can be explained in part by the character of the Canadian constitutional distribution of legislative authority: whereas other federal constitutions have generally set out a considerable number of areas of concurrent jurisdiction, the Canadian constitution places greater emphasis upon the exclusive legislative authority of each order of government. The difficulty of obtaining agreement to substantial constitutional changes in the distribution of powers — not only recently but historically — means that greater reliance has been placed on financial arrangements between the two orders of government, particularly in areas (such as certain aspects of social policy) where the wording of the constitution is not definitive. An additional factor is the extent of provincial diversity within Canada — notably the uniqueness of Quebec, which since the 1960s has been a staunch advocate of lower conditionality. The degree to which Canadian practice and proposals for reform rely less on conditional transfers and provide more protection for provincial autonomy thus would appear to recognize the particular character of the distribution of legislative powers in Canada and the generally greater powers of the Canadian provinces than the constituent units in other federations.

Notes

1. See, for instance, Government of Canada (1969, pp. 9-11); and Hogg (1996, pp. 146-51). Hogg notes that some constitutional lawyers, including Pierre Trudeau before he assumed high federal office, have argued that the federal spending power is confined to objects within federal legislative competence, but Hogg concludes that the broader view of the federal spending power is supported by what case law there is and by most commentators (pp. 149-51). On provinces not recognizing limits to provincial spending powers in areas outside their legislative competence see Hogg, pp. 151-52.
2. On the origins and evolution of conditional grants and shared-cost programs in Canada, see Stevenson (1989, pp. 151-76). See also Banting (forthcoming).
3. For analysis of this proposal see the chapters by Johnson, Hogg, Banting, Lajoie, Petter, Dupré, Fortin, and Boadway *et al.* in Swinton and Rogerson (1988) For the original five conditions identified by the Quebec Liberal Party see Leslie (1986, Appendix A, Address by Gil Remillard, pp. 43-44).
4. Scholars of federalism in the United States have in recent years emphasized the distinction between decentralization (implicitly a top-down process) which may occur in unitary as well as federal systems and constitutional non-centralization, the latter being a definitive characteristic of federal systems. See, for instance, Elazar (1987). They insist that U.S. federalism is characterized by non-centralization rather than decentralization. By contrast, most Canadian literature has ignored this significant distinction and therefore the term decentralization has been generally used elsewhere in this study.
5. Article 1, section 8.
6. See *Oklahoma v. U.S. Civil Service Commission*. (1947) 330 U.S. 227.
7. Data from Finance Canada.
8. The uses of the federal spending power that touch areas of state law-making power are not subject to special decision-making procedures. However, under the current Republican majority control of Congress, the U.S. House of Representatives has adopted a rule requiring sponsors of all legislation to cite the constitutional authority for Congress to enact the proposed legislation. Nevertheless, state roles are limited

