Fiscal Federalism in the United States

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FISCAL FEDERALISM IN THE U.S.A.

A. FEDERALISM IN THE USA: THE CONSTITUTIONAL AND POLITICAL CONTEXT

The United States of America became the first modern federation in 1789 following the failure of the previous confederal form of government established in 1781. At its origin the federation was composed of 13 states. Since then it has expanded across the continent and evolved into a federation of 50 states. The United States survived a devastating Civil War, 1861-1865, during the first century of its existence, but still operates under the original federal constitution of 1789. It is, therefore the longest-standing federation in the world, and it serves as an important reference point in any comparative study of fiscal federalism.

In comparative terms, the United States is moderately noncentralized. The major feature of the distribution of powers, which applies symmetrically to all 50 states, is the arrangement whereby the Constitution lists subject matters delegated to the federal government and leaves fairly substantial residual authority to the states. Those powers delegated to the federal government are mostly concurrent with federal law prevailing in cases of conflict with state laws. In a few areas the states are prohibited from legislating, thus making these matters in effect exclusively federal. While originally a more decentralized federation than Canada, the extensive exercise by the federal government of its authority in areas of concurrent jurisdiction, the broad interpretation of the doctrine of "implied powers" in the interpretation of federal powers by the courts, and the extensive use by the federal government of its spending power have resulted in a federation that is now considerably more centralized than the Canadian federation.

Within the institutions at both levels of government, the separation of powers between executive, legislative and judiciary is the prevailing principle, involving a system of checks and balances among these institutions. The federal Congress includes a directly elected House of Representatives with representation based on population and a directly elected Senate in which the states are each represented by two Senators. The President is also directly elected, state votes being allocated on the basis of an Electoral College. 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. The large number of states and the separation of powers within both levels of government has also lead to a diffused, complex and relatively uncoordinated set of intergovernmental relationships.

Although there is no constitutional requirement for the federal government to cooperate with the states in carrying out policies in those areas in which it has legislative jurisdiction, in practice federal governments have chosen frequently to use state and local governments as administrative agents, sometimes leaving them considerable latitude of operation. To influence the application of its policies, the federal government has relied extensively on conditional grants to the state and local governments. This has given relations between governments in the United States federation a highly interdependent character.

1. CONSTITUTIONAL STATUS OF VARIOUS ORDERS OF GOVERNMENT

The United States of America consists of a federal government, 50 state governments, 2 federacies, 3 local home-rule territories, 3 unincorporated territories, over 130 Native American domestic dependent nations, and numerous municipal (or local) governments.[1] All of the federal and state governments are organized according to the principle of the separation of executive and legislative powers.

The Federal and State Legislatures

The separation of legislative and executive branches of government within the federal and state legislatures, combined with fixed terms of office, has allowed the legislative branch to maintain its independence from the executive. The Senate is the Upper House of the federal legislature. It is composed of two Senators from each state, who are directly elected on state-wide constituencies for six-year terms, one-third being elected each two years. The Senate has equal power with the House of Representatives, and in addition the power to ratify treaties and certain executive and judicial appointments. The prestigious position of Senators makes them rivals to the President for public attention.

The House of Representatives, or Lower House, is elected on the first past the post electoral system, with the number and distribution of seats based on population. The electoral term of the House is relatively short, two years, and the number of members relatively large, at 435.

The separation of legislative from executive power encourages a regime of weak party discipline to prevail throughout the system. As a result members of both the House and the Senate are free to form *ad hoc* cross-party legislative coalitions on an issue-by-issue basis. In a custom referred to as ‘log-rolling’, members trade their support for legislation in which they

have no crucial interest for support from other members on legislation in which they do have a critical interest.

Weak party bonds mean that members of both Houses are, to a great degree, individual 'political entrepreneurs'. Election campaign costs are high, and candidates are largely responsible for raising their own election campaign finances. Thus, members of both Houses, but especially Representatives due to their short electoral terms, are constantly aware of the need to remain attentive to their constituencies. The result is that a member of either House is highly motivated to ensure the member's constituency receives the maximum benefit from the federal treasury.

The separation of legislative and executive power allows for the possibility of differing party affiliations between the two branches, a pattern referred to as 'divided government'. As well, it is possible for there to be differing party majorities in the two Houses of the federal legislature. While such patterns of partisanship can result in legislative impasses, in general the two branches and two Houses simply act as 'checks and balances' on each others' actions.

The separation of powers principle is also adhered to at the state level. State legislatures are bicameral, except for unicameral Nebraska.[2] Governors of states are directly elected on state-wide constituencies, while state Senators and Representatives are elected directly by district.

The Courts

The courts are considered the third element of the system of checks and balances comprising the U.S. governmental structure. The Supreme Court of the United States is the only federal court established by the U.S. Constitution.[3] It has the power of constitutional review and invalidation of any federal or state law which it deems to be contrary to the federal Constitution.

Constitutional Status of the Federal and State Governments

The preamble of the U.S. Constitution makes it clear that it is the people of the United States who are sovereign, and it is they who have established the federal Constitution. Similarly, each of the 50 constituent states of the federation has a constitution of its own design, the authority for which is derived from the people of the state, not from the federal Constitution.[4]

The major feature of the distribution of powers is that the Constitution lists matters under federal authority, most of which are concurrent but some of which are exclusively federal, and

leaves the unspecified residuum to the states. Administrative authority is allocated coincident with legislative authority.

The federal government's legislative ambit includes: the power to levy taxes, provided it does not discriminate among states; the exclusive power to negotiate treaties and conduct foreign relations; the power to regulate foreign and interstate commerce; the principal responsibility for defence and the armed forces; and the jurisdiction to deal with crimes against the United States. The states retain jurisdiction over the greater part of the criminal law and administration of justice; jurisdiction over the civil law; the responsibility for most domestic functions other than those associated with the regulation of the economy, including education, health, environmental protection and social services; and the power to levy taxes and other fees.[5]

Local Governments

The United States' Constitution makes no reference to local governments. The organization and activities of local governments are therefore a subject of the various state constitutions. Consequently, the nature of the relationship between state and local governments, and among local governments, varies from state to state.[6]

2. CONSTITUTIONAL ALLOCATION OF REVENUE AND EXPENDITURE RESPONSIBILITIES AND PROVISIONS RELATED TO INTERGOVERNMENTAL TRANSFERS

Constitutional Allocation of Revenue

The Constitution invests the federal government with a very broad discretionary revenue-raising power.[7] Article One, Section 8 states that "The Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises…and provide for the…general Welfare of the United States." However, as the federal government's power to raise taxes is not exclusive, states retain the right to levy taxes and to regulate the taxing powers of local governments.[8] Thus, although there are no shared taxes, more than one order of government may exploit the major revenue sources. For example, both orders of government may levy personal and corporate income taxes, and selective sales taxes.[9] The U.S. has a decentralised tax administration system, with each order of government having its own administrative system to collect the taxes it imposes.[10]

Personal Income Taxes

Both the federal and state governments levy personal income taxes. Individuals complete their federal tax return first; the state tax burden depends largely on the degree of conformity between the federal and state income tax laws. Overall, the federal government dominates the income tax field. State income taxes tend to be at relatively low levels.

Corporate Income Taxes

Corporate income taxes are levied by both federal and state governments. Businesses that operate in more than one state must apportion their income among the states.[11] Because apportionment formulas vary from state to state, it is possible to have either double taxation of income or to have income escape taxation. A strong case could be made for uniformity in regard to apportionment, but the federal government has no constitutional power to enforce such uniformity.

Sales Taxes

There is no broad-based consumption tax at the federal level.[12] The federal government does, however, impose selective sales taxes. States utilise both general and selective sales taxes.

Constitutional Allocation of Expenditure Responsibilities

In general, the Constitution does not distinguish between the law-making and spending powers of the federal and state governments.[13] Due to the large area of concurrent jurisdiction, there is extensive overlap in the jurisdictions of the two orders of government. In these areas there is extensive federal funding of matters that lie within the legislative competence, although not the exclusive competence, of the states.

Constitutional Provisions Related to Intergovernmental Transfers

There are no provisions in the U.S. Constitution which prescribe intergovernmental transfers. Consequently, there have been no generalized schemes in the U.S. for vertical transfers or for equalization programs.[14] Similarly, there have been no constitutionally specified portions of federal taxes dedicated to federal transfers to state governments. Only a few federal taxes, such

as fuel and airport taxes, have been designated by federal statute for transfer to state or local governments to fund the transportation system.

However, because the Constitution does not prohibit intergovernmental transfers, and because of the broad discretionary revenue-raising and spending power of the federal government, an extensive, if uncoordinated, system of intergovernmental transfers has grown up. State and local governments have become heavily dependent on intergovernmental transfers from the federal government to meet their financial needs. Such transfers are almost solely in the form of conditional grants, often with the conditions closely specified.

Three sets of objectives have contributed to the growth of the system of intergovernmental transfers.[15] First, they have been used by Congress to encourage the states to pursue nationally-defined policies. Second, they have been used to support the modernization of state administrative systems and thus to support the development of more effective policy. Third, they have been used to assist the states in their institution of, and continuing participation in, redistributive policies. The latter is necessary both due to the disparities among the states in regard to revenue-raising capacity, and to federal dominance in the collection of direct revenues, especially income taxes.

Two types of conditional transfers have been utilised: block transfers and categorical transfers. Block transfers apply to broad categories of related functions, and impose few restrictions on how states or local governments allocate funds to activities within the block. Block transfers have been used for areas such as health and social services.

Categorical transfers provide financial support for specific programs. Formula-based categorical transfers distribute resources to state and local governments according to legislative or administrative criteria defined at the federal level. Formula transfers include both open-ended grants with matching requirements, and closed-ended matching and non-matching grants. A second type of categorical transfer, project grants, are awarded selectively on the basis of applications.

Federal transfer programs have been used to cover a wide range of government services. The largest have been in the areas of education, health, social services, transportation, environmental protection, and regional development.[16]

A large proportion of federal grants are passed on from state governments to local governments. In addition, state governments provide some own-source grants to local governments.

3. INSTITUTIONAL OR OTHER SPENDING POWER PROVISIONS

As noted above, the federal government's expenditure powers, "to provide for…the general Welfare of the United States," are very broad. Thus, there are no legal limits or interdictions on the objects on which the federal government may spend its own-source revenues.

The courts have supported a broad interpretation of the federal government's revenue-raising and expenditure powers.[17] Courts have upheld the federal government's rights to these powers in regard to areas of both concurrent and exclusive state jurisdiction. Because the Constitution does not list powers specifically reserved to the states, the only provision protecting the position of the states is the Tenth Amendment, which prescribes that "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 this constitutional provision, nor court rulings based upon it, have been taken to prohibit federal spending in areas of exclusive state jurisdiction.

Two features of the U.S. use of the federal spending power are particularly notable. First, the unsystematic use of conditional transfers produces an uncoordinated, complex web of intergovernmental transfers. Second, the Congress has in the past acted unilaterally to mandate that states or local governments establish programs for which the federal government has not allocated funds. These 'unfunded mandates' became highly controversial politically in the early 1990s, and have subsequently been in decline.

4. POLITICAL AND LEGAL DYNAMICS – INCLUDING THE ROLE OF LAW AND ROLE OF POLITICS IN THE DECISION-MAKING PROCESSES

The United States ranks as one of the most culturally homogeneous federations. While it has substantial black and hispanic minorities, in no state does either of these groups constitute a majority. There are some regional variations in political culture, but generally there is a substantial belief in the benefits of the dispersal of governmental power. It is the latter which supports the persistence of U.S. federalism.

The amendment of the federal Constitution requires the consent of both a majority in the federal Congress and a majority of the state legislatures. This process has proved to be relatively rigid in practice: after the first ten amendments were agreed during the ratification process and enacted in 1791, there have only been seventeen other successful amendments in the ensuing two hundred years.

As American society has evolved over the life of the federation, and as the text of the Constitution has remained relatively unchanged, other devices have been developed to allow the federation to adapt to new circumstances; intergovernmental relations is one of these devices.

Intergovernmental relations in the U.S. are best conceived of as a matrix of connections. Legislators, administrators, and executives in all three levels of government interact in an uncoordinated but ongoing basis. The federal Congress is a site for lobbying not only by societal interest groups but also by agents of state and local governments. The separation-of-powers model of governance allows a lack of party discipline to permeate the system. As a result, state and local views can be accommodated in the process of congressional deliberations.

However, to see the federal capital as the centre of decision-making would be to misunderstand the system. It is because the decision-making networks are not necessarily centred on Washington that U.S. federalism has been described as not only decentralised, but as 'noncentralized'. The locus of decision-making can shift over time due to the extensive area of effective concurrency of constitutional jurisdiction.

