

Centralization, Decentralization and Intergovernmental Competition

Albert Breton

The 1989 Kenneth R. MacGregor Lecturer

Reflections Paper No. 4

**Institute of
Intergovernmental
Relations**

**Queen's University
Kingston, Ontario
Canada**

Canadian Cataloguing in Publication Data

Breton, Albert, 1929-

Centralization, decentralization and intergovernmental competition

(Reflections = Réflexions, ISSN 0838-4460 ; 4)

ISBN 0-88911-564-8

1. Decentralization in government. 2. Intergovernmental fiscal relations. I. Queen's University (Kingston, Ont.). Institute of Intergovernmental Relations. II. Title. III. Series: Reflections (Queen's University (Kingston, Ont.). Institute of Intergovernmental Relations) ; 4.

JS113.B74 1990 350.007'3 C90-093600-2

Reflections/Réflexions

Reflections/Réflexions is a publications series of the Institute of Intergovernmental Relations. Contributions present the personal thoughts and arguments of their authors on a variety of subjects having to do with federalism and intergovernmental relations. The series is intended to place new ideas into the public forum, where they will be open to challenge and rebuttal.

Reflections/Réflexions est une collection de l'Institut des relations intergouvernementales. Les articles publiés sont l'oeuvre d'auteurs dont les points de vue ou les thèses abordent divers sujets touchant le fédéralisme et les relations intergouvernementales. Cette collection se propose de livrer à l'opinion publique de nouveaux motifs de réflexion pouvant prêter au débat de fond, voire à la polémique.

© Copyright 1990

CONTENTS

<i>Foreword</i>	v
<i>Sommaire</i>	vii
INTRODUCTION	1
WORKING ASSUMPTIONS ABOUT DEMAND AND CONSTITUTIONAL ARRANGEMENTS	6
CONCENTRATION AND COMPARATIVE ADVANTAGE	8
i) Free-Riding	8
ii) Welfare Costs	13
REVENUE AND EXPENDITURE CONCENTRATION	15
CONCLUSION	19
Notes	21
References	22

FOREWORD

This publication is the text of a public address by Professor Albert Breton as the fifth Kenneth R. MacGregor Lecturer in Intergovernmental Relations. The lecture was delivered at Queen's University on 16 October 1989.

The MacGregor Lectureship was established in order to bring annually to Queen's University a distinguished individual who has made an important contribution to the understanding or practice of federalism, intergovernmental relations and related issues in Canada or other countries. The lectureship honours Kenneth R. MacGregor, a Queen's graduate, longtime member of the Queen's Board of Trustees, former Superintendent of Insurance of Canada, and retired Chairman of the Mutual Life Assurance Company of Canada. It is funded through the generosity of the company, members of the Queen's Board of Trustees, and friends. Previous distinguished individuals who have been MacGregor Lecturers include former Progressive Conservative leader Robert Stanfield, ex-Premier Peter Lougheed of Alberta, Professor Alan Cairns of the University of British Columbia, and former Saskatchewan Premier Allan Blakeney.

Albert Breton is a Professor of Economics at the University of Toronto and is known widely as the author of a number of stimulating publications on the theory of federalism. He was a Commissioner with the Macdonald Royal Commission on the Economic Union and Development Prospects for Canada and his Supplementary Statement to its final report in 1985 in which he developed a theory of "competitive federalism" has provoked widespread discussion. He is also the author of *The Economic Theory of Representative Government*, 1974, *The Economic Constitution of Federal States*, 1978 (with Anthony Scott), *The Design of Federation*, 1980 (with Raymond Breton), *Why Disunity?* 1980 (with R. Wintrobe), and *The Logic of Bureaucratic Conduct*, 1982.

In this paper Professor Breton develops further his earlier application of economic concepts to the political phenomena of federalism. He examines the advantages and disadvantages of the concentration of the expenditure, regulatory and revenue collecting activities of governments at one level or the other, and concludes that competition between governments located at different

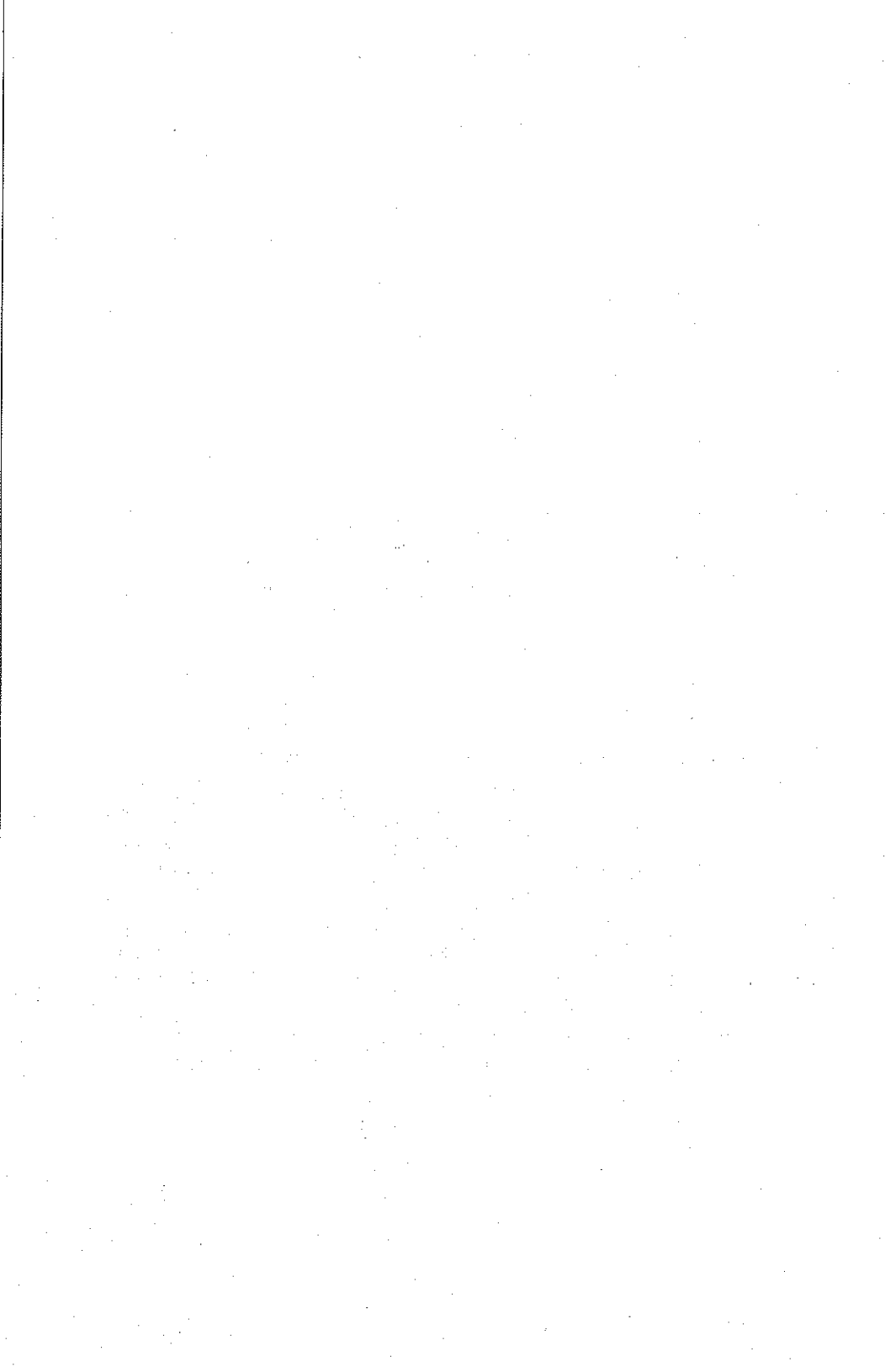
jurisdictional levels is most likely to produce a balance between these advantages and disadvantages. The Institute of Intergovernmental Relations is pleased to be able to publish this contribution to the development of federal theory.