- to political pressure and to challenges in the federal courts to federal uses of the spending power in areas of state law-making power. However, state challenges to congressional uses of the federal spending power are almost always unsuccessful.
9. Although, strictly speaking, there are no equalization transfers in the United States, congressional-presidential decision-making processes for enacting formula-grant programs do not differ from other decision-making processes, except that state and local government officials lobby the Congress and the president more intensively in formula decision-making processes than they do in most other decision-making processes. Formulas, like other legislation, emerge from the congressional-presidential political process. The federal and state courts play no appreciable role in these matters, and the United States Constitution is silent on these matters.
 10. In 1986, General Revenue Sharing (GRS) for local governments, which accounted for about 19 percent of all direct federal transfers to local governments, was minimally conditional, and thus almost unconditional. However, GRS, which had been enacted in 1972, expired in 1986. Consequently, in 1996 all federal transfers to local governments were conditional grant-in-aid programs.
 11. The question of whether conditions attached to federal government transfers or shared-cost programs differ in areas of exclusive state government jurisdiction from those in areas of joint jurisdiction is not applicable to the United States. The principal difference in the United States is that the Congress ordinarily attaches crosscutting conditions to very large grant-in-aid programs (i.e., Medicaid and highway aid) because it is fiscally and politically impractical or impossible for state governments to withdraw from these voluntary programs. Such crosscutting conditions are not ordinarily attached to small grants-in-aid because states can simply refuse to participate in small programs.
 12. See for instance, Bird (1986, p. 165). Although rarely focused on a single location, grants may be used for identified regions.
 13. Generally, three types of conditions are attached to federal transfers to state and local governments. First, program conditions pertain to grant administration (e.g., accounting, auditing, personnel, procedures and expenditure purposes) and performance goals. A common complaint of state and local governments is that these conditions are excessively detailed and rigid. Second, crosscutting conditions are federal regulations that apply to all federal grants-in-aid to state and local governments. Crosscutting conditions include the *Civil Rights Acts* of 1964 (Title VI) and 1968 (Title VII), the *Architectural Barriers Act* of 1968 (for persons with disabilities) and the *National Historic Preservation Act* of 1966. For example, in constructing and maintaining highways with federal aid, state and local governments cannot violate these federal laws by discriminating against contractors on the basis of race, by failing to provide for handicapped accommodations, or by destroying or damaging sites that have, or should have, historic preservation protection. Third, crossover conditions provide that federal funding for a particular grant program will be reduced or terminated for any state or local government that fails to comply with the requirements of another program. One of the first crossover sanctions was the *Highway Beautification Act* of 1965, which was prompted by Lady Bird Johnson's dislike of highway billboards. A recent prominent example is the 21-year old drinking age

requirement that was attached to federal highway aid in 1984 and upheld by the United States Supreme Court in 1987 (*South Dakota v. Dole*). That is, any state that failed to increase to age 21 the legal age for purchasing alcoholic beverages would have lost 5 percent of its federal highway aid if it had not done so by 1986. (This program is funded at a matching rate that is 90 percent federal and 10 percent state.) Approximately 18 such crosscutting conditions are attached to federal highway aid.

14. It is extremely difficult to provide precise data on the proportion of total federal expenditures (including all transfers) devoted to direct transfers to individuals, in part because "direct transfers to individuals" is subject to various definitions. The proportion of total U.S. federal expenditures (including all transfers) that can reasonably be said to be devoted to direct transfers to individuals equalled approximately 43.6 percent in 1986 and approximately 51.8 percent in 1996. Furthermore, the Office of Management and Budget (OMB) estimates that 48.2 percent of all federal transfers to state and local governments in 1986 were for payments to individuals, while 62.8 percent of all such transfers were for payments to individuals in 1995.
15. At least three-quarters of all federal transfer-monies (not programs) is distributed to state and local governments through program-specific formulas that take into account needs-based factors (e.g., population size, proportion of population below the federal poverty level, per capita income, and age of housing stock). Only a very small proportion of federal-transfer formulas include a measure of state fiscal capacity (i.e., Total Taxable Resources). Taking into account all federal grant-in-aid transfers to state and local governments as well as all other federal expenditures in the states, including payments to individuals (e.g., Social Security), 20 states are net donor states, beginning with the largest donor states, Connecticut and New Jersey.
16. The leading example is the Earned Income Tax Credit (EITC), which was enacted in 1975 and considerably expanded by the *Tax Reform Act* of 1986 and then further increased in 1990 and 1993. The EITC is a refundable tax credit. If the EITC owed to a low-income working family is larger than the income tax owed by the family, then the family receives a cheque from the federal Internal Revenue Service for the difference. Working parents with children who have an income slightly below the federal poverty level receive the largest EITC credit. The maximum benefits in 1997 were \$2,210 for parents with one child and \$3,656 for parents with two or more children. The EITC lifted about 2.4 million children out of poverty in 1996 which constituted 37.3 percent of all children lifted out of poverty by all government programs in 1996. (The poverty line for a family of two adults and two children was \$15,911 in 1996). The EITC, therefore, now lifts more children out of poverty than any other single government social-welfare program. The federal income tax itself is progressively redistributive insofar as persons with higher incomes pay higher tax rates than persons having lower incomes. In addition, eligibility for the standard deduction, personal exemption, college-education credit and child-care deduction is reduced or eliminated at certain middle- and upper-class income levels. At the same time, however, the income-tax deductions for homeowners' mortgage interest and property taxes can be said to constitute regressive redistribution. In addition, the federal Social Security and Medicare tax, which is the single largest tax bite from most Americans, is a flat, regressive tax.