Extensive areas of shared jurisdiction thus allow for a degree of flexibility as to where legislative and administrative decisions are taken at a given time. The U.S federation underwent a period of crisis-induced centralization in the 1930-45 period spanning the Depression and World War II.[18] The states proved unable to deal with the economic disruptions of the Great Depression. President Roosevelt's 'New Deal' brought explosive growth in unilateral federal actions, as well as in federal-state and federal-local co-operation. The basic outlines of the U.S. welfare state were defined during this period. The post-war period, from 1945 to the early 1960s was a period of consolidation, but little further federal expansion. The Johnson administration of the mid-1960s brought another period of new social policy initiatives from the federal government. The 'Great Society' initiative was embodied in a host of new federal programs; new federal agencies undertook to implement these programs on the basis of a conception of national needs and priorities.

The perception of the failure of many of the 'Great Society' initiatives, combined with the disillusionment caused by the Vietnam War and Watergate crises, led to a turn back to state powers beginning in the mid-1970s. The Ford and Carter administrations made some attempts to come to grips with this trend, but it was the Reagan administration that pushed the decentralist agenda. Transfer programs were restructured and cut back, and regulations associated with state receipt of federal funds were reduced. States responded by becoming stronger initiators of government services. These trends continued through the Bush and Clinton administrations.

In the latter 1990s one symptom of the decentralist trend has been the conversion of some categorical transfers to block transfers. In the mid-1990s, for example, one of the longest-running welfare state programs, the federal Aid for Families with Dependent Children (AFDC) program, established in 1935, was dismantled and replaced by a block grant program (see Section C, 1(b) below).

Role of Law in the Decision-Making Process

As noted, the non-constitutional processes of shifting of responsibilities according to the principle of concurrency and the noncentralized bargaining processes of intergovernmental relations have played the largest role in the resolution of issues affecting both the overall federal system and the fiscal arrangements within that system. However, the courts, as the third element of the federal system of checks and balances, have also played a significant role in the evolution of U.S. federalism.

While the U.S. Supreme Court was established by the Constitution, its power of judicial review, that is, the power to review the constitutional validity of acts of Congress and the state legislatures, was not explicitly provided for by the Constitution.[19] The Court itself laid claim to the power of judicial review in a landmark decision in 1803.

Over the years the U.S. Supreme Court has been important in setting the legislative boundaries between the national and state governments. While there have been some important exceptions, in general the Court has been very sympathetic to the idea of a powerful national government. In the 1810s and 1820s, the Court established, via a series of decisions, Congress's authority to manage the national economy. In the late 19th century, the Congress established the Interstate Commerce Commission and passed legislation outlawing monopolies; both helped the federal government establish itself as a major actor in the national economy, and both were

upheld by the Court.[20] In the early 20th century, the Court initially denied both orders of government the right to regulate conditions of work, citing the doctrine of economic *laissez-faire*; when the right was finally granted, however, it was held to be within federal jurisdiction.[21] After a constitutional *contretemps* with President Franklin Roosevelt, in the 1930s, over the rights of the federal government, the Court endorsed the federal government's right to regulate the market, redistribute income, create a modest welfare state, and manage the relationship between workers and employers.

The most dramatic Court-supported expansion of federal power came in the early 1960s. The federal government had been hesitant to challenge the system of state-sanctioned racial segregation that operated in the southern states, in part because it believed it lacked the jurisdiction to enforce civil rights. In 1964, however, the Congress used its power over the regulation of interstate commerce to ban discrimination, claiming that it substantially affected such commerce. The Supreme Court not only accepted that rationale, but interpreted so broadly what it meant to 'affect interstate commerce' that both Congress and state legislatures concluded that the Court would allow the federal government virtually unrestrained rights to regulate in this area.

In a 1985 decision, the *Garcia* case, the Court repudiated its role as the adjudicator of disputes between the states and the federal government, noting that the states should look to the political process for their protection. The Court has since moderated this extreme position; however, the long-term record of the Court remains one which indicates a general predisposition to support the expansion of federal power.

Reference Procedures

The U.S. Supreme Court does not accept reference cases; in a 1911 decision it rejected an attempt by Congress to require it to undertake such a task. It retains a strictly adjudicatory power, refusing to determine questions of constitutional validity not arising out of concrete disputes.[22]

Appointments to the Appeal Courts

Appointments to all federal benches are made by the President, subject to ratification by the Senate. While appointments to the lower federal courts are generally uncontroversial, Supreme Court appointments have become increasingly contentious. Presidents regard the appointment of

Supreme Court Justices as an opportunity to entrench their political philosophy in government in a way that will outlast their own term in office. As most Supreme Court nominees are sitting appellate court judges, they have a long history of judgements. The Senate ratification hearings are thus occasions of high political drama, in which the nominee's judicial record, personal qualities, and political leanings are closely examined.

Role of Politics in the Decision-Making Process

Decisions concerning the use of the federal power to spend in areas of concurrent or exclusive state jurisdiction do not require any special procedures.[23] Thus, decisions about federal spending in these areas has rested with the Congress and the President. The Congress has not considered itself restricted by any extra-legal principles, such as federalism, when deciding on the use of its spending power.

The noncentralized nature of intergovernmental relations in the U.S. means that there is little overall coordination between the two orders of government in regard to the design of programs involving the expenditure of federal funds. The diffusion of policy-making in both orders of government due to the institutional separation of powers, the large number of states, and the lack of any formal, high-level intergovernmental linkages all play a part in fostering uncoordinated program formulation. As there is no constitutional or statutory provision for a role for the states in decisions regarding the use of the federal spending power, state and local government representatives participate in lobbying the Congress on its decisions relating to the federal spending power along with a wide variety of other interest groups.

Ultimately, the acceptance or rejection of federal financial transfers is a decision left up to the states. However, there is no system in place which would allow a state which decided to opt-out of a program to receive financial compensation. In practice, therefore, opting-out of a significant federal grant program has not been a realistic option for states. Some states do, however, effectively opt out of some smaller project grants by simply declining to apply.

5. TRANSPARENCY AND ACCOUNTABILITY

As noted above, the federal government has considerable discretionary power in both revenue-raising and expenditure decisions, and has chosen to spend in many areas of both concurrent jurisdiction and exclusive state jurisdiction. An uncoordinated, but extensive, system

of intergovernmental transfers has developed. This combination conduces to a system with both low transparency and low accountability.

Consequently, there has been a high degree of concern in the U.S. literature on fiscal federalism around the principle of financial responsibility.[24] It is often argued that the achievement of political accountability depends upon adherence to the principle that the order of government that raises revenue should be the order of government that determines how that revenue is expended.

It is to be expected that this would be a particular concern in a separation of powers system. In a parliamentary system, accountability for funds transferred intergovernmentally is enhanced as the executive in receipt of the funds is directly responsible to a legislature and thus to an electorate. In the U.S. system, however, the executive branch has no such direct responsibility.

The mechanism used to compensate for this lack of accountability at the state level is the conditional transfer. As the federal government has raised the funds that are transferred, it maintains its accountability for those funds by setting conditions on how the state or local government may expend them. Thus, currently virtually all federal grants to state and local governments are conditional in form. The trade-off for this level of accountability is decreased state autonomy. To the extent that the spending priorities established by the federal government do not coincide with state priorities, but states accept the conditions in order to access the funds, state autonomy is undermined.

One benefit of the extensive use of conditional grants is a higher degree of transparency than is found in some other federations. While we have noted that U.S. intergovernmental relations constitute a complex web, the adherence, to some degree, to the principle of financial responsibility means that citizens have been able to identify the federal government's responsibility.

B: SUMMARY OF FEDERAL, STATE, AND LOCAL BUDGETARY RELATIONS IN THE UNITED STATES

In this section, we describe the trends in the evolving division of responsibilities for expenditures and revenue-raising of the federal, state, and local levels of government in the United States.

Our description of the trends in responsibilities of the various levels of government begins with the shares of federal, state, and local governments in public expenditures. We then examine the trends in the shares of federal, state, and local governments in government revenues. Following this, we examine the importance of transfers in total revenues of state and local governments. Lastly, we describe the importance of vertical and horizontal imbalances.

Federal, State, and Local Government Shares of Total Public Spending

Table B1 provides data from 1960 through 1995 on the shares of federal, state, and local government in total public spending. We have divided the data into two categories: one including intergovernmental transfers and one excluding them. We do this to avoid duplication so that, for example, transfers that are reported as expenditures of the federal government are not also included implicitly in the expenditures of state and local governments that they help finance. Thus, data including transfers treat transfers as expenditures of the disbursing governments, whereas data excluding transfers treat them as receipts of the recipient governments.

Examination of the data in Table B1 shows that there has been a small tendency for spending to become more decentralized over time from the federal to the state governments. This is true both including and excluding transfers. The federal share of total spending including (excluding) transfers was 64.3% (59.7%) in 1960 and had fallen to 60.1% (51.9%) in 1995. During the same period, the states' share of spending has increased from 16.5% (14.5%) to 22.2% (21.1%). Despite the tendency for state spending responsibilities to grow over time, the federal government still commands a dominant role in public spending in the United States. While many state and local expenditure responsibilities are in areas of high growth (e.g. education and health care), the federal

Table B1: Federal, State, and Local Government Shares of Total Public Spending (Percentages)

	Including Transfers			Excluding Transfers		
Year	**Federal**	**State**	**Local**	**Federal**	**State**	**Local**
1960	64.3	16.5	19.1	59.7	14.5	25.8
1961	63.6	17.1	19.3	59.3	14.9	25.8
1962	64.4	16.6	19.1	60	14.4	25.6
1963	64.2	17.2	18.6	59.6	15.0	25.4
1964	64.1	17.0	18.9	59	15.2	25.9
1965	63.2	17.4	19.4	57.9	15.3	26.9
1966	63.6	17.4	19.0	57.8	15.1	27.1
1967	64.7	17.5	17.8	58.9	15.4	25.7
1968	65.3	17.7	17.0	58.9	15.3	25.8
1969	63.6	18.4	18.0	57.3	15.8	26.9
1970	62.5	19.4	18.1	55.5	16.5	27.9
1971	61.2	20.5	18.2	53.8	17.9	28.4
1972	60.7	20.3	19.0	52.3	17.9	29.9
1973	62.4	20.1	17.5	53	17.9	29.1
1974	61.7	21	17.3	52.7	18.0	29.2
1975	60.8	21.8	17.4	51.9	19.0	29.1
1976	62.4	20.4	17.2	51.3	17.9	30.8
1977	63.3	20.2	16.5	52.4	18.0	29.6
1978	64.1	20.1	15.8	53.5	18.0	28.6
1979	64.4	20.3	15.4	54.1	17.9	28.0
1980	64.2	20.0	15.8	54.7	17.8	27.4
1981	64.6	19.9	15.5	56.1	17.8	26.1
1982	64.4	19.6	16.0	57.5	17.1	24.0
1983	64.6	19.5	15.9	57.7	17.2	25.0
1984	64.9	19.2	16.0	57.9	17.0	25.0
1985	65.2	19.3	15.5	58.4	17.1	24.5
1986	64.5	19.2	16.3	57.7	17.0	25.3
1987	63.4	19.9	16.7	57.2	17.5	25.3
1988	63.3	19.7	17.0	57.1	17.2	25.7
1989	62.5	20.3	17.2	56.3	17.6	26.1
1990	62.8	19.6	17.6	56.2	17.2	26.6
1991	62.2	20.1	17.7	55.5	18.1	26.4
1992	61.4	21.0	17.6	54.0	19.3	26.8
1993	61.0	21.2	17.8	53.1	19.9	27.0
1994	60.6	21.6	17.7	52.5	20.6	26.8
1995	60.1	22.2	17.6	51.9	21.1	26.9

Source: U.S. Census Bureau, *Statistical Abstract of the United States,* selected years and The Tax Foundation, *Facts and Figures on Government Finance*, 1999.

government is actively involved in many high growth areas either concurrently with the states (e.g. health care) or predominantly independently (e.g. national defense and social security). Somewhat surprisingly, the same trend of increasing expenditure shares has not occurred with respect to local governments.

Federal, State, and Local Government Shares of Total Government Revenues

Data on federal, state, and local government shares of government revenues are provided in Table B2. Again, we provide the data under the two categories including and excluding transfers. Data including transfers treats them as revenues of the recipient governments. Data excluding transfers indicate own-source revenues. As was the case for spending shares, we see in the data that there has been a small tendency for revenue-raising responsibilities to become more decentralized to the states. Indeed, this trend is more pronounced for revenues than it is for expenditures. The data including transfers also indicates that there has been a slight increase in revenues of local governments to finance their expenditures.

Two trends are noteworthy in examining the data in Table B2. The first is that federal own-source revenues (i.e. excluding transfers) continue to dominate state and local government own-source revenues. However, the opposite is true if we include transfers as revenues at the state and local levels. Here, the federal share has fallen from 60.6% in 1960 to 47% in 1995. This indicates that transfers from the federal to the state and local governments have increased in importance. The second noteworthy trend is that the federal government continues to have a dominant role in revenue-raising despite the ability of the states to access many major tax fields.