Ronald L. Watts
Director
January 1990

SOMMAIRE

Cette étude vise à différencier les phénomènes de concentration et de centralisation, celle-ci renvoyant à un partage des compétences entre des paliers de gouvernement donnés tandis que celle-là a trait aux opérations gouvernementales touchant les dépenses, la perception des impôts et la réglementation. On pose en principe ici que la concentration accrue comporte à la fois sa part d'avantages et d'inconvénients. S'agissant des avantages, il appert qu'un plus grand nombre de gouvernements centraux auraient un avantage relatif à contrôler le resquillage car, en s'employant à cette tâche, ces derniers diminueraient d'autant les occasions grâce auxquelles les citoyens profitent d'un bien ou d'un service sans y avoir contribué de manière commensurable. Les inconvénients pour leur part viennent de ce que la perte de bien-être ou d'utilité encourue — autrement dit, les coûts générés dès lors que la quantité de biens ou de services fournie ne coïncide pas avec la quantité désirée — a tendance à être moindre lorsqu'on est en présence d'un gouvernement provincial ou de type fédéré. Du reste, la concentration qui se trouve à l'équilibre rend égaux, à la marge, les avantages et les inconvénients en question. La présente étude démontre en fait que cet équilibre intervient par suite de la concurrence que se livrent les divers paliers de gouvernements.

En outre, il a été établi que la dynamique qui donne naissance à un taux d'équilibre de cette concentration ainsi qu'aux variations de ce taux est la même qui détermine le partage des compétences et ce, à l'encontre de ce que l'on peut croire communément. Toutefois, cette étude reconnaît que dans le cadre d'un système de gouvernement stable, l'inévitable partage des compétences oblige à coup sûr à des ajustements pour faire face à d'éventuels chocs extérieurs.



CENTRALIZATION, DECENTRALIZATION AND INTERGOVERNMENTAL COMPETITION

INTRODUCTION

To introduce my subject, I must first dispose of a minor semantic issue. Our habit of thinking of governments as monolithic institutions is so engrained that we do not appear to possess, in ordinary discourse, words that would make it easy to distinguish between the whole apparatus of government on the one hand and the multiplicity of units which constitute the whole on the other. We lack, in other words, a distinction such as that between industries and firms which plays such an important role in the analysis of competitive market supply. To remedy the situation I will adopt the convention of calling the apparatus of state in its entirety the *governmental system*; this expression will, therefore, be the counterpart of the term industry in the analysis of market supply. What corresponds to firms, I will simply call *governments*.

Having dealt with this problem of vocabulary, let me begin by remarking that modern democratic governmental systems, even those of unitary states, are all multi-level systems. That statement continues to be true even if we insist in recognizing as jurisdictional levels only those at which political decision-makers are popularly elected. France and Italy, for example, which are often used to illustrate what the typical unitary state looks like, each have four levels of elected governments. Britain, outside London and its six other metropolitan conurbations,¹ also has four tiers of elected governments.² I have, indeed, not been able to find, among contemporary democracies, a single example of a governmental system in which there are fewer than three jurisdictional levels (see, however, note 2). Furthermore, if we do not require that political decision-makers be elected, the number of levels becomes larger mostly, but not exclusively, because of the importance in some countries of special authorities and of special district governments — in France, *syndicats* and in Italy, *consorzi* — which can have the responsibility for such functions as schools, fire protection, police, public transportation, water, sewage, libraries, hospitals and cemeteries.

Governments at all levels spend, regulate, and collect revenues. Some perform the latter function directly through a variety of means, including taxation and user fees, while others — some, but not all, special district governments for example — do so indirectly through the mediation of other public bodies. In addition, the great majority of governments receive from other governments sums which are usually called grants, but which are sometimes camouflaged under other labels. However, in dollars per period, the distribution between

jurisdictional levels of these expenditure, regulatory and revenue raising activities varies considerably over time within any given country and even more between countries.

Economists, jurists, political scientists and other scholars have, for a long time, tried to account for these variations. The large literatures on federalism, on the assignment of constitutional powers, on centralization and concentration, on horizontal and vertical imbalances, and on intergovernmental grants — when they are not solely hortatory or exclusively descriptive and numerical — are witnesses to that fact. However, all these writings notwithstanding, there are some very important questions that still cannot be answered.

Let me illustrate with the problem of centralization without specifying clearly the nature of the object that is being centralized, thus continuing, but not beyond this Introduction, a long tradition of imprecision on the subject. I could, however, have chosen, with the same result, the closely related issue of vertical imbalance, sometimes identified as the problem of fiscal dependence, or that of intergovernmental transfers. Alexis de Tocqueville (1840), James (Lord) Bryce (1888), Johannes Popitz (1927)³ and Harold Laski (1939), to limit myself to a few writers who are no longer alive but continue to have an active presence in the centralization literature, have all argued that there is a basic tendency toward centralization in federalism — the kind of governmental system that one would have been inclined to think would be the least prone to that sort of drift. Though often the object of epigrammatic quotations and of esoteric labels — Bryce's Law of federalism as "simply a transitory step on the way to governmental unity" (McWhinney, 1965, p. 105) or Popitz's Law of the "force of attraction of the highest budget" (Gerelli, 1966, p. 273) — it is not at all clear what these writers are telling us.