17. Article 3 enshrines cantonal sovereignty except as limited by the federal constitution. Articles 8-42 specify the federal legislative powers. Among these, those relating to federal revenue-raising powers are article 18 (military exemption tax), articles 28, 29 and 30 (customs duties), article 32 bis (duties on distilled spirits), article 41 bis (a range of taxes including stamp duties anticipatory income taxes, tobacco taxes), article 41 ter (a range of taxes including turnover taxes, special consumer taxes, and individual and corporate income taxes), and article 42 (federal receipts from specified activities). For some of these taxes (listed in article 41 bis) the federal government has an exclusive right but in other cases (listed in article 41 ter) cantons may also levy taxes. The federal income tax is levied on behalf of the federal government by the cantons who retain three-tenths of the gross yield with at least one-sixth of the total apportioned to the cantons being used for financial equalization among cantons. For the implications of this distribution of powers and resources for the federal spending power, see especially Bird (1986, p. 56).
18. The specific powers are promotion of Swiss films (article 27 ter), protection of the national inheritance (article 24 sexies), establishment of a national broadcasting system (article 55 bis) and promotion of the four Swiss national languages (article 27).
19. Articles 41 bis, 41 ter and 42. See also articles 18, 28, 29, 30, 32 bis and footnote 15 supra. For an analysis of these, see Bird (1986, pp. 37-41, 48-56) and Dafflon (1998, pp. 11-14).
20. See Bird (1986, pp. 41-44) and Dafflon (1998, pp. 9-10) on the expenditures of the three orders of government within the Swiss federation.
21. Dafflon (1998, p. 22). See section in paper regarding the United States and Canada.
22. Since 1989, under a new accounting arrangement, direct transfers to individuals or organizations are no longer shown separately.
23. Sections 51, 52, 90, 107, and 109.
24. Sections 51 and 109. These range from taxation, defence, immigration and external affairs to marriage, invalid and old age pensions, weights and measures, copyright and lighthouses, and include labour and social services.
25. Sections 52 and 90. The three areas of exclusive federal jurisdiction are: (i) its own seat of government, (ii) its public service departments, and (iii) other matters declared by the constitution to be exclusively federal. The main item in the third category is jurisdiction over customs, excises and bounties vested exclusively in the federal Parliament by section 90.
26. Section 107.
27. *Uniform Tax Cases (South Australia v. Commonwealth)* (1942) 65 C.L.R. 373; *Victoria v. Commonwealth* (1957) 99 C.L.R. 575.
28. *A.G. Vic. V. Commonwealth (Pharmaceutical Benefits)* (1945) 71 C.L.R. 237; *Victoria v. Commonwealth (Australian Assistance Plan)* (1975) 134 C.L.R. 338.
29. The most notable case was *South Australia v. The Commonwealth* (1942) 65 C.L.R. 373 in which the making of grants by the federal government to the states to induce them not to impose an income tax was held to be valid.