The Importance of Intergovernmental Transfers

Data showing the importance of transfer payments from one level of government to another are provided in Table B3. We have divided the data into: (i) federal to state government transfers as a share of total state revenues, (ii) federal to local government transfers as a share of local government revenues, (iii) state to local government transfers as a share of local government revenues, and (iv) combined federal and state transfers to local governments as a share of local government revenues.

Table B2: Federal, State, and Local Government Shares of Total Government Revenues (Percentages)

	Including Transfers			Excluding Transfers		
Year	**Federal**	**State**	**Local**	**Federal**	**State**	**Local**
1960	60.6	15.0	24.3	65.2	17.0	17.8
1961	59.4	15.2	25.4	63.8	17.5	18.6
1962	58.7	15.7	25.6	63.3	17.9	18.7
1963	58.8	15.9	25.3	63.5	18.2	18.3
1964	57.6	16.7	25.7	62.9	18.6	18.6
1965	56.7	16.9	26.5	62.1	19.0	18.9
1966	56.7	16.8	26.5	62.6	19.1	18.4
1967	57.9	16.4	25.7	63.9	18.5	17.6
1968	55.4	17.2	27.3	62.2	19.8	18.0
1969	57.8	16.3	25.8	64.1	18.9	17.1
1970	54.6	17.7	27.7	61.6	20.6	17.8
1971	51.4	19.0	29.6	59.5	21.9	18.7
1972	49.6	19.4	31.0	58.3	22.0	19.6
1973	49.2	20.3	30.5	58.7	22.5	18.8
1974	50.6	19.3	30.1	59.5	22.2	18.3
1975	48.7	19.9	31.4	58.2	23.0	18.8
1976	44.5	21.6	33.9	56.6	24.4	19.0
1977	46.9	21.4	31.8	58.1	23.7	18.2
1978	47.9	21.3	30.8	58.7	23.4	17.8
1979	50.0	20.5	29.6	60.2	22.9	16.9
1980	50.7	20.6	28.7	60.5	22.8	16.7
1981	52.5	20.1	27.4	61.3	22.3	16.4
1982	52.3	20.2	26.0	59.8	22.9	17.4
1983	49.5	21.5	28.9	57.4	24.1	18.5
1984	50	21.8	28.2	57.5	24.1	18.3
1985	49.2	22.1	28.7	56.8	24.6	18.6
1986	48.2	22.8	29.1	55.8	25.2	19.0
1987	50.0	22.1	27.9	56.7	24.7	18.6
1988	50.1	21.7	28.1	56.8	24.5	18.7
1989	50.2	21.7	28.1	56.8	24.6	18.6
1990	49.1	22.1	28.8	56.3	24.7	19.0
1991	48.9	22.0	29.1	56.4	24.3	19.3
1992	47.4	23.5	29.2	55.6	25.3	19.1
1993	46.4	24.6	29.0	55.0	26.0	19.0
1994	47.0	24.3	28.7	55.6	25.3	19.0
1995	47.0	24.6	28.4	55.7	25.7	18.6

Source: U.S. Census Bureau, *Statistical Abstract of the United States* and The Tax Foundation, *Facts and Figures on Government Finance*.

Table B3: Transfer Payments from Federal to Subnational Governments as a Share of Subnational Government Revenues (Percentages)

Year	Federal to State	Federal to Local	State to Local	Total Local
1960	19.7	1.6	25.3	27.0
1961	18.7	1.5	25.1	26.6
1962	19.1	1.5	25.3	26.8
1963	19.3	1.5	26.1	27.6
1964	20.2	2.1	25.7	27.8
1965	20.4	2.2	26.4	28.7
1966	21.5	2.3	28.3	30.6
1967	22.5	2.2	29.4	31.5
1968	22.5	3.9	30.2	34.1
1969	22.3	3.1	30.8	33.9
1970	21.9	4.3	31.3	35.6
1971	23.4	4.7	32.3	37.0
1972	24.1	5.7	31.0	36.7
1973	24.4	7.5	30.9	38.4
1974	22.7	7.7	31.6	39.3
1975	23.3	8.3	31.8	40.1
1976	23.2	14.0	29.9	43.9
1977	22.8	13.5	29.2	42.7
1978	22.6	12.9	29.2	42.1
1979	22.3	12.6	30.4	42.9
1980	22.5	10.8	30.9	41.7
1981	22.0	9.1	31.0	40.1
1982	20.1	0.7	32.6	33.2
1983	19.5	6.9	29.1	36.0
1984	19.4	6.2	28.9	35.1
1985	19.5	5.6	29.4	35.0
1986	19.5	5.2	29.5	34.7
1987	18.7	3.4	29.7	33.1
1988	18.8	3.7	29.8	33.5
1989	18.7	3.5	30.2	33.7
1990	19.0	4.9	29.1	34.0
1991	20.7	4.1	29.6	33.7
1992	21.7	4.1	30.5	34.6
1993	22.3	3.9	30.5	34.4
1994	23.1	3.7	30.2	33.8
1995	22.7	4.1	30.6	34.6

Source: U.S. Census Bureau, *Statistical Abstract of the United States* and the Tax Foundation, *Facts and Figures on Government Finance*.

Beginning with the column showing transfers from federal to state governments, we see that there have not been any sizeable changes in the importance of federal transfers as a source of state revenues. Federal transfers constitute roughly 20% of state revenues, with only slight variations around that percentage in the period from 1960 to 1995. There has, however, been greater variation in the importance of federal transfers in local government revenues. In particular, there was a large increase in intergovernmental grant programs in the 1960s and 1970s under the Johnson and Nixon administrations. Significantly, many of these programs specified direct transfers from the federal government to local governments, thereby by-passing state governments altogether. This trend came to an end in the 1980s under the Reagan administration and, today, direct federal transfers to local governments represent only a small share of local government revenues. This small share is misleading, however, because if we examine the importance of state transfers to local governments, we recognize that a significant proportion of federal transfers to state governments are passed on to local governments. By the mid-1990s, local governments relied on state and federal transfers for roughly 35% of their revenues. This percentage has increased gradually over time.

Vertical Fiscal Imbalances

Vertical fiscal balance occurs when subnational governments are able to raise sufficient revenues to finance their expenditures. This allows them full autonomy and accountability to their citizens. In most federations vertical fiscal imbalances are the norm and are dealt with through intergovernmental transfers from higher levels of government to lower levels. While this compromises lower-level governments' autonomy and accountability, there are arguments in favour of assigning greater revenue-raising abilities to higher levels of government. These arguments are described in Section C.

Table B4 reports figures for vertical fiscal imbalances in the United States without intergovernmental transfers. In Table B4, the vertical fiscal imbalances for the federal

government are measured as the difference between expenditures net of transfers to lower-level governments and revenues as a percentage of expenditures net of transfers. The vertical fiscal imbalances for the states are measured as the difference between expenditures net of transfers to local governments and own-source revenues as a proportion of expenditures net of transfers. In the last column, the vertical fiscal imbalances for the local governments are the difference between expenditures and own-source revenues as a proportion of expenditures.

Vertical fiscal imbalances excluding transfers measure both the extent of deficit financing and the extent that own expenditure needs exceed own-source revenues. Since deficit financing is much more accessible to the federal government in the United States, the deficit financing component of the vertical fiscal imbalance is evident for the federal government in Table B4.[25] In particular, we observe a sharp turn-around in the early 1980s when the federal government began to run very large budget deficits. During this period, the vertical fiscal imbalance went from negative to positive, reflecting the large deficits of the federal government.

The vertical fiscal imbalances for the states are consistently negative and large in absolute value, whereas those for the local governments are consistently positive and large. From this data we see the importance of intergovernmental transfers from state to local governments. The importance of transfers is also evident when we examine the data including intergovernmental transfers. When intergovernmental transfers are included, the vertical fiscal imbalances measure only deficits and surpluses.

Horizontal Fiscal Imbalances

Horizontal fiscal imbalances (HFIs) result from differences in the abilities of state and local governments to provide government services. HFIs can occur because of differences in the ability to raise revenues and because of differences in expenditure needs and costs. Programs that address HFIs are called equalization programs. A good equalization program addresses need, cost, and fiscal capacity differences. In contrast to several other federations (e.g. Canada and Australia), the United States has no explicit equalization program. However, many categorical grant programs have equalization components built within them.

Table B4: Vertical Imbalances Between Federal, State, and Local Governments [(Expenditures-Revenues)/Expenditures]*100

	Excluding Intergovernmental Transfers			Including Intergovernmental Transfers		
Year	Federal	State	Local	Federal	State	Local
1960	-10.5	-18.8	30.3	-2.6	-3.4	4.5
1961	-3.6	-13.4	30.4	3.4	1.2	5.2
1962	-0.7	-18.5	30.2	6.2	-2.5	4.6
1963	-3.9	-18.2	29.8	3.6	-2.5	3.0
1964	-4.4	-19.9	29.6	4.0	-5.3	2.6
1965	-5.7	-22.5	30.8	3.2	-6.1	3.0
1966	-8.6	-26.7	31.9	1.3	-7.6	1.9
1967	-6.3	-18.0	33.0	3.3	-2.9	2.2
1968	0.7	-21.2	34.3	10.4	-3.8	0.4
1969	-13.0	-20.6	35.8	-1.8	-3.0	2.9
1970	-11.2	-24.8	36.0	1.3	-4.8	0.6
1971	-2.0	-12.9	39.3	10.4	1.4	3.6
1972	-7.1	-18.4	37.0	7.8	-2.9	0.5
1973	-9.6	-24.2	36.2	7.0	-8.0	-3.7
1974	-14.1	-24.9	36.8	2.4	-5.4	-4.1
1975	-3.9	-12.1	40.0	11.2	1.9	-0.2
1976	-0.8	-24.4	43.6	17.0	-6.7	-0.6
1977	-7.2	-27.2	40.6	11.3	-9.9	-3.8
1978	-7.8	-28.2	38.7	10.1	-11.1	-5.8
1979	-10.9	-27.7	40.1	6.7	-9.5	-5.0
1980	-7.5	-24.4	40.8	8.4	-8.2	-1.7
1981	-5.8	-21.8	39.2	8.1	-6.8	-1.5
1982	3.4	-24.0	36.9	13.9	-6.4	5.5
1983	13.1	-22.5	35.3	22.3	-6.5	-1.1
1984	9.1	-29.9	33.0	18.8	-12.0	-3.2
1985	12.7	-29.0	31.8	21.8	-11.1	-5.0
1986	13.6	-32.4	32.9	22.7	-13.5	-2.8
1987	8.3	-31.1	31.7	17.2	-12.0	-2.1
1988	7.9	-31.6	32.7	16.9	-11.7	-1.2
1989	4.6	-31.6	32.7	14.2	-11.3	-1.6
1990	7.6	-32.5	34.1	17.3	-12.8	0.2
1991	9.1	-20.0	34.8	19.0	-6.2	1.7
1992	6.4	-19.5	35.3	17.8	-7.5	1.1
1993	4.3	-20.6	35.0	16.7	-10.0	0.8
1994	1.0	-14.9	33.8	14.2	-7.3	-0.1
1995	-1.5	-15.2	34.8	12.4	-7.3	0.3

Source: U.S. Census Bureau, *Statistical Abstract of the United States* and The Tax Foundation, *Facts and Figures on Government Finance.*

In tables B5 through B7, we provide data on differences among states with regard to expenditures and revenues. To make the tables less cumbersome to read, we have grouped the states according to regions. This aggregation will necessarily smooth out differences among states. Consequently, in the appendix tables 1,2 and 3, we provide similar data on a state-by-state basis.

(i) HFI of State Expenditures

In table B5, we show per capita state government expenditures as a percentage of the United States average. As the data shows, there is considerable variation across regions and over time. The East and West South Central regions tend to have low per capita expenditures compared to the national average, whereas the Pacific and, more recently, the New England and Mid-Atlantic regions tend to have per capita expenditures above the national average.[26] Several regions, including the Mid-Atlantic, East North Central, West North Central, and South Atlantic regions, have all seen their expenditures per capita increase over time relative to the national average.

Examination of the data over time shows that there has been a small progression towards lower HFIs of state expenditures. This tendency can be caused by several factors. One possible factor, as we noted above, is that federal grant-in-aid programs to state and local governments have equalization-type components within them. The increase in the importance of intergovernmental transfers has thus served to partially reduce HFIs. Another possible factor leading to the reduction in HFIs is that there has been an increase in coordination among states and between the states and the federal government with regard to the uniformity of program requirements. Other possible factors may be a convergence of preferences among states for government expenditure programs.

(ii) HFI of State Revenues Before Intergovernmental Transfers

Table B6 provides data on per capita state revenues excluding transfers from the federal government as a percentage of the national average. Differences across regions arise due to differences in preferences and in the ability to raise revenues. With regard to the latter, there is a wide variation among states in types of revenue sources. For example, several states levy no personal or corporate income taxes or sales taxes. Some states levy property taxes at the state level, the local level, or both.