Tocqueville, for example, defines centralization as the concentration of political power. He sees that concentration as resulting from the inevitable spread of equality among human beings. Centralization is achieved when there remains only "one sole uniform and strong government" (p. 673) in the country. Bryce sees centralization as resulting from unifying social and economic forces such as "the influence of easier and cheaper communications, of commerce and finance, of the telegraph...". He describes, in the following terms, the centralization which, at the end of the 19th century, he was sure was already taking place in the United States and the further centralization that he anticipated for the future: "[t]he rôle of the State[s] is socially and morally, if not legally, smaller now than it then was..." (vol. 2, p. 905) and "[i]t may therefore be concluded that while there is no present likelihood of change from a Federal to a consolidated republic, and while the existing legal rights and functions of the several States may remain undiminished for many years to come, the importance of the States will decline as the majesty and authority of the National government increase" (vol. 2, p. 906).

Popitz defines centralization as the concentration of functions *and* funds (Hanusch, 1978, p. 130) in the central government. It is produced, he argues, by three factors: i) the necessity of uniform economic policies to standardize the *Lebensraum* of an economy and nation; ii) the ever-increasing propensity of citizens to channel their demands toward the centre instead of the periphery; and iii) the growing inadequacy of revenues at the local level. Laski declares federalism obsolete because that type of governmental structure is radically incapable of dealing "with the issues [that] giant capitalism has raised" (p. 112) — essentially social and environmental issues. Though his paper is entitled "The Obsolescence of Federalism", Laski's discussion pertains to intragovernmental as well as to intergovernmental organization as his discussion of judicial review in the American government makes clear. Only a strong centralized executive, according to Laski, can meet the demands of citizens, because state governments are the creatures of giant capitalist enterprises whose interests are opposed to these demands. In his own words "Delaware is merely a pseudonym of the du Ponts, and Montana little more than a symbol of the Anaconda Copper Corporation" (p. 115). A strong central executive alone can resist being captured by business interests, hence the need for centralization.

It is intriguing that other British students of federalism besides Bryce and Laski — among them Albert Dicey (1962), Henry Sidgwick (1919) and Kenneth Wheare (1963) — have concluded that, to quote Daniel Elazar (1987), "federalism [is] no more than a technique for political integration — occasionally useful, transitory in nature, and ultimately [destined] to evolve into a more simple form of decentralization within a strong unitary government" (p. 149). Is it possible that these scholars have all seen governmental systems evolving toward the British model, because, if they had not, they would have had to think the unthinkable — a federal system of government for the United Kingdom? However that may be, the most remarkable fact about Tocqueville, Bryce, Popitz and Laski's discussions — and also about those of Dicey, Sidgwick and Wheare which, to economize on time, I have not sketched — is that even if they all diagnose and identify a trend toward centralization in governmental systems, none of them diagnose and identify the same thing!

If we turn our attention from these essentially qualitative discussions to the quantitative or, more precisely, to the numerical literature which derives from Alan Peacock and Jack Wiseman's (1961) pathbreaking monograph on public expenditures in the United Kingdom, we enter a different universe of discourse. Peacock and Wiseman define centralization — their own word is concentration — as the central government's share of expenditures in total public expenditures and, on the basis of such an index, argue that centralization was occurring in the United Kingdom between 1890 and 1955 — the period covered by their study. Later work, among which one should mention that of Frederic Pryor (1968), David Davies (1970), Wallace Oates (1972, 1978) and Werner

Pommerehne (1977), on the basis of a similar index as that used by Peacock and Wiseman and of variants thereon, has concluded that there is a tendency toward decentralization, not toward centralization, in governmental systems.

As Richard Bird (1979, 1986) has repeatedly noted, it is not obvious, however, what these "centralization indexes" measure. His views, which in a way provide us with a bridge between the qualitative and the numerical discussions can, I think, be summarized in the four following propositions: i) indexes of centralization are "potentially useful" for certain limited tasks such as establishing whether more centralization "is associated with...larger or smaller public sectors or with greater (or lesser) ease in managing the economy" (1979, p. 64); ii) even for these limited tasks, the indexes should be used with caution because "there are many possible measures of centralization" and not all of them "necessarily move in the same direction at the same time" (1979, p. 64); iii) more importantly, such indexes do not tell us anything useful about "decision-making power" (1979, p. 64; 1986, p. 18); and iv) because "it is possible for countries in which by most measures state governments seem to be very independent to be in reality much less 'federalist' than other countries in which state governments may appear, in terms of most fiscal centralization measures, to have less autonomy" there is no point in engaging in "such a misleading exercise as measuring fiscal centralization, particularly in internationally comparable terms" (1986, p. 20).⁴ Without necessarily agreeing with every one of these points, especially with the second part of the last one, we would be well-advised to keep them in mind in discussing centralization.

There are two other recent contributions on the subject — one by Gérard Bélanger (1985) and the other by Richard Simeon (1986) — which bear on the matters of "decision-making power" and of what constitutes 'federalist' systems of government. After quoting Tocqueville and Bryce on the tendency toward centralization, Bélanger adds, without defence, that the "history of federations tends to confirm these assessments" (p. 16). He then remarks "that the distribution of spending among levels of government is a poor indicator of the evolution of centralization in a federal state" (p. 17); The sentence is a euphemism because Bélanger believes that centralization indexes are totally incapable of measuring the real degree of centralization. Indeed, even though his discussion is not systematic, he argues that centralization can be "measured" by two things: i) the intrusion of the central government "in fields over which the provinces [have] primary constitutional authority" (p. 17); and ii) effective, though not formal, changes in the division of powers effected by the mediation of intergovernmental grants.

Simeon's essay on "Centralization and Decentralization" is too all-encompassing to be briefly summarized. I mention it here to point to his steadfast refusal to be entrapped in a narrow notion of centralization and to the consequent necessity for him, much as is the case for Bélanger, to use an essentially

political notion of the concept. A sentence like "[c]entralization [came to] be defined in terms of maintaining the integrity of the Canadian union in the face of ... fissiparous tendencies" (p. 372) illustrates what I am trying to describe. Elsewhere in his essay Simeon uses what is effectively a centralization index based on expenditure shares to measure the "attenuation of federal power"⁵ — not powers — which, in the context, is the true measure of decentralization (p. 370).