30. See Table 4. Only in Spain and Austria has this percentage been higher.
31. See section on the link to revenue-raising powers in the United States, p. 10.
32. Section 105A inserted by a constitutional amendment in 1928.
33. The Commonwealth Grants Commission has taken into account both the revenue-raising capacity of the states and their expenditure needs in calculating their recommendations. See, for instance, Walsh (1998, p. 32).
34. For details of the 68 programs see pp. 37-40 and Government of Australia (1997, Table A2) which sets these out in extensive detail.
35. See, for instance, Bird (1986, p. 111).
36. Data on the extent of these has been difficult to obtain.
37. See, for instance, Walsh (1992, pp. 26-30). See also Brown (1998).
38. Following the reunification of Germany the accounting system for revenue and expenditure allocation and those relating to equalization were substantially modified. As a result figures prior to reunification and after are not strictly comparable and this needs to be borne in mind in subsequent references and tables comparing data for 1986 and 1996.
39. The law-making power is set out in article 105 and the spending power in article 104a.
40. These joint task areas were established under a constitutional revision in 1969. Joint tasks were established as policy areas in which both levels of government were to interact in planning and spending: university construction, regional policy, agriculture structural policy and coast preservation, education planning, and research policy. The first three tasks in effect replaced specific federal grants in these areas. See Bird (1986, pp. 89-91).
41. Articles 106(5), 106(3) and 105(3)1 and 106(3)3 and (4). Note the Land portion of the turnover tax was 35 percent in 1986 but this was subsequently amended to 49.5 percent.
42. In Table 2 these figures are indicated in brackets.
43. Articles. 105(3), 106(3)3 and (4), 107(2)3.
44. Article. 104a(3).
45. For this purpose the constitutionally allocated Land and local shares of taxes are not included in the total transfers. The percentages are for portions of the two categories of transfers referred to in this paragraph.
46. It should be noted that in the Bundesrat each Land votes as a block (as instructed delegates of their Land), but the votes of the Länder carry a weighting of three, four or six votes according to the size of the Land. See Watts (1996, pp. 84-89).
47. See Tables 2 and 3 for a comparative overview.
48. See Table 4 for a comparative overview.
49. See especially, Bird (1986, pp. 100, 102-03).
50. *The Belgian Constitution, 1993*, articles 4, 175, 176, 177, 178.

51. Alen, (1992, pp. 250-531). A measure of fiscal centralization based on central government taxes as a percentage of the total taxation based on OECD data averaged from 1975, 1985, and 1992 indicated 61.4 percent for Belgium compared to 43.1 percent for Canada, but this was based on data before Belgium had fully evolved into a federation. See Walsh, (1997, p. 19, Table 9).
52. From *Second Report of the Union Powers Committee*, 5 July 1947, in Constituent Assembly of India, *Reports of Committees* (1st series 1947), p. 71
53. For recent examples, see for instance, the chapter by Hemming *et al.* (1997); and Vijapur (1998).
54. Constitution, article 282.
55. The "Gadgil" formula currently reflects weights of 60 percent for population, 25 percent for per capita income, 7.5 percent for a combined index of tax effort, literacy, and completion of foreign aid projects, and 7.5 percent for special problems.
56. Article 82 enables the federal financing of any matter specified in the concurrent list; article 92 authorizes federal funding relating to national development; article 109(3) empowers Parliament to make grants to any of the states on such terms and conditions as it may determine.
57. Article 158(2). Furthermore, article 157(1)(c) also makes provision for transfers from the central government to the Autonomous Communities.
58. Or in the case of Spain, a federation in all but name.
59. For purposes of comparison with the other federations considered in this study see Table 3.
60. For a comparison of federal government expenditures (after transfers to subnational governments) as a percentage of GDP see Table 1. While the figure for the European Union in 1996 was 1.2 percent, in the federations it ranged from 11.7 percent in Switzerland to 19.4 percent in the United States.
61. Belgium provides the closest parallel, but because the establishment of the federal system was so recent and is still in a transitional phase these issues have not been at the forefront in the same way.
62. See for instance the oft-quoted definition of federal government in Wheare (1963, pp. 1-15).
63. Such fields are recognized in some of the more recent federal constitutions elsewhere, however, frequently as concurrent jurisdiction.
64. In this respect India and, to some extent, Malaysia have been much influenced by the Australian model in establishing formal institutions for reviewing or approving financial arrangements.
65. But we have noted in the section on Australia above that a considerable portion of the Australian special-purpose payments have nevertheless been for health, education and housing which are areas of exclusive state jurisdiction. See the section on the nature and extent of the use of the federal spending power in Australia.
66. The equalization transfers in Canada are clearly unconditional. The CHST does involve a general conditionality, but compared to the detailed conditions set forth in

the conditional grants in other federations they are at most semi-conditional transfers and for purposes of comparison come closer to unconditional transfers. The CHST transfers accounted for 39.3 percent of all the federal transfers to the provinces in 1996.

67. See earlier sections on Australia. See also Bird (1996, pp. 91-95, Germany; and 37-41, 48-59, Switzerland).
68. This initiative is described in Canada. Department of Finance (1998, pp. 109-11).
69. See earlier section in Chapter 2 on decisions on the use of the federal spending power.