Table B5: State Government Per Capita Expenditures as a Percentage of United States Average

Year	New England	Mid Atlantic	E. No. Central	W. No. Central	So. Atlantic	E. So. Central	W. So. Central	Mountain	Pacific
1970	98.2	94.9	82.4	87.2	90.8	86.6	84.4	110.4	161.8
1971	101.0	95.7	81.8	86.2	91.4	85.3	83.4	105.4	168.9
1972	100.1	100.8	83.7	85.3	92.2	83.9	84.1	104.7	166.9
1973	101.1	101.3	86.3	84.9	96.1	82.5	81.7	99.7	168.1
1974	99.1	103.8	88.7	86.9	96.5	83.2	81.8	98.9	163.8
1975	94.1	103.3	90.4	87.9	96.5	83.7	82.1	100.1	164.4
1976	98.1	99.9	87.8	88.9	94.0	84.2	84.4	102.7	160.5
1977	95.4	102.5	89.3	91.8	92.8	84.2	83.7	101.5	161.0
1978	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)
1979	96.4	94.8	88.6	90.7	94.3	88.2	83.1	100.6	163.0
1980	95.5	92.1	88.3	91.5	89.2	85.8	81.8	98.6	179.2
1981	93.3	92.9	86.9	83.0	89.2	83.0	80.1	101.5	193.6
1982	91.5	92.4	81.6	89.2	85.4	76.6	82.6	101.2	202.3
1983	96.1	94.2	86.2	89.1	84.4	78.5	82.4	99.9	193.8
1984	96.0	95.9	86.5	91.5	83.2	77.8	80.3	102.1	189.6
1985	96.3	96.7	86.3	90.6	84.5	76.8	77.6	100.8	193.3
1986	97.0	111.8	95.1	96.0	77.6	77.7	85.2	108.8	158.5
1987	88.1	89.6	77.0	79.0	76.0	67.0	239.3	87.1	147.0
1988	106.9	107.0	89.7	88.8	90.6	80.2	76.8	98.8	164.8
1989	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)
1990	110.5	104.0	87.9	89.9	91.4	80.3	77.8	99.0	160.0
1991	110.2	104.0	87.8	90.2	91.8	81.4	80.1	97.9	158.5
1992	111.1	116.6	86.0	89.8	87.6	82.7	83.2	96.5	157.7
1993	111.9	110.1	89.0	85.6	89.6	83.5	85.7	96.9	157.0
1994	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)
1995	108.5	111.5	91.6	90.9	91.9	84.7	84.1	94.9	150.1
1996	107.9	108.4	91.5	90.4	93.8	86.8	83.5	96.2	147.1
1997	106.0	101.3	92.1	93.5	95.0	88.5	84.1	96.1	145.2

Source: U.S. Census Bureau, *Statistical Abstract of the United States*.

The data shows that New England, the Mid-Atlantic, and the Pacific regions have been consistently above the national average in revenues per capita.[27] As was true for per capita expenditures, the East and West South Central regions are considerably below the national average. The New England and West North Central regions have witnessed a considerable increase in revenues per capita compared to the national average whereas the Pacific and Mountain regions have seen a considerable decrease.

(iii) HFI of State Revenues After Intergovernmental Transfers

In Table B7, we provide data on state per capita revenues including transfers from the federal government as a percentage of the national average. By comparing this data to that of Table B6, we are able to determine whether intergovernmental transfers have had any effect on reducing HFIs on the revenue side. A comparison with Table B6 shows that there has been a slight equalization of revenues per capita because of intergovernmental transfers. One striking anomaly is the Pacific region. In that region, transfers have increased revenues per capita even more above the national average. If we ignore the Pacific region, the equalization among the other regions would likely be more pronounced.

The extent of equalization of revenues can be measured by the coefficient of variation. Tables 2 and 3 in the Appendix provide measures of the coefficient of variation of revenues across states for selected years from 1970 to 1995. As is evident in the tables, the variation in revenues is reduced because of intergovernmental transfers for all years except 1975, where it is slightly higher after transfers.

The data in Tables B6 and B7 show that the New England, Mid-Atlantic, and East and West North Central regions are net contributors to redistribution among regions. Note that the latter two are net contributors despite being below the national average. Also noteworthy is the fact that the East and West South Central regions continue to be well below the national average despite intergovernmental transfers.

Table B6: State Governments Per Capita Revenues, Before Intergovernmental Transfers, as a Percentage of the United States Average

Year	New England	Mid Atlantic	E. No. Central	W. No. Central	So. Atlantic	E. So. Central	W. So. Central	Mountain	Pacific
1970	99.7	112.1	96.1	91.7	93.2	84.3	85.5	107.8	129.7
1971	101.5	112.4	97.4	92.5	95.5	85.0	88.3	110.3	117.2
1972	106.7	114.0	96.6	93.2	95.3	84.8	87.3	106.0	116.1
1973	108.6	118.2	97.2	95.5	96.6	85.6	84.1	101.5	112.6
1974	103.8	115.9	97.9	101.0	95.4	85.5	86.9	102.4	111.3
1975	97.6	111.7	96.4	97.8	93.9	86.2	87.9	108.1	120.4
1976	105.0	113.0	93.6	96.4	90.3	84.0	90.3	106.0	121.4
1977	103.9	115.4	95.4	95.2	89.9	84.7	87.2	103.4	124.8
1978	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)
1979	102.8	106.0	96.6	96.1	91.8	85.9	87.9	107.5	125.6
1980	102.9	105.9	93.7	96.6	88.6	81.3	90.9	105.5	134.6
1981	102.9	104.3	90.9	92.5	87.1	84.3	95.5	106.2	136.3
1982	109.0	109.6	91.1	94.8	89	81.8	101.3	115.9	107.6
1983	111.4	112.2	93.4	97.5	86.9	80.7	87.1	104.8	126.1
1984	113.3	105.1	99.3	99.0	86.8	81.5	83.6	106.3	125.1
1985	114.6	118.1	95.2	95.1	86.3	79.0	85.1	103.8	122.9
1986	122.4	119.8	95.4	92.3	86.4	78.7	80.4	101.6	122.9
1987	126.9	123.3	95.6	92.1	87.4	78.2	74.1	98.9	123.5
1988	123.0	120.3	95.6	95.8	90.7	79.1	79.5	98.8	117.2
1989	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)
1990	124.0	120.5	97.6	98.2	92.8	63.5	80.3	102.1	121.1
1991	121.2	116.5	94.7	97.2	89.3	83.4	80.4	98.9	118.4
1992	125.3	125.8	92.0	95.6	87.5	82.3	79.4	97.1	115.0
1993	125.2	119.8	93.9	96.4	89.0	82.4	80.2	99.8	113.3
1994	123.2	118.7	96.4	98.1	90.9	83.9	79.2	98.6	110.9
1995	124.4	119.0	99.3	96.1	91.4	84.6	78.5	93.2	113.5
1996	125.3	114.9	98.8	97.6	91.9	84.3	78.5	93.5	115.1
1997	124.0	114.4	99.3	101.4	90.3	83.2	80.2	93.9	113.4

Source: U.S. Census Bureau, *Statistical Abstract of the United States*.

Table B7: State Governments Per Capita Revenues, After Intergovernmental Transfers, as a Percentage of the United States Average

Year	New England	Mid Atlantic	E. No. Central	W. No. Central	So. Atlantic	E. So. Central	W. So. Central	Mountain	Pacific
1970	81.4	80.8	75.7	77.6	78.8	74.4	77.4	99.1	254.7
1971	95.7	92.6	85.6	89.1	93.3	88.0	87.8	112.2	155.6
1972	99.4	97.7	88.4	88.0	94.4	86.3	89.6	109.5	146.8
1973	101.1	103.4	89.7	89.5	95.8	87.2	86.3	105.3	141.5
1974	99.0	101.6	92.1	92.6	95.7	85.9	87.1	104.0	142.1
1975	95.4	96.8	89.0	93.5	95.4	86.0	87.1	107.0	149.9
1976	97.1	94.4	86.5	91.0	90.8	83.2	86.8	105.6	164.7
1977	95.4	98.5	87.3	90.5	90.4	83.3	84.0	103.7	166.9
1978	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)
1979	95.2	94.2	88.1	88.4	92.8	84.9	85.2	104.6	166.6
1980	89.4	88.2	80.2	86.6	84.7	77.5	81.9	98.0	213.5
1981	82.9	81.7	74.7	80.0	79.3	73.3	78.8	94.9	254.3
1982	83.5	84.5	72.1	78.4	77.3	68.5	78.6	101.0	256.1
1983	91.1	92.5	80.0	84.3	82.5	72.5	76.8	100.1	220.3
1984	92.7	98.4	85.4	86.7	83.1	73.8	74.8	100.4	204.7
1985	94.7	99.7	83.9	85.2	85.0	74.1	77.2	100.8	199.4
1986	98.9	102.9	85.8	83.9	85.4	74.9	76.0	100.5	191.7
1987	105.1	109.1	88.5	85.7	89.1	75.8	76.0	98.9	171.8
1988	103.5	106.1	87.5	88.0	89.7	77.3	77.2	97.1	173.6
1989	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)
1990	104.3	105.5	88.4	90.0	91.7	69.6	80.7	101.0	168.8
1991	101.5	102.8	86.2	89.6	88.6	81.9	80.2	97.0	172.2
1992	107.0	113.0	84.5	88.5	88.4	82.1	81.8	95.8	158.9
1993	105.4	107.4	86.1	89.3	88.3	81.8	83.0	97.5	161.3
1994	105.7	106.9	89.7	91.9	91.5	83.4	82.9	98.3	149.7
1995	107.5	110.4	90.8	90.1	91.1	83.9	83.4	94.1	148.7
1996	107.2	107.8	90.9	89.9	93.2	86.3	83.0	95.6	146.1
1997	102.9	104.4	89.0	90.9	91.4	84.2	82.3	94.0	160.8

Source: U.S. Census Bureau, *Statistical Abstract of the United States*.

APPENDIX TO SECTION B

Appendix B, Table 1: State Government Per Capita Expenditures as a Percentage of the United States Average, Selected Years

Year	1970	1975	1980	1985	1990	1995
New England						
Maine	90.2	101.3	91.3	90.1	101.3	100.2
New Hampshire	68.6	77.3	71.7	62.4	68.6	80.2
Vermont	139.6	127.1	106.9	109.7	118.0	107.4
Massachusetts	94.5	108.9	105.1	107.4	128.4	122.0
Rhode Island	99.3	103.1	112.3	113.5	124.3	121.1
Connecticut	96.9	47.2	85.5	94.4	122.5	120.2
Mid-Atlantic						
New York	121.3	126.2	109.3	115.4	125.3	127.2
New Jersey	72.9	86.0	88.9	96.4	105.9	112.7
Pennsylvania	90.4	97.7	78.1	78.3	81.0	94.5
East North Central						
Ohio	62.4	73.8	73.3	80.6	85.7	85.6
Indiana	70.0	74.2	72.8	74.1	81.7	83.7
Illinois	82.3	93.0	86.9	78.8	79.5	82.9
Michigan	93.0	103.0	102.0	95.1	95.4	110.0
Wisconsin	104.3	107.6	106.5	103.0	97.3	96.2
West North Central						
Minnesota	105.3	108.3	111.7	109.9	107.9	108.7
Iowa	91.6	89.8	95.9	90.2	96.9	94.3
Missouri	72.9	67.8	66.1	66.5	68.3	72.6
North Dakota	104.3	106.4	117.4	129.3	112.6	108.2
South Dakota	84.7	86.8	92.7	83.8	83.5	82.4
Nebraska	71.2	77.1	76.7	79.2	80.9	84.6
Kansas	80.3	78.9	80.0	75.3	79.2	85.4
South Atlantic						
Delaware	139.1	129.4	123.8	123.7	135.8	128.0
Maryland	89.9	111.4	101.0	89.4	93.3	86.8
Virginia	77.9	89.1	82.7	78.0	87.1	80.2
West Virginia	105.8	99.4	104.3	88.3	89.3	100.5
North Carolina	83.0	86.2	81.7	77.0	85.9	88.1
South Carolina	78.9	95.8	80.7	80.9	88.1	91.4
Georgia	79.6	81.7	75.2	72.9	79.8	83.5
Florida	71.7	78.9	64.6	65.7	72.1	76.8
East South Central						
Kentucky	91.8	87.2	103.4	82.2	93.6	89.5
Tennessee	74.1	76.0	69.4	64.9	73.1	81.2
Alabama	86.8	82.5	82.7	84.8	82.9	83.7
Mississippi	93.5	88.9	87.7	75.4	76.1	84.3

Appendix B, Table 1 (Continued): State Government Per Capita Expenditures as a Percentage of the United States Average, Selected Years

Year	1970	1975	1980	1985	1990	1995
West South Central						
Arkansas	54.7	78.2	63.3	63.1	62.9	82.8
Louisiana	98.6	99.3	95.4	90.0	91.6	102.6
Oklahoma	97.6	82.5	85.2	81.4	80.9	78.3
Texas	68.3	68.4	68.3	65.9	63.1	72.9
Mountain						
Montana	104.0	92.7	98.6	98.1	93.7	99.8
Idaho	95.9	95.2	87.2	76.9	82.4	85.4
Wyoming	142.4	117.0	137.3	164.9	148.3	127.5
Colorado	91.4	92.9	80.2	80.9	77.5	76.2
New Mexico	123.0	109.0	115.0	121.0	117.0	118.0
Arizona	99.3	95.5	80.9	82.0	93.2	79.3
Utah	110.0	97.7	98.2	95.8	91.3	91.5
Nevada	117.0	101.0	91.9	86.6	89.3	82.1
Pacific						
Washington	101.2	108.2	115.0	119.2	118.9	132.9
Oregon	100.7	95.3	102.0	91.2	88.8	102.3
California	114.4	104.9	111.7	106.8	107.0	100.9
Alaska	271.9	329.8	433.6	543.7	353.3	283.8
Hawaii	203.1	182.1	143.3	121.4	145.2	154.3

Source: U.S. Census Bureau, *Statistical Abstract of the United States*, Selected Years.