I have dwelt on parts of the centralization literature not to make a contribution to the history of thought, but to illustrate some lessons that can be learnt from these writings. I retain three. First, it is clear from a comparison of the qualitative and of the numerical literatures and, in particular, from the *weltansicht* of all the authors which I have barely more than acknowledged that we must distinguish more sharply than is conventional between the assignment of constitutional powers on the one hand and the distribution, in dollars, of activities (spending, regulating and collecting revenues) on the other. In other words, we must distinguish between the degree of centralization of powers and the degree of centralization of activities. To entrench this distinction, I will retain the word *centralization* for the first phenomenon and use *concentration* — as did Peacock and Wiseman (1967) — for the second. Concentration and centralization are obviously related, but, I will suggest, not in the way we usually suppose.

Second, we should avoid making the assumption that the division of powers determines or preordains the division of activities between jurisdictional levels. As we will see, the division of powers and the division of activities are related, but the idea of unidirectional causation should be jettisoned. I hope to show later that abandoning this idea is not only intellectually liberating, but is a necessary first step for an understanding of the actual evolution of constitutional arrangements. Third and last, when trying to discover long-term trends it is important to avoid violating the elementary precept — derived from the idea of equilibrium or scarcity — which stipulates that one should look for balancing forces. It is true that a balance of forces can trend toward, let us say, more centralization, but that is not foreordained as it is when compensating and countervailing factors are disregarded. If, for example, Tocqueville and Bryce, in trying to ascertain the future, had made use of the same judicious balancing of forces that characterizes the rest of their work, they would not, I believe, have seen a necessary trend toward centralization. They would, of course, rank lower in the citation index, but their prognostications would have been better.

WORKING ASSUMPTIONS ABOUT DEMAND AND CONSTITUTIONAL ARRANGEMENTS

I have just noted that we must distinguish between centralization and concentration. But as will become apparent, we must further distinguish between *expenditure* and *revenue* concentration. The first pertains to the share of total public expenditures on goods and services,⁶ including in principle, regulatory expenditures, undertaken by governments at every jurisdictional level. For reasons that should become clear later, intergovernmental grants should be treated as expenditures only when they are used to purchase goods and services; grants from the central government to the provinces are not, therefore, to be counted as expenditures of the first, but of the second tier of government, assuming that the grants are all spent on goods and services at that level.

Revenue concentration relates to the share of total revenues from taxation, user fees, grants, sales of assets and borrowings collected by governments at every jurisdictional level. As we will see later on, the degree of revenue concentration and that of expenditure concentration will, in general, be different. Still, in discussing certain problems, it is possible without creating confusion, to dispense with the qualifying epithets and refer to concentration alone. I will do this whenever the context permits.

In my Presidential Address to the Canadian Economics Association last June,⁷ I discussed the age-old problem of the growth of governments. I proposed a model in which the demand for goods and services — those supplied by governments, but also those provided by other types of institutions — depends on relative prices inclusive of transaction and welfare costs, and on incomes and preferences. I also assumed that consuming households are indifferent about the source or provenance of the goods and services they want to consume. As a consequence, they choose to procure the goods and services they demand from the source or the sources that offer them the best terms and conditions.

I went on to argue that the supply side is constituted of a number of competing institutions whose success as effective suppliers depends on their comparative advantage. I identified, as much to illustrate as for historical relevance, five different types of suppliers: families, voluntary not-for-profit institutions, co-operatives, business enterprises and governments. I suggested that the determinants of each one's comparative advantage were factors such as differential productivity growth and differential economies of scale, but I mostly stressed the relative capacity of each institution to control free-riding and its relative ability to reduce the welfare costs of the sums that have to be collected to pay for the goods and services demanded by the public.

In this lecture, I will seek to demonstrate that one can explain the degree of concentration of governmental systems and variations in that measure over societies and over time by simply extending the model I have just sketched.

Such an extension is, in fact, a basic logical requirement. That is easy to see. If the model which I have proposed to explain the growth of governments could not be extended to account for changes in the degree of concentration, something would be profoundly wrong. Indeed, the second problem pertains to the organization of governmental systems as suppliers of goods and services, while the first relates to the organization of all establishments, including governments, as suppliers of goods and services, so that the two problems relate to the same fundamental matter.

I will, therefore, assume, as I did in my Presidential Address that the people of a country have a demand for goods and services and that that demand depends on properly specified relative prices, incomes and preferences. Though one should not divide demand functions into a sub-set that belongs to publicly supplied goods and services and another that pertains to privately provided goods and services, it will simplify the presentation if I do assume separability and if I restrict myself to the first sub-set of demand functions. Generalizing the analysis to incorporate the second kind of demand is straightforward.

I will also assume that people are indifferent about supply sources. They do not care, in other words, if a particular good or a particular service is supplied by the central government, or by governments located at the regional, provincial, or communal level to illustrate with the nomenclature of the governmental system of Italy. This assumption, by the way, is related to, but is not the same as that made by James Buchanan and Gordon Tullock (1962), by Geoffrey Brennan and James Buchanan (1980) and by others who divide decision-making in two stages: a first one called "constitutional" when such matters as the number of jurisdictional levels and the assignment of powers to these levels are decided upon and a second, labelled "in-period", when day-to-day policy decisions regarding the supply of goods and services are made.

The general practice in these "contractarian" models is to assume that people have preferences for constitutional matters — for some degree of centralization of governmental systems, let us say. That assumption is essential to these models because "constitutional" decisions are assumed to always precede "in-period" decisions. As the later discussion will make clear, I do not conceive of the world in that way, and, therefore, do not need this assumption. But, like the "contractarians", I wish to keep "constitutional" and "in-period" matters separate. I, therefore need an assumption about the influence of the division of powers or of the degree of centralization on the degree of concentration.

Until I introduce the division of powers and centralization into the picture, I will assume that governments are not prevented by constitutional provisions or by other legal restrictions from supplying any good or service. This means that there is no *de jure* or *de facto* division of powers. When the time comes to drop this assumption, we will discover that though the division of powers has an

influence on the equilibrium degree of concentration of governmental systems, it does not work itself out in the way we generally imagine.