References

- Advisory Commission on Intergovernmental Relations (1993), *Significant Features of Fiscal Federalism, 1993*, 2 volumes, (Washington, DC: Advisory Council on Intergovernmental Relations).
- Alen, A. ed. (1992), *Treatise on Belgian Constitutional Law* (Brussels: Kluwer).
- Alen, A. and P. Peeters (1995), "The Belgian Federal State after the Fourth State Reform," *European Public Law*, 1(1):8-15.
- _____ (1997), "The Competences of the Communities in the Belgian Federal State: The Principle of Exclusivity Revisited," *European Public Law*, 3(2):165-73.
- _____ (forthcoming), "Federal Belgium: Within the International Legal Order: Theory and Practice," (in preparation).
- Alen, A. and R. Ergec (1994), *Federal Belgium after the Fourth State Reform of 1993* (Brussels: Ministry of Foreign Affairs, External Trade and Development Corporation).
- Annuaire statistique de la Suisse, various years* (Zurich: Verlag Neue Zürcher Zeitung, Office fédérale de la statistique, various years).
- Ball, R. and J. Linn (1994), "Fiscal Decentralization and Intergovernmental Transfers in Less-Developed Countries," *Publius: The Journal of Federalism*, 24(1): 1-19.
- Banting, K. (forthcoming), *The Federal Spending Power and Social Policy: Process, Substance and Legitimacy in Historical Perspective* (in preparation).
- Banting, K.G., D.M. Brown and T.J. Courchene, eds. (1994), *The Future of Fiscal Federalism* (Kingston: School of Policy Studies, Queen's University).
- Birch, A.H. (1955), *Federalism, Finance and Social Legislation in Canada, Australia and the United States* (Oxford: Clarendon Press).
- Bird, R.M. (1986), *Federal Finance in Comparative Perspective* (Toronto: Canadian Tax Foundation).
- Boothe, P. ed. (1996), *Reforming Fiscal Federalism for Global Competition: A Canada-Australia Comparison* (Edmonton: University of Alberta Press and Western Centre for Economic Research at the University of Alberta).

- Brown, D. (1998), "Intergovernmental Reform in Australia: An Independent Assessment of Recent Developments," report to the Federal-State Committee, Parliament of Victoria, Melbourne, Australia.
- Canada. Department of Finance (1998), *The Budget Plan 1998* (Ottawa: Department of Finance).
- Canadian Tax Foundation (various years), *The National Finances* (Toronto: Canada Tax Foundation).
- Craig, J. (1997), "Australia," in Ter-Minassian ed., *Fiscal Federalism*.
- Dafflon, B. (1995), *Fédéralisme et solidarité: Etude de la péréquation en Suisse* (Fribourg: Institut du Fédéralisme).
- _____. (1998), "Fiscal Federalism in Switzerland: A Survey of Constitutional Issues, Budget Responsibility, and Equalization," paper presented at the International Association of Centres for Federal Studies, Adelaide, Australia.
- Elazar, D.J. (1987), *Exploring Federalism* (Tuscaloosa: University of Alabama Press).
- Exler, U. (1992), "Financing German Federalism: Problems of Financial Equalization in the Unification Process," *German Politics*, 1 (3): 22-37.
- Fletcher, C. (1991), *Responsive Government: Duplication and Overlap in the Australian Federal System* (Canberra: Federalism Research Centre, Australian National University).
- Galligan, B. (1995) *A Federal Republic: Australia's Constitutional System of Government* (Cambridge: Cambridge University Press).
- Government of Australia (1997), 1997-98 Budget Paper No. 3, *Federal Financial Relations 1997-98* (Canberra: Australian Government Publishing Service, 1997).
- Government of Canada (1969), *Federal Provincial Grants and the Spending Power of Parliament* (Ottawa: Supply and Services Canada).
- _____. (1991), *Shaping Canada's Future Together: Proposals* (Ottawa: Supply and Services Canada) pp. 192-224, 354-60.
- Grodzins, M. (1966), *The American Political System: A New View of Government in the United States* (Chicago: Rand McNally).
- Hemming, R., N. Mates and B. Potter (1997), "India," in Ter-Hinassian, ed. *Fiscal Federalism*.
- Hogg, P. (1996), *Constitutional Law of Canada*, 4th ed. (Toronto: Carswell).
- Hunter, J.S.M. (1997) *Federalism and Fiscal Balance: A Comparative Study* (Canberra: Australian National University Press and Centre for Research on Federal Financial Relations).
- Institute of Intergovernmental Relations (1991), *Approaches to National Standards in Federal Systems* (Kingston: Institute of Intergovernmental Relations).
- _____. (1997), *Assessing ACCESS: Towards a New Social Union* (Kingston: Institute of Intergovernmental Relations, Queen's University).