Appendix B, Table 2: State Government Per Capita Revenues, Before Intergovernmental Transfers, as a Percentage of the United States Average, Selected Years

Year		1970	1975	1980	1985	1990	1995
New England							
	Maine	79.9	88.9	80.5	85.2	102.9	102.2
	New Hampshire	70.7	92.8	76.5	83.2	102.1	97.5
	Vermont	52.1	60.4	51.2	54.5	59.1	73.4
	Massachusetts	115.4	129.2	100.7	106.9	116.4	112.0
	Rhode Island	79.1	93.5	93.8	99.3	111.0	111.8
	Connecticut	90.9	105.9	105.7	114.9	118.4	129.1
Mid-Atlantic							
	New York	109.7	125.0	100.3	116.9	127.2	121.3
	New Jersey	65.6	77.2	83.2	102.8	109.5	120.2
	Pennsylvania	76.4	95.7	81.5	78.3	81.2	94.3
East North Central							
	Ohio	57.1	72.8	64.0	78.7	81.1	85.0
	Indiana	70.1	91.0	71.3	73.4	88.1	89.9
	Illinois	81.3	95.1	82.5	74.0	82.8	83.9
	Michigan	90.0	98.3	92.8	93.8	96.6	115.8
	Wisconsin	102.2	115.0	99.3	96.4	101.9	102.2
West North Central							
	Minnesota	94.2	130.2	112.4	114.9	115.3	116.7
	Iowa	79.5	96.2	86.5	77.8	94.5	96.6
	Missouri	57.1	66.1	58.2	63.0	70.2	70.2
	North Dakota	91.8	135.7	117.8	121.5	107.4	103.5
	South Dakota	68.5	76.1	72.7	64.8	71.4	71.4
	Nebraska	68.2	75.5	76.7	67.7	79.7	86.5
	Kansas	69.4	86.7	76.3	72.5	80.0	89.5
South Atlantic							
	Delaware	126.4	154.5	131.5	154.4	156.1	145.4
	Maryland	91.9	108.8	99.3	93.7	101.1	93.5
	Virginia	73.4	90.8	78.8	79.3	89.1	88.4
	West Virginia	74.2	98.2	85.6	84.3	92.7	89.9
	North Carolina	77.7	86.3	75.3	74.7	84.6	89.7
	South Carolina	71.1	92.2	76.2	76.6	86.3	87.5
	Georgia	67.8	76.5	66.0	66.7	74.2	80.6
	Florida	68.2	81.0	65.0	61.6	74.3	80.0
East South Central							
	Kentucky	73.7	95.5	82.6	77.9	87.2	89.8
	Tennessee	59.6	69.4	58.6	57.8	65.4	73.3
	Alabama	69.1	81.7	70.3	73.6	37.1	80.7
	Mississippi	40.0	47.1	36.7	30.5	34.5	44.5

Appendix B, Table 2 (Continued): State Government Per Capita Revenues, Before Intergovernmental Transfers, as a Percentage of the United States Average, Selected Years

Year	1970	1975	1980	1985	1990	1995
West South Central						
Arkansas	60	74.4	69.1	65.8	71.7	77.8
Louisiana	88.1	105.9	94.5	88.4	89.5	87.2
Oklahoma	77.5	88.5	88.7	89	85.2	80.4
Texas	62.5	77.2	72.2	67.2	66.3	70
Mountain						
Montana	69.9	89.5	84.2	86	92.8	93
Idaho	74.3	93	76.6	69.2	86.2	88.8
Wyoming	101.9	117.5	135	185.1	146.9	104.3
Colorado	78.4	95.4	79.7	71.6	77.7	74.8
New Mexico	107.8	133.8	136.7	134.1	125.8	124.2
Arizona	92	104.1	84.8	83	89.8	81.6
Utah	86.3	90.6	82.6	82.6	86.1	91.8
Nevada	101.1	115.5	84.8	88.7	91.7	92.1
Pacific						
Washington	101.7	111.1	101.4	94	110	115.6
Oregon	76.6	96	93.1	84.1	85.3	96.4
California	92.8	112.6	108.3	97.2	103.4	98.7
Alaska	1015.9	228.3	749.2	713.9	443.8	340.2
Hawaii	151.2	177.4	149.6	128.5	168.7	166.4
Coefficient of Variation	1.336	0.300	0.962	0.923	0.556	0.403

Source: U.S. Census Bureau, Statistical Abstract of the United States, Selected Years.

Appendix B, Table 3: State Government Per Capita Revenues, After Intergovernmental Transfers, as a Percentage of the United States Average, Selected Years

Year	1970	1975	1980	1985	1990	1995
New England						
Maine	75.6	97.9	87.7	90.7	102.9	100.2
New Hampshire	56.5	66.6	61.1	61.1	62.6	80.2
Vermont	114.9	124.8	103.2	105.1	113.0	107.4
Massachusetts	81.9	94.4	98.4	102.0	116.0	122.0
Rhode Island	86.0	102.7	104.9	109.8	114.0	121.1
Connecticut	77.6	83.5	83.8	103.0	117.0	120.0
Mid-Atlantic						
New York	106.7	121.1	105.1	120.3	129.4	127.2
New Jersey	63.6	77.8	81.3	100.0	105.0	113.0
Pennsylvania	74.1	90.4	79.5	80.3	82.0	94.5
East North Central						
Ohio	56.7	70.2	63.8	78.6	81.7	85.6
Indiana	66.4	80.6	65.9	73.8	85.7	83.7
Illinois	78.4	90.0	80.9	76.2	80.9	82.9
Michigan	85.8	96.3	92.9	95.4	94.1	110.0
Wisconsin	94.4	106.0	99.5	97.9	99.6	96.2
West North Central						
Minnesota	93.1	121.0	108.0	113.0	112.0	109.0
Iowa	78.2	90.8	84.9	79.3	93.2	94.3
Missouri	62.1	66.9	62.4	65.7	69.5	72.6
North Dakota	94.4	128.2	116.2	122.8	113.1	108.2
South Dakota	79.7	86.1	85.3	75.0	83.5	82.4
Nebraska	68.3	75.5	75.6	71.3	80.3	84.6
Kansas	71.6	83.3	76.6	73.3	78.6	85.4
South Atlantic						
Delaware	112.5	133.2	125.5	141.7	140.2	128.0
Maryland	85.3	100.1	95.9	92.3	97.0	86.8
Virginia	70.9	86.7	78.8	77.0	83.4	80.2
West Virginia	87.7	107.0	93.5	87.5	94.4	101.0
North Carolina	74.8	88.0	76.5	75.7	82.6	88.1
South Carolina	70.0	89.4	78.0	77.6	88.2	91.4
Georgia	70.7	81.1	70.2	72.4	76.7	83.5
Florida	64.0	75.2	62.8	59.5	70.8	76.8
East South Central						
Kentucky	78.4	95.0	85.6	82.7	88.5	89.5
Tennessee	64.9	71.8	65.1	64.2	72.7	81.2
Alabama	75.2	85.4	78.2	78.7	39.0	83.7
Mississippi	81.7	90.4	82.4	72.2	78.0	84.3

Appendix B, Table 3 (Continued): State Government Per Capita Revenues, After Intergovernmental Transfers, as a Percentage of the United States Average, Selected Years

Year	1970	1975	1980	1985	1990	1995
West South Central	68.8	79.5	77	70.9	76.6	82.8
Arkansas	91.2	101.6	95.4	88.7	93.9	102.6
Louisiana	87.1	90.3	86.7	85.4	84.3	78.3
Oklahoma	65.3	75.5	70.1	65.6	67.8	72.9
Texas						
Mountain	89	99.9	100.6	96	101.6	99.8
Montana	80	95	81.3	73.8	87.9	85.4
Idaho	130.6	132.9	142.4	191.3	162	127.5
Wyoming	83.4	96.2	80.8	73.1	77.9	76.2
Colorado	119.6	129.4	127.7	124.9	119.3	117.6
New Mexico	92.7	94.2	79	77	84.6	79.3
Arizona	98.5	96.3	89.2	89.7	90.9	91.5
Utah	105.8	108.4	86.9	85.3	83.8	82.1
Nevada						
Pacific	99.8	110	97.9	96	105	109
Washington	83.2	99.1	97.9	86.7	91	102
Oregon	103	108.6	104.7	99.8	103.3	100.9
California	844.6	261.2	630	598.1	390.8	283.8
Alaska	153.7	167.8	141.9	121.7	153.9	154.3
Hawaii						
Coefficient of Variation	1.092	0.305	0.788	0.756	0.475	0.318

Source: U.S. Census Bureau, Statistical Abstract of the United States, Selected Years.

C. THE SYSTEM OF INTERGOVERNMENTAL TRANSFERS IN THE UNITED STATES

In this section, we describe the system of intergovernmental arrangements in the United States and how they have evolved over time. We begin with a discussion of the types of intergovernmental arrangements that exist between the federal and the state/local governments. Next, we discuss the need for intergovernmental transfers. Lastly, we describe the programs directed towards correcting vertical and horizontal fiscal imbalances.

Prior to the Great Depression, federal intergovernmental transfers represented only a small fraction of revenues of state and local governments. The 1930s and again in the 1960s and 1970s witnessed a substantial increase in federal intergovernmental transfers. For example, in 1929, federal transfers comprised only 1.3% of state and local government revenues, whereas in 1997, they comprised 20% of state revenues and 3% of local government revenues. As well, intergovernmental transfers from state to local governments represented approximately 35% of local government revenues in 1997.

As was discussed in Section B, revenue-raising in the United States is relatively centralized, although states have considerable taxing ability. At the same time, most services are provided by state and local governments. This asymmetry between revenues and expenditures at the state/local level means that the federal government today plays a significant role in financing and influencing the provision of services at the state and local levels of government. The areas affected by most federal grants-in-aid are those traditionally reserved for the states as part of their residual powers in the United States Constitution.[28] However, the delegated powers of the Congress have been interpreted over the years in a way that allows the federal government very few restrictions on the use of its spending power.

The states, in turn, play a significant role in the financing and influence of the provision of services at the local level. Given that local government powers are granted by the state governments, there is no common system of local government in the United States and the amount of state financial aid to local governments varies considerably among states. Some states allow local governments considerable discretion in the financing and provision of services while others tightly control the activities of local

governments. Given the limited revenue-raising ability of local governments, however, intergovernmental transfers from the federal to local governments and from state to local governments comprise a significant proportion of local revenues.

We now describe the different forms in which intergovernmental arrangements take in the United States.

Types of Federal-State/Local Fiscal Arrangements

1. Categorical Grants

The categorical grant is the most popular form of federal financial assistance to subnational governments. Categorical grants provide funds for specific programs. Use of these types of grants allows the federal government to influence and increase the provision of services at the state and local levels. Categorical grants also provide incentives for subnational governments to implement projects and programs that adhere to national goals. Most categorical grants in the United States require subnational governments to match a portion of the federal funding.

There are two types of categorical grants: formula grants and project grants. The distribution of a formula grant is based on a formula containing factors such as population and per capita income. These grants thus contain an equalizing component. Project grants, on the other hand, are distributed at the discretion of federal administrators.

Categorical grants provide financing for numerous projects and programs. The more important funding areas are described below. Table C1 provides data on federal aid to state and local governments for selected years from 1970 to 1998.

(a) Health Care[29]

The largest intergovernmental assistance program is Medicaid. Medicaid was created in 1965 and provides health care to the poor, aged in nursing homes, blind, and disabled. It is administered by the states and they have considerable discretion over eligibility standards. The federal government does, however, stipulate a minimum level of benefits. The federal government provides 20-50% of the financing of benefits and 50% of the financing of administrative costs. Expenditures for Medicaid have increased significantly in recent years and are expected to continue increasing into the future.