CONCENTRATION AND COMPARATIVE ADVANTAGE

Given these assumptions about consuming citizens and about constitutional arrangements, what will determine the degree of concentration of governmental systems? It should be clear that even though a demand for publicly supplied goods and services is assumed to exist, the assumptions that citizens are indifferent about supply sources and that there is no division of powers between governmental tiers mean that it cannot be factors associated with demand that shape the degree of concentration. We must, therefore, turn our attention to the supply side. The first thing to recognize when we do so is that governments at different jurisdictional levels compete with each other. They are engaged in what we may call vertical competition that we should distinguish from intra-tier or horizontal competition. I will describe later the *modus operandi* of that kind of competition. Let me simply note here that successful competition is a reflection of comparative advantage. I, therefore, turn my attention to a discussion of some of the factors that help determine that phenomenon.

I will adopt the strategy I followed in discussing the growth of governments and focus on only two determinants of comparative advantage: i) the differential capacity of governments at different levels to control free-riding; and ii) their differential abilities to reduce the welfare cost of the revenues that have to be collected to pay for the goods and services supplied. I will look at each of these in turn.

i) Free-Riding

Many circumstances act as inducements to free-ride. Among them one can mention the supply of public goods, namely goods like national defence or television signals which can be consumed irrespective of whether one pays for them or not. The removal of negative externalities, as happens when the ambient atmosphere is cleansed, is also an incentive to free-ride since clean air can be "consumed" by all people in a given airshed whether one has contributed to cleaning it or not. The recipients of income redistribution have an incentive to free-ride by, let us say, reducing the amount of work they do. Institutions such as academic tenure which are beneficial in many ways, also act as an inducement to free-ride, that is to work less. To put it differently, free-riding means sharing in the benefits of a good or service without a corresponding participation in its costs.

There are many ways of controlling free-riding (see Breton, 1989) and, depending on circumstances, governments make use of most or all of these. However, in what follows, I will consider only factors that relate to tax

enforcement. Buchanan (1967, especially pp. 117-121) has shown that if tax rates and tax bases are given and, one must add, if enforcement is perfect, free-riding will not exist. Buchanan was concerned with the role and importance of constitutional rules and, for that purpose, his argument is compelling that if taxes *must* be paid then free-riding cannot occur. However, to analyse what determines the degree of concentration of governmental systems — as well as virtually all, if not all, problems concerned with public or collective choices — we must examine free-riding and its relationship to tax enforcement in more detail.

Standard public finance discussion of tax administration distinguishes between enforcement and compliance. The first is assumed to be a governmental function and the second to reflect the behaviour of taxpayers. These can pay the amount of taxes they owe or they can avoid and/or evade paying all or part of these sums. Avoidance is legal while evasion is illegal. Enforcement is concerned with evasion. An important theoretical literature — for example, Allingham and Sandmo (1972), Srinivasan (1973), and Sandmo (1981) — has grown on the subject. It tells us that the incidence of evasion falls as the probability of detecting evaders increases — a probability that is assumed to vary directly with the amount of resources allocated to that end — and as penalty rates inflicted on apprehended and convicted evaders are raised. There is also an empirical literature replete with estimates of the size of “underground economies” — for a good survey, see Pommerehne and Frey (1981). The size of these economies is, of course, related to the incidence of tax evasion but, because it is related to many other things as well, there does not appear to be any established connections in the literature between measures of the size of underground economies, detection probabilities (resources allocated to enforcement) and penalty rates.

The standard or conventional approach to enforcement and compliance is very neat and tidy. The law must distinguish between the allocation of resources directed at obtaining favourable readings and interpretations of tax laws and at securing advantageous changes in these laws through political pressure (avoidance), and the allocation of resources directed at bribing tax assessors and/or tax collectors, at laundering funds through tax havens, and/or at concealing incomes, purchases and other flows or stocks that serve as tax bases (evasion). However, it is not clear that the social sciences and, in particular, public choice should make the same distinctions.

The problem has already been perceived. For example, Richard Musgrave (1969), aware that the distinction between avoidance and evasion cannot carry the weight placed on it, distinguishes between taxpayer and “tax collector compliance” (p. 128) and Carl Shoup (1969) distinguishes between “unilateral” and “bilateral evasion” (pp. 427-432) to account for the fact that at the level of tax collection, if not at that of tax legislation, both payers and collectors may

collaborate to "evade" taxes. Serge-Christophe Kolm (1973), in an insightful *obiter dictum*, notes that "it is estimated that one third of the French income tax base fails to be reported", but because most evaders are small and form a majority of the electorate, they are capable of opposing "strong detection, enforcement and penalt[ies]" (p. 270). If one follows the logic which is implicit in the distinctions and insights of Musgrave, Shoup and Kolm, one is led to abandon the legal "compartmentalization" of avoidance and evasion and to recognize that, in terms of behaviour, they are usually either substitutes or complements.⁸ Given that both avoidance and evasion are costly — avoidance requires the use of one's time and/or that of lawyers and accountants, while evasion has an expected cost related to detection probabilities and penalty rates — a rational taxpayer will act in such a way that, for a given volume of free-riding, the marginal rate of substitution between avoidance and evasion is equal to the ratio of their marginal costs.

Avoidance and evasion are not the only vehicles that can be used to reduce the tax burden of publicly provided goods and services while continuing to share in their benefits. Tax exporting is another. When a fraction of the revenues of the government of a given jurisdiction is paid by the residents of another, there is tax exporting. This will happen when, for example, commodities are taxed on an "origin-basis" and sold in another jurisdiction because the firm raises prices charged to persons or firms in other jurisdictions to recoup the tax. More generally, there is tax exporting whenever a tax is incident on people who reside outside the taxing government's jurisdiction. There are some obvious differences between avoidance and evasion on the one hand and tax exporting on the other. One of these is that the first two erode the tax bases in the free-riders' own jurisdiction, while the latter erodes bases outside their jurisdiction.