- Kincaid, J. (1993), "From Cooperation to Coercion in American Federalism: Housing, Fragmentation and Preemption, 1780-1992," *The Journal of Law and Politics*, 9(2): 333-430.
- _____ (1998), "The Devolution Tortoise and Centralization Hare in Contemporary U.S. Federalism," paper delivered at the International Association of Centres for Federal Studies, Adelaide, Australia.
- Lane, P.H. (1994), *An Introduction to the Australian Constitution*, 6th ed. (Sydney: The Law Book Company Ltd.).
- Leslie, P.M. (1986), *Rebuilding the Relationship: Quebec and Its Confederation Partners* (Kingston: Institute of Intergovernmental Relations, Queen's University).
- _____ (1996) *The Maastricht Model: A Canadian Perspective on the European Union* (Kingston: Institute of Intergovernmental Relations, Queen's University).
- Lodge, J. ed. (1993), *The European Community and the Challenge of the Future*, 2d ed. (London: Pinter), esp. pp. 69-111.
- Mathews, R. L. ed. (1981), *Regional Disparities and Economic Development* (Canberra: Australian National University, Centre on Federal-Financial Relations).
- May, R.J. (1969), *Federalism and Fiscal Adjustment* (Oxford: Clarendon Press).
- Ministerial Council on Social Policy Reform and Renewal (1995), *Report to Premiers* (St. John's: The Council).
- Molle, N. (1994), *The Economics of European Integration: Theory, Practice, Policy*, 2d ed. (Aldershot; Dartmouth).
- Nathan, R.P. and J. R. Lago (1990), "Intergovernmental Fiscal Roles and Relations," *The Annals of the American Academy of Political and Social Sciences*, 509: 36-47.
- Nugent, N. (1994), *The Government and Politics of the European Union*, 3d ed. (London: Macmillan).
- Pernthaler, P. (1983), *Federal Fiscal Relations in Austria*, Occasional Paper No. 30 (Canberra: Centre for Research on Federal Financial Relations, Australian National University).
- Provincial/Territorial Council on Social Policy Renewal (1997), *New Approaches to Canada's Social Union: An Options Paper* (St. John's: Council).
- Scharpf, F. (1988), "The Joint Decision Trap: Lessons from German Federalism and European Integration," *Public Administration*, 66: 238-78.
- Schmitt, N. (1998), "Fiscal Equalization in Switzerland: Is Asymmetry without Compensation the Death of Federalism?" paper presented at the International Association of Centres for Federal Studies, Adelaide, Australia.
- Schuetz, C.F. (1993), *Revising the Federal Constitution of Switzerland* (Ottawa: Department of Political Science, Carleton University).
- Solé-Vilanova, J. (1990), "Regional and Local Government Finance in Spain: Is Fiscal Responsibility the Missing Element?" in R.J. Bennett, ed., *Decentralization, Local Governments, and Markets: Towards a Post-Welfare Agenda* (Oxford: Clarendon Press), pp. 331-54.