Table C1: Federal Aid to State and Local Governments, Percentage of Federal Aid, Selected Years

Program	1970	1980	1990	1998
National Defense	0.1	0.0	0.1	0.0
Energy	0.0	0.2	0.1	0.1
Natural resources and environment	0.6	2.1	1.0	0.6
Environmental Protection Agency	0.3	1.8	0.7	0.4
Agriculture	0.9	0.2	0.3	0.1
Commerce and Housing Credit	0.0	0.0	0.0	0.0
Transportation	7.0	5.2	5.0	3.8
Airports	0.1	0.2	0.3	0.2
Highways	6.7	3.7	3.7	2.9
Urban mass transit	0.2	1.3	1.0	0.6
Community and regional development	2.7	2.6	1.3	1.1
Appalachian regional development	0.3	0.1	0.0	0.0
Community development block grants	0.0	1.6	0.7	0.7
Education, employment, training,	9.7	8.7	6.1	5.3
social services	0.0	0.0	0.0	0.0
compensatory education for the	2.2	1.3	1.2	1.1
Disadvantaged	0.0	0.0	0.0	0.0
School improvement programs	0.1	0.2	0.3	0.2
Bilingual and immigrant education	0.0	0.1	0.0	0.0
Federally affected areas impact aid	0.9	0.2	0.2	0.1
Vocational and adult education	0.4	0.3	0.3	0.2
Payments to states for Family	0.1	0.2	0.1	0.0
Support Activities	0.0	0.0	0.0	0.0
Social services-block grants	0.9	1.1	0.7	0.4
Children and Family services programs	0.6	0.6	0.7	0.7
Training and employment assistance	1.4	2.5	0.8	0.5
Office of libraries	0.2	0.1	0.0	0.0
Health	5.8	6.3	11.5	15.4
Alcohol, drug abuse, and mental health	0.2	0.3	0.3	0.3
Grants to states for medicaid	4.1	5.6	10.7	14.8
Income security	8.8	7.4	9.2	8.6
Family support payments	6.3	2.8	3.2	0.3
Food stamps-administration	0.8	0.2	0.6	0.5
Child nutrition/special milk programs	0.6	1.4	1.3	1.2
Housing assistance	0.7	1.4	2.5	2.9
Veterans benefits and services	0.0	0.0	0.0	0.0
Administration of justice	0.1	0.2	0.1	0.5
General government	0.7	3.4	0.6	0.3
Grant-in-aid Shared Revenues	36.4	36.6	35.3	35.9

Source: U.S. Census Bureau, *Statistical Abstract of the United States: 1999.*

(b) Income Redistribution[30]

Another large categorical matching grant is directed towards assistance to low income families. Aid to Families with Dependent Children (AFDC) was introduced in 1935 and was replaced in 1997 with a block grant program entitled Temporary Assistance for Needy Families (TANF). AFDC was a joint federal and state program, as is TANF. States administer the program and set benefit levels. The federal government provides one-half to three-quarters of the financing, depending on a state's per capita income.

The Medicaid program described above is also aimed at redistributing income. It provides medical care to the poor (especially children), the aged in nursing homes, the blind, and the disabled. Prior to the reform of AFDC in 1996, all families receiving benefits under AFDC were entitled to Medicaid. Today, states are required to provide Medicaid to families who would have been eligible to receive benefits under AFDC. In addition, the Children's Health Insurance program (CHIP) was introduced in 1997 and provides funds to states to provide health care for children with family incomes below 200% of the federal poverty threshold.

(c) Education

The federal government provided nearly 10% of the funding for education in 1996 in grants-in-aid to state and local governments. Federal aid, however, is directed primarily toward special programs for the disadvantaged, children and family services, and training and employment assistance. The bulk of expenditures for elementary and secondary schools and higher education are financed by state and local governments.

(d) Transportation

The federal government provides grants-in-aid to state and local governments for transportation, which includes airports, highways, and urban mass transit. Close to 80 percent of federal funding for transportation in 1996 was directed towards highways. Federal funds comprise nearly 25% of state and local expenditures on highways. The federal government assists in highway funding by contributing to the states' highway trust funds.

(e) Housing and Community Development

Federal grants to state and local governments for housing and community development comprised nearly 70% of state and local funding in 1996. The funding is distributed by the Department of Housing and Urban Development (HUD). Close to half of the funding from HUD is directed towards lower income housing assistance and, thus, can also be grouped with the federal government's income redistribution programs.

2. Conditional Block Grants

Conditional block grants are funds provided for expenditures incurred within a general functional area such as welfare or housing. There is no matching component. They allow greater discretion for how funds are spent than do categorical grants. The states and local governments generally prefer the added flexibility of block grants. In addition, regulations for block grants tend to be shorter and simpler than for categorical grants. Critics of block grants argue that there is less adherence to standards, less oversight of grant monitoring, and that they provide less assistance to poorer segments of the population.

In the past thirty years, there has been a movement towards converting categorical grants into block grants. For example, in 1971, 129 categorical grant programs for education, law enforcement, community development, urban development, manpower training, and transportation were converted into 6 block grants. Again in 1981, 57 categorical grants were converted into 9 block grants. As noted above, in 1997 one of the largest categorical matching grant, Aid to Families with Dependent Children, was converted into a block grant entitled Temporary Assistance for Needy Families.

3. General-Purpose Grants: General Revenue Sharing

A program of general revenue sharing was enacted in 1972 under the State and Local Fiscal Assistance Act. The program provided funds for state and local governments to spend at their discretion. From 1972 to 1980, states received one-third of the funds and local governments received two-thirds. In 1980, states were removed from eligibility in the program and the program for local governments was terminated in 1986. There is now no general-purpose grant program in the United States.

4. Tax Deductions

Historically, Congress allowed deductibility of most state and local taxes from federal income tax. Today, only income and property taxes are deductible, and limitations on this have also been imposed. Tax deductibility allows state and local governments to raise their taxes without the full burden falling on their citizens. In essence, then, tax deductibility is a form of financial assistance from the federal government to the state and local governments.

5. Tax-Exempt Municipal Bond Interest

Interest income from state and local government bonds are exempt from federal taxation. This provision essentially lowers the rate of interest that state and local governments pay on borrowed funds. To the extent that the proceeds from issuing debt are used to finance government services such as education, policing, etc, this provision provides another means through which the federal government helps finance services provided by subnational governments.

6. Federal Mandates

Often, the federal government mandates that subnational governments undertake specific activities or provide specific services. Examples of federal mandates are the removal of asbestos from school buildings, the filtering of drinking water, and access by the disabled to public buildings and public transportation. While state and local governments often support these regulations, they are expensive and the federal government often does not provide the funds needed for their implementation. The imposition of "unfunded mandates' by Congress has been highly controversial.

7. Threats of Loss of Funds

The federal government sometimes threatens the loss of funds if state and local governments do not comply with congressional statutes. For example, in 1974 Congress wanted the official speed limit on highways to be reduced to 55 miles per hour. To ensure that states complied with this reduction, the federal government threatened to

remove 10% of a state's highway aid funds if it did not reduce the speed limit. Other examples where threats of loss of funds have been employed are allowing right turns on red lights, raising the minimum age to purchase alcohol, and implementing affirmative action programs.

The Need for Intergovernmental Transfers

There are varied opinions on the need for intergovernmental transfers. Those in favour of transfers point to the improved efficiency and equity that results from assigning superior taxing powers to higher levels of government while assigning greater spending responsibilities to lower levels of government. Those against transfers argue that accountability and efficiency suffer when lower levels of government are prevented from raising the revenues needed to finance programs designed to respect the preferences of their citizens. Complete decentralization of tax and expenditure powers, however, can result in inefficiencies and inequities, which may be corrected by utilizing intergovernmental transfers.

(i) Correcting for externalities

Many government services impart benefits and costs that reach beyond municipal or state boundaries. For example, education creates positive externalities when educated citizens relocate to other regions of the country. Another example is when citizens who travel from other jurisdictions benefit from a state highway system. If these positive externalities are not taken into account by lower-level governments, then too little spending is undertaken. Intergovernmental transfers can correct for these inefficiencies. As well, it can be argued that government services that affect citizens across jurisdictions should conform to some type of uniform standards. Consequently, when conditions are attached to the transfers, they persuade subnational governments to implement programs that adhere to national standards.

Subnational governments can also enter into competition with each other in attracting certain types of individuals and businesses and discouraging others from moving into their jurisdictions. For example, because individuals and business activity are mobile across the federation, a state or local government may be reluctant to implement a

progressive tax system or a generous welfare or health care program. Intergovernmental transfers can then be used to persuade subnational governments to implement national redistributive policies.

(ii) Correcting for Vertical Fiscal Imbalances

The mobility of people and business activity creates a rationale for assigning a greater responsibility to higher levels of government in raising tax revenues from mobile tax bases. In the United States, the federal government dominates the personal income tax, corporate income tax, and payroll tax fields. The state and local governments rely mostly on sales and property taxes. In addition, the federal government can resort to deficit financing much easier than can states and local governments. As a result, federal receipts have traditionally grown faster than state and local revenues. Furthermore, demand for state and local government services has grown considerably. These two facts have resulted in a vertical fiscal imbalance whereby federal revenues exceed federal expenditures (excluding intergovernmental transfers) and state and local government expenditures exceed their tax revenues. Similarly, the limited taxing ability of local governments has resulted in a large vertical fiscal imbalance between states and local governments. Intergovernmental transfers correct for vertical fiscal imbalances and offer subnational governments the ability to provide more and better government services.

(iii) Correcting for horizontal fiscal imbalances

In the United States, there is considerable variation in the abilities of state and local governments to raise revenues to finance their expenditures. The ability to raise revenues is defined as the government's fiscal capacity. Differences in fiscal capacity are especially prominent among local governments. Thus, poor jurisdictions must levy higher tax rates than rich jurisdictions in order to provide the same level of services. Furthermore, there is considerable variation in the need for and the costs of certain types of expenditures across jurisdictions. For example, some states or municipalities may have a larger proportion of elderly or poor individuals. Inefficiencies arise when individuals make their location decisions based on horizontal fiscal imbalances. Intergovernmental transfers can correct for these horizontal inequities.[31]

Programs Mainly Focused on Vertical Fiscal Imbalances

Vertical fiscal imbalances arise when revenues of higher-level governments exceed their spending responsibilities (excluding intergovernmental transfers). As described earlier, the federal government has superior taxing powers than the state and local governments. At the same time, the states and local governments are responsible for providing numerous government services. The combination of these two facts result in a vertical fiscal imbalance among the three levels of government.

In order to correct for vertical fiscal imbalances, a General Revenue Sharing program was implemented in 1972, but was terminated in 1986. It is the only program in the United States that had, as a main purpose, the correction of vertical fiscal imbalances.[32] The program provided funds for state and local governments to spend at their discretion. Two formulas were employed to determine the amount of funds a state would receive. The House of Representatives' formula was based on population, urban population, per capita income (inversely), state income tax collections, and tax effort. The Senate's formula was based on population, per capita income (inversely), and tax effort.[33] The state would receive whichever formula provided the highest transfer. The formula used for determining the amount of funds a local government would receive was based on population, per capita income (inversely), and tax effort. From 1972 to 1980, states received one-third of the funds and local governments received two-thirds. In 1980, states were removed from eligibility, leaving transfers only to local governments. The program for local governments was terminated in 1986.

Today, no program exists that explicitly corrects for vertical fiscal imbalances. However, the whole system of categorical grants and conditional block grants from federal to state and local governments and from state to local governments can perhaps be viewed in part as correcting for vertical fiscal imbalances. While there are other motives for these grants, such as persuading governments to adopt national policies and correcting for horizontal imbalances, their very existence derives from vertical fiscal imbalances.

Programs Mainly Focused on Horizontal Fiscal Imbalances

Horizontal fiscal imbalances arise when state or local governments differ in their ability to provide government services. These differences occur because of different fiscal capacities and needs. Horizontal fiscal imbalances are important at both the state and local levels of government, but are especially prominent at the local level. Local governments are responsible for a large proportion of service provision, but they have limited ability to raise revenue. The base of their primary revenue source, the property tax, is inequitably distributed within states and across states. Reliance on this revenue source results in large horizontal fiscal imbalances.[34] The states thus provide a large proportion of local revenue in the form of grants-in-aid in order to correct for these imbalances. As was described in Section B, real per capita intergovernmental aid from state to local governments has increased significantly over time.

Just as for vertical fiscal imbalances, there is now no program that explicitly addresses horizontal fiscal imbalances. The General Revenue Sharing program discussed in the previous section and is no longer in existence was also intended to address horizontal fiscal imbalances. As was described earlier, the formulas used to determine the level of transfers had equalizing components in them, such as tax effort, per capita income, urban population, and personal income tax revenues. Today, equalization is addressed in part by the system of categorical and conditional block grants. Many of these grants have equalizing components in that their allocation is based on criteria such as per capita income and tax effort, but there is no systematic overall scheme of equalization.