This is an important fact to keep in mind when analysing tax exporting. (I have used the expression tax exporting in the above discussion because that is the one used in much of the literature on the subject. A no less appropriate term would be tax spillovers.) Indeed, its existence means that the relevant magnitude on which to focus is *net* revenues. Suppose, to illustrate, that there are only two jurisdictions A and B and that the government in A imposes a tax on a particular base whose incidence in B produces a revenue (from B) of X dollars. If B's government also levies a tax which raises Y dollars in A and if $X = Y$, the net amount of tax exporting is zero. There is no free-riding. Jurisdiction A will be tax exporting (revenue importing) only if $X > Y$. Because of this basic interdependence, the volume of net tax exporting (free-riding) in a world of competing jurisdictions will depend on the strategies adopted by taxpayers who act to maximize net out-of-jurisdiction revenues and on the assumptions that are made concerning the conjectures which taxpayers in a jurisdiction make about the successive responses of taxpayers in other jurisdictions in regard to

their actions. It would take me too far afield and would serve no immediate purpose to investigate the properties of an equilibrium assuming, let us say, Cournot-Nash interactions — for interesting analyses based on this assumption see Kolstad and Wolak (1983), Gordon (1983) and Mintz and Tulkens (1984). I simply assume that an equilibrium exists. I further assume that any *tax importing* jurisdiction can displace that equilibrium by allocating resources to that end and that when it does the volume of free-riding is reduced.

The foregoing reasoning can be applied *mutatis mutandis* to benefit spillovers resulting from public goods, externalities or production economies, because these are essentially a mirror image of tax exporting. Benefit spillovers have not, to my knowledge, been explicitly analysed as a mode of free-riding. However, because they are a consequence of the provision of public goods and/or of the removal of some negative externalities, they obviously produce free-riding. In the present context, the free-riding manifests itself in an absence of payment for benefits received.

Given the various modes that can be used to free-ride — avoidance, evasion, tax exporting, spillover benefits and others (such as smuggling) that I have not examined — we must turn our attention to an examination of the factors that determine the equilibrium volume of that activity or, to put it differently to an analysis of the factors that control the benefits and costs of engaging in free-riding. I assume, first, that the marginal benefits (measured in dollars) of free-riding are positive but that they are not related to factors that control the level of enforcement designed to reduce the volume of free-riding and, most importantly, to the degree of revenue concentration.

There are also costs to free-riding. Many factors affect these costs. I have already mentioned the probability that one may be apprehended when avoiding taxes and the penalty rates that will have to be paid if convicted. These detection probabilities and penalty rates may also apply to tax avoidance if that results from (say) bribing officials. I have noted the cost of lawyers and accountants. A number of writers have sought to document empirically that “norms” and what could be broadly called “public morality” are also important, see, for example, Schwartz and Orleans (1967), Vogel (1974), and Spicer and Lundstedt (1976). In what follows, I treat these variables as exogenous. I also assume that the level of intergovernmental coordination is constant or, more precisely, that it is only capable of exogenous changes.

The last variable, namely the level of coordination, has received considerable attention from economists, students of public administration and others. For good discussions and extensive references to the literature, see Thirsk (1980) and Bird (1984 and 1986, Chapter 7) for fiscal measures, and Ostrom, Tiebout and Warren (1961) and Ostrom (1969) for interjurisdictional spillovers. In particular, it has played a central role in the analysis of federalism and, therefore, of the structure of governmental systems, see Breton and Scott

(1978). The phenomenon has, however, seldom, if ever, been analysed as an instrument to control free-riding. That is regrettable because many of the institutional manifestations of fiscal coordination would seem to have little to do with achieving tax "neutrality" — the motivating force in the literature on the subject — but much to do with the control of free-riding. There are, to be sure, institutions such as agreements to assess tax bases — property, for example — by using a common method across jurisdictions that will make the tax system more neutral and also help reduce free-riding. But the use of formulae to apportion corporate income between jurisdictions or the operation of an institution such as the Tax Collection Agreements in Canada can easily make a tax system less neutral, but there can be no doubt about their capacity to restrain free-riding. Still other institutions, such as the joint auditing of accounts and the exchange of information between governments, would seem to be unrelated to neutrality and motivated exclusively by a desire to control free-riding.

Free-riding can also be controlled by increasing the degree of revenue concentration. To understand how this variable operates, we must recognize that it is easier to free-ride the greater the interjurisdictional mobility of tax bases, the greater the difficulty of appraising their sizes, and the greater the ease of obtaining favourable alterations in bases and rates through political pressures. Let me assume and seek to justify that these variables are positively related to the number of jurisdictions.⁹

If capital is mobile, its interjurisdictional mobility will increase as the number of jurisdictions increases. As a consequence, when there are more jurisdictions it is easier to reside in a high benefit jurisdiction and to invest in one in which tax rates on capital income are low. If jurisdictions are numerous and small enough and if labour income is taxed at source, it is again easier to free-ride by living in a high benefit area and working in a low tax one. Similarly for sales — it is easier to purchase goods and services that are taxed at lower rates outside the jurisdiction of residence. In addition, a large number of jurisdictions increases the incidence of multi-jurisdictional enterprises and, therefore, increases the capacity to shift profits between jurisdictions through the use of "transfer pricing". Finally, the larger the number of jurisdictions, the greater will be the interjurisdictional flow of goods, services and factors, and the greater will be the ability to export taxes and to enjoy unpaid benefit spillovers.

When the number of jurisdictions is large, the number of taxpayers who will earn income and other taxable benefits in a multiplicity of jurisdictions will be larger, thus complicating the "reporting" problem; that is, the problem of ascertaining the size of the tax bases. That too will make free-riding easier. There is finally the matter of political pressures. It is sometimes said, see, for example, Tullock (1969b, p. 21) and Rosen (1985, p. 511), that local govern-

ments are more responsive to the demands of their peoples than more senior governments. If the proposition contains any truth, it must mean that politicians and bureaucrats at the local level allow more free-riding than politicians and bureaucrats at higher jurisdictional levels. Indeed, to the extent that the effectiveness of political pressures depends on trust and on interpersonal relations,¹⁰ we expect that the larger the number of jurisdictions and, therefore, the smaller their size, the greater will be the trust and the stronger the interpersonal relations. That will facilitate free-riding. The point is not that free-riding resulting from political pressures is confined to jurisdictional levels with a large number of small jurisdictions, but that for any particular tax base there is more free-riding when the number of jurisdictions is large than when it is small.