- Stevenson, G. (1989), *Unfulfilled Union: Canadian Federalism and National Unity*, 3d. ed. (Toronto: Gage).
- Swinton, K.E. and C. J. Rogerson, eds. (1988), *Competing Constitutional Visions – The Meech Lake Accord* (Toronto: Carswell).
- Tannenwald, R. and J. Cowan (1997), "Fiscal Capacity, Fiscal Need, and Fiscal Comfort among U.S. States: New Evidence," *Publius: The Journal of Federalism*, 27 (Summer): 113-25.
- Ter-Minassian, T. ed. (1997), *Fiscal Federalism in Theory and Practice* (Washington, DC: International Monetary Fund).
- Treff, K. and D.B. Perry (1997), *Finances of the Nation 1996* (Toronto: Canadian Tax Foundation).
- Vijapur, A.D. (1998). "Fiscal Federalism in India: An Overview," paper presented at the International Association of Centres for Federal Studies, Adelaide, Australia.
- Voigt, R. (1989) "Financing the German Federal System in the 1980s," *Publius: The Journal of Federalism*, 19(4): 99-113.
- Walsh, C. (1992), *Fiscal Federalism: An Overview of Issues and a Discussion of their Relevance to the European Community* (Canberra: Federalism Research Centre, Australian National University).
- ____ (1997), "Reconciling Regional Diversity with National Objectives and Priorities: Lessons for Australia's Federal Experience," paper presented at a conference in Turin, Italy, October.
- ____ (1998), "Fiscal Federalism, Australian Style," paper delivered at the International Association of Centres for Federal Studies, Adelaide, Australia, March.
- Watts, R.L. (1966), *New Federations: Experiments in the Commonwealth* (Oxford: Clarendon Press) esp. pp. 192-224, 354-60, 367-75.
- ____ (1989), *Executive Federalism: A Comparative Analysis* (Kingston: Institute of Intergovernmental Relations, Queen's University).
- ____ (1996), *Comparing Federal Systems in the 1990s* (Kingston: Institute of Intergovernmental Relations, Queen's University).
- Wheare, K.C. (1963), *Federal Government*, 4th ed. (London: Oxford University Press).
- Wilson, L.S. (1996), *Federal-State Fiscal Arrangements in Malaysia* (Kingston: John Deutsch Institute for the Study of Economic Policy, Queen's University).
- Zimmerman, J.F. (1992), *Contemporary American Federalism: The Growth of National Power* (Leicester: Leicester University Press).

Queen's Policy Studies

Recent Publications

The Queen's Policy Studies Series is dedicated to the exploration of major policy issues that confront governments in Canada and other western nations. McGill-Queen's University Press is the exclusive world representative and distributor of books in the series.

School of Policy Studies

Canada's National Defence, vol. 2, *Defence Organization*, Douglas L. Bland (ed.), 1998
Paper ISBN 0-88911-797-7 Cloth ISBN 0-88911-799-3

Diplomatic Missions: The Ambassador in Canadian Foreign Policy, Robert Wolfe (ed.), 1998
Paper ISBN 0-88911-801-9 Cloth ISBN 0-88911-803-5

Issues in Defence Management, Douglas L. Bland (ed.), 1998
Paper ISBN 0-88911-809-4 Cloth ISBN 0-88911-811-6

Canada's National Defence, vol. 1, *Defence Policy*, Douglas L. Bland (ed.), 1997
Paper ISBN 0-88911-792-6 Cloth ISBN 0-88911-790-X

Lone-Parent Incomes and Social-Policy Outcomes: Canada in International Perspective, Terrance Hunsley, 1997
Paper ISBN 0-88911-751-9 Cloth ISBN 0-88911-757-8

Social Partnerships for Training: Canada's Experiment with Labour Force Development Boards, Andrew Sharpe and Rodney Haddow (eds.), 1997
Paper ISBN 0-88911-753-5 Cloth ISBN 0-88911-755-1

Institute of Intergovernmental Relations

Canada: The State of the Federation 1998/99, vol. 13, *How Canadians Connect*, Harvey Lazar and Tom McIntosh (eds.), forthcoming 1999 Paper ISBN 0-88911-781-0 Cloth ISBN 0-88911-779-9

Canada: The State of the Federation 1997, vol. 12, *Non-Constitutional Renewal*, Harvey Lazar (ed.), 1998
Paper ISBN 0-88911-765-9 Cloth ISBN 0-88911-767-5

Canadian Constitutional Dilemmas Revisited, Denis Magnusson (ed.), 1997
Paper ISBN 0-88911-593-1 Cloth ISBN 0-88911-595-8