D. TAX HARMONIZATION AND TAX COLLECTION

In the United States, the federal government and the states have considerable independent taxing powers. While the federal government is the dominant player in raising revenues, the United States Constitution allows the states to levy any type of tax except import and export duties and duties on tonnage. Thus, states raise a considerable proportion of their revenues through the use of personal and corporate income taxes, sales taxes, property taxes, and payroll taxes. There is, nonetheless, an enormous variation among states in the types of taxes that they levy. For example, some states have no income tax or sales tax and rely primarily on property taxes and payroll taxes. Other states rely heavily on income and sales taxes for their revenues.

The primary sources of revenue for the federal government are the personal income and payroll taxes. Taken together, these two taxes provide roughly 80 percent of federal revenues. Payroll taxes are used mainly to finance social insurance and hospital costs in the Medicare program.[35] The next largest revenue source is the corporate income tax, which contributes about 12% of total federal revenues. Note that the federal government does not levy a sales tax. By contrast, the primary tax revenue sources for state and local governments are retail sales and property taxes, contributing over 40 percent of their total revenues. Personal income taxes make up about 15% of state and local revenues. In addition, transfers from the federal government contribute roughly 20% of state and local revenues.

The legal and constitutional right of the federal and state governments to levy taxes independently means that the issue of tax harmonization is likely to be an important one for the United States. Without harmonization, administrative and compliance costs are higher when both the federal and state/local levels of government levy taxes on the same base. These costs are compounded when each level provides different deductions, credits, and exemptions, thus introducing differences in tax bases. As well, issues of tax competition can arise among states when they levy taxes on mobile bases such as personal and corporate income. These types of problems can be alleviated or avoided by either assigning tax bases exclusively to one level of government or by developing tax harmonization and tax collection systems.

Despite the potential problems that result when both the federal and state/local levels of government have access to a wide range of tax instruments, there is no system of tax harmonization in place in the United States for any taxes. With regard to tax collection systems, the only arrangements that exist are very minor and occur at the state/local level. In particular, in some states, the state government collects revenues from sales and/or income taxes and remits part of the proceeds to local governments.

Since the federal government does not have a broad-based sales tax and the property tax is entirely left to the state/local government, the issue of tax harmonization is particularly relevant in the United States only for the personal and corporate income taxes, although the corporate income tax is a relatively minor tax at the state level. As described above, the federal and state/local governments levy personal and corporate income taxes independently. Thus, there are likely to be large administrative and compliance costs that would be avoided if there were a system of tax harmonization in place such as exists in most provinces in Canada.

With respect to sales taxes, the issue of tax harmonization will become important if ever the federal government decides to adopt a broad-based sales tax such as a VAT. If this ever comes to be, it would be desirable on both administrative and compliance grounds for there to be some arrangement of coordinating sales taxes at both levels of government. However, negotiating the arrangement with 50 states with widely varying sales tax systems would be a very difficult task.

Although payroll taxes are levied at both levels of government, the issue of tax harmonization is not as important as it is for, say, income taxes. The reasons for this are that payroll taxes are levied at flat rates and on payroll as the tax base. Thus, administration and compliance costs are low, so that administration and collection at one level of government is not as important an issue with the payroll tax.

E. ANALYSIS

1. ECONOMIC ASPECTS

There is a large body of theory dealing with the optimal relationship among levels of government within a federation. As a practical matter, however, there is no definitive consensus on what this optimal relationship should be. Much depends on how best the federal system in a particular nation fits the underlying assumptions of the theory. Thus, whether economic efficiency is best served through a highly decentralized or highly centralized system is a matter of debate. A factor that makes this debate a more difficult one to resolve in the United States is the wide variation that exists among states. The federal system in the United States is comprised of one federal government, fifty states, and over 87,000 local governments. There are very large states and very small states. Some states levy income and sales taxes, while others do not. Some states leave the provision of major expenditures to local governments, whereas others do not. Some states have generous programs for the sick, aged, and needy, whereas others do not. Some states depend a great deal on transfers from the federal government, whereas others do not. This variation among states is shaped by historical factors as well as the evolving preferences for the role of government within the economy. Consequently, rather than attempt to determine one way or the other whether the current system in the United States is an ideal one, we will discuss some of the theoretical arguments of the federalism literature in light of the experience in the United States.

1. Impacts on Economic Efficiency

It is generally agreed that national public goods and services should be provided and financed by the federal government. National public goods and services are those whose benefits or costs accrue to citizens across the country. The rule for assigning national public goods and services to the federal government is indeed followed in the United States. The federal government is responsible for “national” areas such as national defense, energy, the money supply, international commerce, and the postal service. What is more debatable is whether subnational governments should be responsible for providing and financing subnational public goods and services, i.e. those goods and services that mainly benefit citizens within a particular jurisdiction. A famous theory of

fiscal federalism, known as the Tiebout Hypothesis[36], argues in favour of decentralized provision of goods and services because competition among subnational governments ensures that citizens of a particular jurisdiction receive the public goods and services that best represent their preferences. Decentralized expenditure provision and revenue raising also improves accountability by ensuring that the level of government responsible for providing goods and services is also responsible for financing them. Two key assumptions for the Tiebout hypothesis to hold are that citizens must be mobile, so that they may easily relocate in response to differences in the provision and financing of public goods and services, and that there are no spillovers across jurisdictions. The first assumption is likely to hold in the long-run in the United States due to the absence of language and cultural barriers and the absence of restrictions in hiring citizens from other jurisdictions. In the short-run, migrating across jurisdictions is costly in terms of having to find new employment, sell one's house, etc. Consequently, citizens are more likely to move in the long-run to jurisdictions that have the mix of expenditure and taxation that best satisfies their preferences. The second assumption of no spillovers across jurisdictions is likely not to hold, but its degree of severity is open to debate. Many public goods and services can have benefits or costs that cross state (or local) boundaries. Spillovers (or externalities) can take many forms. Highways, for example, can benefit citizens residing outside the state or local boundary. As well, education can benefit citizens of other jurisdictions either directly, if they attend a particular state university, for example, or indirectly, if they migrate to another jurisdiction, bringing the skills learned with them. Externalities are also created when citizens move across jurisdictions to take advantage of generous health or welfare programs. Similar arguments can be made on the taxation side. State and local governments may compete for mobile individuals or businesses by offering lower tax rates. They do so without taking into account the effects of their tax incentives on citizens in other jurisdictions. When externalities of this sort are present, there is a rationale for more central control of goods and service provision and taxation.

The provision of subnational public goods and services is relatively decentralized in the United States. State and local governments provide many goods and services and they have wide discretion on the details of the various programs provided. Although the

federal government stipulates conditions in many of its grant-in-aid programs to the state and local governments, the United States follows a general principal of state sovereignty in the provision of subnational goods and services. As a result, inefficiencies that may result from spillovers across jurisdictions may be left uncorrected in the United States. On the other hand, efficiency may be enhanced for those goods and services with benefits or costs accruing to citizens within a particular jurisdiction.

Turning to the raising of revenues, we saw in Section B that large vertical fiscal imbalances exist in the United States and, thus, revenue-raising is much more centralized in the United States than expenditure provision. This is true despite the fact that states have access to most major tax sources. Whether this situation is more efficient than one where states have greater revenue-raising responsibilities is open to debate. Certainly, the fact that state and local governments are responsible for providing various goods and services to their citizens but are not fully responsible for financing them detracts from accountability. It is also true, however, that administrative and compliance costs are lowered by assigning greater taxing powers to the central government. Also important are the facts that citizens and businesses are fairly mobile in the United States and that there are no tax harmonization agreements. These two facts imply that that tax competition among state and local governments is likely to be important in the United States. This is especially relevant for redistributive or ability-to-pay taxes. A state wishing to increase the amount of redistribution in its tax system would likely find those that contribute to the system migrating out of the state and those that could benefit from the system migrating from other states. As a result, it can be argued that for administrative, compliance, and tax competition reasons, efficiency is enhanced in the United States because the federal government has greater revenue-raising powers than lower-level governments.

2. Impacts on Equity

As was mentioned above, the United States has a relatively decentralized system of expenditure provision. This is true even for redistributive programs such as the former Aid to Families with Dependent Children program, the current Temporary Assistance for Need Families program, and Medicaid. Two notable exceptions are the Food Stamps and Medicare programs, which are federal. The federal government does attach conditions

when financing redistributive programs. Nevertheless, the states have a great deal of discretion in the design of the programs, which results in citizens residing in different states having access to different levels of service. Some may argue that this is not very equitable and should be corrected by the federal government assuming a greater role in the design and implementation of redistributive programs. Others, on the other hand, have argued strongly that achieving more equity detracts from efficiency in the abilities of the states to provide services that respect the preferences of their citizens.

On the revenue side, we already mentioned above that the federal government has a dominant role in the United States in levying redistributive taxes such as the personal income tax. This allows for greater redistribution because a large federal role mitigates the states' abilities to compete for mobile tax bases. It does not eliminate tax competition completely, however, since the states do have access to the income tax base.

Redistribution not only applies to individuals; it also applies to state and local governments. The issue of whether the federal government should redistribute economic activity across states is a hotly debated one in the United States. Because states differ in their abilities to provide goods and services, individuals in similar circumstances will necessarily be treated differently across states. Those in favour of redistribution argue that all citizens of similar economic status within a federation should have access to similar public goods and services at similar tax levels. These people would thus argue for a strong federal role in redistribution across states. This argument has, however, had relatively little impact on the design of intergovernmental transfers in the United States. As we have noted in earlier sections, there is no explicit system of equalization in the United States. There are, however, equalization-type components imbedded in the system of grants-in-aid. Those opposed to redistribution across states argue that states should receive "fair" treatment from the federal government in the sense that what each state pays in taxes should equal what it receives in expenditures. Furthermore, they argue that redistribution exacerbates inequities and inefficiencies by encouraging poorer individuals to stay in poorer regions.

2. POLITICAL ASPECTS

1. Impact on Stability

The process of intergovernmental relations and fiscal arrangements has been both a stabilizing influence and a source of conflict in the United States.

Areas of Consensus

Lack of Equalization: One area in which a consensus exists is in attitudes to a generalized equalization program. No such program exists, and none is contemplated. The U.S. is, among federations, exceptional in this regard. While the scope of equalization transfers in federations varies, it is noteworthy that all other developed countries utilising a federal system of government have some type of equalization system. The lack of such a program in the United States cannot be attributed to a lack of need for such a system, based on a dearth of horizontal fiscal inequities. In fact, horizontal fiscal inequities among U.S. states are of the same order of magnitude as among Canadian provinces.[37] Explanation of the absence of an equalization program may be attributable to cultural factors, discussed below.

Areas of Dispute

Goals of federal spending: There is no consensus in the U.S. as to whether it is a goal of the federal fiscal transfer system to redistribute economic activity across states, or whether such redistribution is merely an unintended consequence of decisions taken with other motivations.[38] Three differing conceptions of the federal financial role can be detected in different parts of the ongoing debate.

One political conception of the federal financial role is that federal transfers should be *designed to be neutral* across states; i.e., that each state should get back a close approximation of what it pays in. Under this conception, the federal government's role is to operate a unified tax system, but not to redistribute the collected resources via the federal fisc.

A second conception of the federal financial role is that the federal fiscal transfer system should be *designed to redistribute* resources among the states. This conception prescribes that the federal government should use resources available from states with

higher per capita incomes or stronger economies to finance programs that less wealthy states would be unable to support using their own resources alone.

A third conception of the federal financial role is that net redistribution of resources and economic activity among states is allowable as long as it is an *unintended consequence* of individual programs designed to achieve important federal purposes. This conception prescribes that programs should be financed through a unified tax system, but that program spending should be located wherever activities need to be, or best can be, carried out; program spending would thus be 'blind' to any redistributional effects.

Given this lack of consensus as to the goals of federal transfers, it is no surprise that concerns about whether states receive a 'fair' proportion of federal expenditures, or pay more than their 'fair' share in federal taxes, have become a prominent feature of political debates at the federal level. That is, as participants in policy debates have differing conceptions of the goals of the system, they differ as to their evaluations of what is 'fair'. Consider, for example, the political difficulties involved in designing a new welfare system to replace the AFDC (Aid to Families with Dependent Children) program.

The AFDC program, a categorical transfer program, was in 1996 converted to a block transfer program and renamed Temporary Assistance for Needy Families (TANF). Under TANF, the states were given almost total discretion to set program rules; thus, there is relatively little policy to be set at the federal level, other than the distribution of federal funding levels among states. Consequently, one of the most contentious issues in designing TANF became finding 'fair formulas' to allocate and distribute federal transfers.

Some wealthier states argued that fairness prescribed that future allocations should be based on past allocations. Under AFDC, state contributions were matched by federal transfers, so that states had an incentive to contribute more. If the new block transfers were distributed based on prior year allocations, states that were receiving a relatively large amount of federal support because of their own spending would continue to receive higher funding. This would persist even if they subsequently cut their own contributions.