The most important implication of the foregoing discussion is that a *ceteris paribus* increase in the degree of revenue concentration will reduce the volume of free-riding, because revenue concentration increases its costs. In other words, more senior governments have a comparative advantage over more junior ones in controlling free-riding and, therefore, in collecting revenues.

ii) Welfare Costs

What is the welfare cost of a tax of 10 per cent levied on (let us say) commodity X? The conventional answer, which can be found in any Public Finance textbook, is that in addition to the direct burden of the sum which the taxpayer sends to the Exchequer, he or she suffers an additional reduction in utility or welfare derived from X, because of the "forced" substitution away from X which the tax causes. It is important to note that in addition to the factors stressed in these textbooks — the height of tax rates, the nature of tax bases (commodity X or Y or income), the ease of substituting away from these bases and the size and distribution of "prior distortions" — the size of the welfare costs associated with a particular tax also depends on whether that tax is perceived by consuming citizens as the tax-price of some of the goods and services provided by governments and, if it is perceived in that way, on the exact strength of the link between those tax-prices and the quantities of the goods or services provided — a link which economists sometimes call the "Wicksellian" connection between tax-prices and quantities (Wicksell, 1896). The textbooks on the subject generally assume, though tacitly, that taxes are not tax-prices — they assume a behavioural separation between government revenues and expenditures — so that the only link between public incomes and outlays is an accounting or bookkeeping one.

It is, therefore, very important to know if there is a behavioural relationship of some kind between taxation and expenditures. I have summarized much of the more relevant theoretical and empirical literature in my Presidential Address and concluded that a behavioural connection must be presumed to exist. I will make the same assumption here, but explicitly recognize that the connection

can be stronger or weaker. In fact, I will devote the first part of the following discussion to an analysis of the factors that are likely to make the connection stronger or weaker and the second part to an examination of the operation of these factors at different jurisdictional levels.

To proceed, I will assume that the Wicksellian connection is stronger and the welfare cost of public supply accordingly lower: i) the more homogeneous the preferences of citizens living in a given jurisdiction; ii) the less the extent of "bundling" of goods and services (defined below); and iii) the more vigorous the competition between governments. Let me look at each of these in turn.

Welfare costs arise when the quantity supplied of a good or service is greater or smaller than the quantity that is desired at the ruling tax-price. To avoid welfare costs when the preferences of people differ markedly, it is necessary to supply a variety of quantities simply to match the amounts desired by each sub-set of more or less identical consuming citizens. That may be difficult to achieve especially if the goods or services supplied are significantly public in a technical sense or if decisions are based on majority rule and the outcome determined by a median voter, see Tullock (1969a). When preferences are homogeneous, it is as if the jurisdiction was made up of only one person. Choosing a volume of output that matches the quantity desired by that person is easier. We can, therefore, be confident that the more homogeneous the preferences of people in a jurisdiction, the lower the welfare costs of public supply.

Bundling is the provision in a package of a number of goods and services on a take-it or leave-it basis. Yoram Barzel (1969) has shown that it imposes welfare costs on consuming citizens. Qualitatively the argument is the same as for heterogeneous preferences: goods and services that are evaluated differently are lumped together and provided at a single tax-price. Total or partial unbundling makes it possible for each good or service previously in the bundle to be supplied in amounts that more closely approximate the quantities desired by citizens and, therefore, leads to lower welfare costs of public supply.

Finally, intergovernmental competition will reduce the welfare cost of public supply. There are two mechanisms in the literature that are associated with that kind of competition. One, which derives from Charles Tiebout's (1956) model of local public goods, relies on the interjurisdictional mobility of citizens. The other, due to Pierre Salmon (1987), is based on the idea, adapted from the theory of rank-order tournaments developed by Edward Lazear and Sherwin Rosen (1981), that the citizens of a jurisdiction can use the actions of governments outside their jurisdiction to evaluate the performance and eventually decide on the fate of the government of their own jurisdiction.

The Tiebout and the Salmon competitions will both lead to a better match between quantities desired and quantities provided and, therefore, to lower welfare costs. The Tiebout mechanism does this by assuming either that people

move to the bundles of goods and services that best satisfy their preferences or that those politicians who seek to attract people to their jurisdiction do so by offering bundles of goods and services that people most desire. The Salmon mechanism achieves the same end by reinforcing electoral competition.

How should we expect these different factors — the degree of homogeneity of consumer preferences, the incidence of bundling, and the strength of intergovernmental competition — to operate at different jurisdictional levels? The generally accepted proposition is that the variance in the distribution of preferences is smaller, the extent of bundling less, and the strength of intergovernmental competition greater at more junior levels of government. As a consequence, the welfare costs of public supply rise as the degree of expenditure concentration increases. To put it differently, the more junior governments have a comparative advantage when it comes to reducing welfare costs.

REVENUE AND EXPENDITURE CONCENTRATION

We conclude from all this that, as the concentration of revenues and expenditures become greater, first, free-riding will fall and, at given tax rates, more revenues will be collected and, second, the welfare costs of public supply will increase. The equilibrium value of these two variables are, however, determined separately. I am assuming that demand and, therefore, expenditures are exogenously given. In equilibrium, revenues have to be equal to these pre-set expenditures. If the level of intergovernmental coordination, detection probabilities, penalty rates, the mobility of tax bases and all the other factors that affect the cost of free-riding are held constant, the degree of revenue concentration will have to be set at a level which insures that the required revenues are collected. The equilibrium degree of expenditure concentration, in turn, is the one which insures that *ceteris paribus* the marginal welfare costs of public and of private supply are equal.¹¹

Revenue concentration will, in general, not be equal to expenditure concentration. Though either one can be larger than the other, let me assume, to save time and because that is the most common real world situation, that revenue concentration is larger than expenditure concentration. This implies that intergovernmental grants which flow from the top down are an integral part of the organization of governmental systems. In other words, vertical fiscal imbalance or fiscal dependence will be a characteristic of an equilibrium structure in many governmental systems.

Should we think of these grants as conditional or unconditional? Though they are payments in lieu of tax revenues and, therefore, designed to match these revenues dollar for dollar, should we expect the welfare cost of public supply to be the same when financed by intergovernmental grants as it is when financed by taxes? Let me answer these two questions in sequence.