Canada: The State of the Federation 1996, Patrick C. Fafard and Douglas M. Brown (eds.), 1997
Paper ISBN 0-88911-587-7 Cloth ISBN 0-88911-597-4

Comparing Federal Systems in the 1990s, Ronald Watts, 1997
Paper ISBN 0-88911-589-3 Cloth ISBN 0-88911-763-2

John Deutsch Institute for the Study of Economic Policy

Equalization: Its Contribution to Canada's Economic and Fiscal Progress, Robin W. Boadway and Paul A.R. Hobson (eds.), Policy Forum Series no. 36, 1998
Paper ISBN 0-88911-780-2 Cloth ISBN 0-88911-804-3

Fiscal Targets and Economic Growth, Thomas J. Courchene and Thomas A. Wilson (eds.), Roundtable Series no. 12, 1998 Paper ISBN 0-88911-778-0 Cloth ISBN 0-88911-776-4

The 1997 Federal Budget: Retrospect and Prospect, Thomas J. Courchene and Thomas A. Wilson (eds.), Policy Forum Series no. 35, 1997 Paper ISBN 0-88911-774-8 Cloth ISBN 0-88911-772-1

The Nation State in a Global/Information Era: Policy Challenges, Thomas J. Courchene (ed.), Bell Canada Papers no. 5, 1997 Paper ISBN 0-88911-770-5 Cloth ISBN 0-88911-766-7

Reforming the Canadian Financial Sector: Canada in a Global Perspective, Thomas J. Courchene and Edwin H. Neave (eds.), 1997 Paper ISBN 0-88911-688-1 Cloth ISBN 0-88911-768-3

Available from:

McGill-Queen's University Press

Tel: 1-800-387-0141 (ON and QC excluding Northwestern ON)

1-800-387-0172 (all other provinces and Northwestern ON)

E-mail: customer.service@ccmailgw.genpub.com

The following publications are available from:

Institute of Intergovernmental Relations
Queen's University, Kingston, Ontario K7L 3N6

Tel: (613) 533-2080 / Fax: (613) 533-6868

email: iigr@qsilver.queensu.ca

Securing the Social Union: A Commentary on the Decentralized Approach, Steven A. Kennett, 1998
ISBN 0-88911-767-5

Comparaison des régimes fédéraux des années 1990, Ronald Watts, 1997
ISBN 0-88911-771-3

Assessing ACCESS: Towards a New Social Union, Proceedings of a symposium held at Queen's University, 31 October-1 November 1996, 1997
ISBN 0-88911-591-5

Equalization on the Basis of Need in Canada, Douglas M. Brown, 1996
ISBN 0-88911-585-0

The New Face of Canadian Nationalism, Roger Gibbins, 1995
ISBN 0-88911-577-X

Integration and Fragmentation: The Paradox of the Late Twentieth Century,
Guy Laforest and Douglas M. Brown (eds.), 1994
ISBN 0-88911-567-2

Working Paper Series

1. *The Meaning of Provincial Equality in Canadian Federalism* by Jennifer Smith, Dalhousie University
2. *Considerations on the Design of Federations: The South African Constitution in Comparative Context* by Richard Simeon, University of Toronto
3. *Federal Systems and Accommodation of Distinct Groups: A Comparative Survey of Institutional Arrangements* by Ronald L. Watts, Queen's University
4. *De Jacques Parizeau à Lucien Bouchard: une nouvelle vision? Oui mais . . .* by Réjean Pelletier, Université Laval
5. *Canadian Federalism and International Environmental Policy Making: The Case of Climate Change* by Heather A. Smith, University of Northern British Columbia
6. *Through the Looking Glass: Federal Provincial Decision-Making for Health Policy* by Candace Redden, Dalhousie University
7. *Drift, Strategy and Happenstance: Towards Political Reconciliation in Canada?* Extraits des actes du symposium tenu à l'Université Queen's les 28 et 29 mai 1998, avec annotations de Stéphane Dion, David R. Cameron, Richard Dicerni, Daniel Soberman et John Courtney, sous la direction et avec une introduction de Tom McIntosh