Many poorer states took a different view of what would be a fair allocation. At one point, a group of 30 Senators from the "Sunbelt" states proposed a formula that would have taken child poverty rates and the size of the state into account. Under this formula,

more money would have been directed to southern states and states with small populations. Wealthier states, that had been able to afford higher own-source funding under AFDC, would have experienced a commensurate drop in federal transfers.

In the end, a compromise involving transitional measures was agreed upon. What the TANF debate demonstrates is that without political agreement on the goals of federal transfers, determination as to what constitutes a 'fair' funding formula must be made on a case-by-case, *ad hoc* basis.

Beyond the difficulties involved in formulating 'fair' rules for transfers given a lack of consensus of the overarching goals of the transfer system, are the problems associated with the uncoordinated nature of the transfer system. As the system is not often considered in its totality, but rather only on an issue-by issue or program-specific basis, policy debates are plagued by misconceptions as to the actual redistributive effects of federal transfers. For example, it is commonplace for citizens and even policy-makers to consider the large cities of the north-east and Great-Lakes regions to be beneficiaries of federal transfers due to high welfare costs; in fact, however, the states of the north-east and Great Lakes regions are net contributors to the federal revenues while many Sunbelt and western states are net recipients.[39]

Unfunded Mandates: Mandates is a broad term used to refer to a number of different tools used by the federal government to regulate the activities of state and local governments.[40] Four types of tools are relevant to the discussion of fiscal federalism. First, there are the program-specific conditions attached to conditional transfers. These requirements, attached to major fiscal assistance programs, demand significant fiscal and policy actions by state and local governments. As we have noted, while it is technically possible for state and local governments to avoid the conditions by non-participation in a program, this is not practically feasible in the case of the major programs. Avoidance is also made more difficult by the next two types of mandates.

Second, there are 'crossover sanctions'. Such sanctions link compliance with conditions of smaller programs to the continued receipt of funds from larger programs. They may mandate a withdrawal of all or a portion of a federal transfer; for example, federal funding for highways is dependent upon a state maintaining a minimum legal drinking age of 21 years.

Third, there are 'cross-cutting requirements' attached to many transfers. Technically, these are conditions of transfers as well. However, these cut across policy areas, making it difficult for recipient governments to avoid them. The stipulation that capital funding on any federally-funded facility is dependent upon the facility being accessible to the disabled is an example of such a cross-cutting requirement.

Fourth, there are direct orders. These are seen as the most coercive of mandates, and involve federal direction of policies or programs to be carried out by state or local governments. Typically, these carry criminal or civil sanctions for non-compliance. Examples include federal labour and environmental standards.

State and local officials oppose mandates principally on three grounds.[41] First, they argue that mandates distort their priorities by tying up resources to comply with federal priorities. As the ability of state governments to respond to state priorities is diminished, they argue, the political viability of state-order government is undermined. Second, mandates carry non-fiscal implications for state and local governments. It is argued that the initiative of these governments to experiment with innovative approaches to policy problems is diminished. Third, it is argued that mandates serve to undermine accountability. To the degree that mandates are 'unfunded', federal legislators are free to enact benefits without facing the concomitant political pressures associated with paying for them.

Supporters of mandates counter with four arguments. First, they argue that states, if left to their own devices, would provide inadequate levels of funding and services to what have been identified as national priorities. They believe a federal role is thus justified in such areas as assistance for those with disabilities or protection of the environment. Second, economists argue that federal action is necessary due to spill-over effects. Federal regulation prevents states from exporting costs in policy areas such as higher education and environmental protection. Third, it is argued that the U.S. needs a national system of regulation of corporate activity, as it has developed a nationally integrated economy. Federal regulation is seen as necessary to prevent 'jurisdiction shopping' by corporations. Fourth, it is argued that the U.S. has become a national community, with expectations of common levels of public services and benefits. It is thus argued that only the federal government can avoid a patchwork of services.

The significant use of mandates began in the 1960s, and continued through the 1970s. The Reagan administration ameliorated the effects of unfunded mandates in the 1980s by requiring all executive regulations to undergo cost-benefit analyses. However, the number of mandates imposed by Congress continued to grow, and the fiscal pressures related to the recession of the early 1990s led to high-profile protests by state and local governments against unfunded mandates. A coordinated National Unfunded Mandates Day, first held on October 23, 1993, received wide-spread press attention.

The federal legislative response to state and local protest was the Unfunded Mandates Review Act of 1995. In the aftermath of the Act, some unfunded mandates were reversed, and new mandates were modified.[42] However, as the Act covers only one of the four types of mandates identified above, i.e., direct orders, the political debate on mandate issues can be expected to endure.[43]

Ability to Adapt to Changes

The U.S. fiscal transfer system has shown a remarkable ability to adapt to changing circumstances. As we have noted, the matrix of connections among legislators, administrators, and executives in all three levels of government produces an uncoordinated but flexible system. The federal Congress, as a site for lobbying by agents of state and local governments, is able to incorporate regional views in its decision-making processes.

The noncentralized character of U.S. federalism has allowed the locus of legislative and administrative decision-making to evolve over time. Periods of more centralised decision-making, such as that induced by the crises of the Great Depression and the Second World War, have alternated with periods of greater legislative and fiscal decentralization, such as the period beginning in the 1980s. Such flexibility has been facilitated by the Constitution's provision of extensive areas of shared jurisdiction.

2. Transparency and Accountability Considerations

The complex uncoordinated system of intergovernmental transfers produces a system with both low transparency and low accountability. However, because of the degree of

concern in the U.S. around the principle of financial responsibility, accountability has been enhanced via the extensive use of conditional transfers.

A benefit of the systematic use of conditional grants is a relatively high degree of transparency. While it is true that the U.S. system of intergovernmental relations constitutes a complex matrix, the importance attached to the principle of financial responsibility means that citizens are able to identify the site where decisions are taken. As compared to the relatively closed system of intergovernmental relations in those federations utilising executive federalism, the bargaining 'free for all' which takes place in the U.S. Congress is relatively open.

3. Political Culture

United States' society is characterized by relative homogeneity and the process of intergovernmental relations and fiscal arrangements reflects and reinforces this characteristic.

Overall, cultural homogeneity is reflected and reinforced by the conditional transfer system. The federal government has been able to use conditional transfers to develop a relatively uniform set of nation-wide programs and services. While states and localities are allowed some discretion in regard to implementation of these programs, the over-arching principle has been support for uniform federation-wide standards.

The political culture of the United States has been described as being civic, republican, and participatory.[44] While there are regional variations, this political culture places an emphasis on the individual, as opposed to the group, as the primary political unit. It is in this context that the systems of intergovernmental relations and fiscal transfers must be understood.

Rather than relating to each other as coherent entities, the governments of the U.S. relate as congeries of interests. That is, in the federations utilising executive federalism (such as Canada and Germany) each government defines a constituent-unit interest which is a compromise worked out within the political community of the constituent unit. That collective interest is then represented by the executive of the constituent-unit government in intergovernmental bargaining. In the U.S., by contrast, constituent-unit interests are not defined at the state-government level and then represented; rather, each interest

represents itself in the uncoordinated bargaining that occurs in Congress. State legislators, and state and local executive agencies pursue what they perceive to be in their individual or institutional interests. Definition and representation of a collective, state-wide interest has not been in practice the overriding concern.

The fiscal transfer system is also in accord with a political culture rooted in individualism. The lack of an overarching equalization system is consonant with a focus on individuals, rather than on states as collectivities. The tolerance for horizontal fiscal imbalances among states may be related to the belief that individuals have the ability to avoid the effects of such imbalances by relocating to more prosperous areas. Such relocation is in practice facilitated by the relative cultural homogeneity of the United States since there are no linguistic barriers to overcome when moving from one region of the country to another.

NOTES

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[1] Ronald L. Watts, *Comparing Federal Systems* (2nd ed.; Montreal and Kingston: McGill-Queen's University Press, 1999),21.
[2] Daniel Elazar, *Federal Systems of the World: A Handbook of Federal, Confederal and Autonomy Arrangements* (Harlow, Essex, UK: Longman, 1991), 311.
[3] Ibid., 311.
[4] Ibid.
[5] Ibid., 312.
[6] Janet G. Stotsky and Emil M. Sunley, "United States," in Teresa Ter-Minassian, ed., *Fiscal Federalism in Theory and Practice* (Washington: International Monetary Fund, 1997), 359-60.
[7] Ronald L. Watts, *The Spending Power in Federal Systems: A Comparative Study* (Kingston: Institute of Intergovernmenal Relations, 1999), 10.
[8] Stotsky and Sunley, 364.
[9] Ibid., 368.
[10] Ibid., 361.
[11] Ibid.
[12] Ibid., 368.
[13] Watts, *Spending*, 10.
[14] Ibid.,11.
[15] Ibid.
[16] Stotsky and Sunley, 370-71.
[17] Watts, *Spending*, 10.
[18] Elazar, 313.
[19] Jennifer Smith, "Judicial Review and Modern Federalism," in Herman Bakvis and William M. Chandler, eds., *Federalism and the Role of the State* (Toronto: University of Toronto Press, 1987), 114.
[20] Robert C. Vipond, "Canadian and American Federalism: A Comparative Perspective," in Martin Westmacott and Hugh Mellon, eds., *Challenges to Canadian Federalism* (Scarborough: Prentice-Hall Canada, 1998), 19.
[21] André Bzdera, "Comparative Analysis of Federal High Courts: A Political Theory of Judicial Review," *Canadian Journal of Political Science* 26:1 (March 1993), 9.
[22] Smith, 116.
[23] Watts, *Spending*, 12.
[24] Ronald L. Watts, "Comment: The Value of Comparative Perspectives," in K.G. Banting and D.M. Brown, eds., *The Future of Fiscal Federalism* (Kingston: School of Policy Studies, Queen's University, 1994), 327.
[25] During the period under consideration, state governments were generally experiencing surpluses.
[26] Table 1 in the Appendix shows that Alaska has very high per capita expenditures relative to the national average. Thus, the Pacific region data is heavily influenced by Alaska.
[27] As was true for expenditures, revenues per capita in Alaska are very high relative to the national average, and this is reflected in the data for the Pacific region.
[28] The powers reserved for the states are in three broad categories: (i) The police power, which includes powers such as the regulation of hospitals and doctors, zoning laws, child labour laws, and working hours; (ii) Public services, which include schools, police force, welfare services, public health, transporation services, and agricultural and research services; and (iii) The Local Government System. See Zimmerman (1991) for more information.
[29] The federal government is involved in the financing of health care in several ways. Medicaid involves financial assistance to the states. However, the federal government administers and finances Medicare, which is a health care program directed to the aged. As well, the federal government finances the Public Health Service, veterans hospitals, and medical research and teaching.
[30] In addition to the intergovernmental financial assistance programs for income redistribution, the federal government also administers and finances the food stamps program, the Head Start program, which

[1]

provides preschooling for children of low-income families, Pell grants, which provides funding for college education for children of low-income families, and the Low-Income Home Energy Assistance Program (LIHEAP).

[31] Note that some economists argue that transfers directed towards correcting for horizontal imbalances create inefficiencies in that they result in individuals staying in less productive regions.

[32] For a description of the General Revenue Sharing program, see Aronson and Hilley (1986), pp. 56-58.

[3333] Tax effort is measured as the ratio of total tax revenue to personal income.

[34] These inequities among local governments have led poorer regions to file lawsuits against the state. School districts in several states have won court battles arguing that, since the state is responsible for creating the system of local governments, it is responsible for addressing the inequitable distribution of tax bases. For a discussion of this, see J. Stonecash (1998), pp. 77-78.

[35] The Old-Age, Survivors, and Disability Insurance (OASDI) program is the largest social insurance program in the United States. The second largest is Medicare. Both programs are administered and financed by the federal government and both provide insurance and redistribute income. The OASDI is financed by a payroll tax that is shared between employers and employees. Hospital costs in the Medicare program are financed through a payroll tax.

[36] C. Tiebout (1956), "A Pure Theory of Local Expenditure", *Journal of Political Economy*, 64, 416-24.

[37] Ronald L. Watts, *The Spending Power in Federal Systems: A Comparative Study* (Kingston: Institute of Intergovernmenal Relations, 1999), 11.

[38] Herman B. Leonard, Jay H. Walder, and José A. Acevedo, *The Federal Budget and the States: Fiscal Year 1998* (Cambridge, Mass., U.S.A.: Taubman Center for State and Local Government, 1999), 17.

[39] Ibid., 2-3.

[40] Paul I. Posner, *The Politics of Unfunded Mandates: Whither Federalism?* (Washington: Georgetown University Press, 1998), 4, 13.

[41] Ibid., 6.

[42] Ibid., 206.

[43] Ibid., 204.

[44] Daniel Elazar, *Federal Systems of the World: A Handbook of Federal, Confederal and Autonomy Arrangements* (Harlow, Essex, UK: Longman, 1991), 313.

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