Before doing so, I must, however, insist that these grants, which we may call revenue grants, will seldom add up to the total flow of grants in real world governmental systems. As I have argued elsewhere some grants are also needed to stabilize horizontal intergovernmental competition. These later grants, which we may call stabilizing grants, must be strictly unconditional. Revenue and stabilizing grants, however, do add up to the total flow of intergovernmental grants in any governmental system.¹²

Though useful for some purposes, the notions of conditional and unconditional which we often use to qualify grants do not always correspond to much that is important in the real world. See, for example, Strick (1971), Bella (1979) and Chernick (1979). This is particularly true of conditional grants because these are always "negotiated" or "contractual" grants. As a consequence, the "authoritarian" model of intergovernmental grants (see any Public Finance textbook) which conceives of conditional grants as the outcome of a process in which a senior government transfers funds if and only if certain conditions unilaterally set by the transferor are met by the transferees is largely invalid. In that sense the revenue grants that derive from the present analysis are not conditional grants. They are, however, the outcome of contractual arrangements according to which a government collects revenue for others. These arrangements necessarily contain agreed-upon provisions and conditions that both parties must meet. In that sense they are conditional grants.

Under certain circumstances an income tax can be interpreted as a benefit tax, see, for example, Musgrave (1959) and Buchanan (1964). Even under these circumstances, it is recognized, however, that an income tax departs more significantly from the benefit principle — the principle which requires that taxpayers make tax payments that reflect their demand for publicly supplied goods and services — than does, let us say, a user charge. In the language of this lecture, the welfare cost of public supply associated with the income tax is larger than that related to the user charges, because the Wicksellian link between quantities and tax-prices is weaker for the first mode of payment than for the second.

As a general rule we should expect the strength of the Wicksellian connection and, therefore, the size of welfare costs to vary from one revenue base to another. That holds for grants also. It will never be possible to rank revenue bases according to the welfare loss associated with each simply because that magnitude depends on the distributions of incomes and preferences as well as on the characteristics of the revenue bases. It would seem reasonable to assume, however, that the Wicksellian link between quantities and revenue grants (conceived as tax-prices) would be weaker and welfare costs accordingly larger than the link between quantities and any taxes that, to control free-riding, these grants were replacing. This implies that as the gap between expenditure and

revenue concentration increases the welfare costs of public supply would also increase.

We must now turn our attention to the forces that produce an equilibrium of revenue and expenditure concentration and more precisely that move the system from one equilibrium to another. The idea is not to provide an explicit dynamic, but because the present exercise is one in positive analysis we cannot presume that a benevolent dictator, an "ethical observer", or even a Breton-Scott (1978) cost-minimizing "constituent assembly" exists to perform those tasks.

What then moves a governmental system from one equilibrium point to another? To answer this question assume that there is an exogenous reduction in the unit cost of coordination and recall that the present analysis is conducted under the (temporary) assumption that there are no *de jure* or *de facto* constitutional provisions limiting the behaviour of actual or potential political entrepreneurs. Under such circumstances, a fall in the cost of coordination will act as an incentive for governments at lower tiers to engage in more coordination. This will make it possible for them to collect more of their own revenues and, therefore, to reduce their dependence on revenue grants. That, in turn, will reduce the degree of revenue concentration and the gap between revenue and expenditure concentration. The reduced gap will cause a fall in the welfare cost of public supply and, as a consequence, in the tax-prices of publicly provided goods and services.

The response to a reduction in the cost of coordination is, therefore, caused by the possibility it gives to political entrepreneurs in governments located at lower jurisdictional levels to reduce the welfare costs of supplying some goods and services and, thereby, attract the support of citizens. If these entrepreneurs neglected to exploit the possibility offered by this exogenous change in the cost of coordination — or by any other — other political entrepreneurs would appear to take advantage of the opportunity.

The force which moves a governmental system from one concentration equilibrium to another is, therefore, intergovernmental competition. Actual and potential political entrepreneurs are led to engage in that competition because citizens are assumed to "give" their support to those entrepreneurs who provide them with the lowest cost goods and services. Competition is, then, a requirement of survival. It follows that the revenue grants that flow through governmental systems are also the product of competition.

It is time to recognize a formal division of powers. The literature on the subject assumes that when a division is known so is the distribution of spending, regulating and revenue collection activities between governmental tiers. Indeed, in that literature, the division of powers is presumed to control the distribution of activities so completely that one need be preoccupied with the latter only as a measure of what is happening to the former.

Such a view is untenable essentially because there is often no relationship between the authority conferred by a constitutional power and the sums that can be spent (or collected in taxes) under that authority. At the same time, we must recognize that the division of powers together with other constitutional provisions do sometimes constrain — John Whyte's (1985) words are "condition..., restrict... or frustrate..." (p. 29) — the expenditure, regulatory and revenue raising activities of governments. How can these two "realities" be reconciled? I can do no more, in this already long lecture, than sketch an answer.

I start with the assumption that "in the beginning", before the appearance of any constitution and, therefore, of any division of powers, competition between governments has produced a distribution of activities between jurisdictional levels resulting in an equilibrium degree of revenue and expenditure concentration. During this "initial" period, we can presume that rules exist to insure that competition is efficient, but there is no division of powers to restrict or frustrate its operation. I now assume that in a second period the country we are looking at is invaded by constitutional experts who, after having deciphered the distribution of activities reflected in the equilibrium degree of revenue and expenditure concentration and in the flows of revenue grants determined during the initial period, proceed to codify all of this in a "constitution". These experts, I should insist, do not undertake such a codification because that is what they have been trained to do or because it is lucrative to do so, but because suppliers and demanders are willing to pay for the "property rights" which the constitution provides.¹³ In the process I am describing, the distribution of activities *precedes* the division of powers and, as I will stress immediately, "determines" it. I suggest that this is the frame of reference that we should use when reading Bryce, Bélanger, and Simeon, even Tocqueville and Laski.

We must, I believe, agree with Whyte (1985) that "[c]onstitutions are ethical documents..." (p. 33). That will even be true of the limited constitution drawn up during the second period of the model I am outlining, because constitutional experts will not read the equilibrium distribution of activities determined in the "initial" period in the same way, will anticipate different future disturbances, and will be differently risk averse with respect to these disturbances. Constitutional experts, in other words, will generally have different interests and they surely cannot be placed, in Rawlsian (1971) fashion, "behind a veil of ignorance" (p. 136). As a consequence, the constitution of period two could be, in the language of Bryce (1911) and his followers, either "flexible" — more easily amendable — or "rigid". It will be recalled that for these scholars flexible and rigid constitutions are those of unitary and federal states respectively. I will return to this distinction in a moment.

In the meantime, let us assume that in a third period there is an exogenous shock which leads to a change in the equilibrium degree of concentration established in the "initial" period. Should we expect this change to produce a

corresponding change in the degree of centralization? The answer depends on the nature of the disturbance. Suppose, to illustrate, that the constitution drafted during the second period assigns the authority over education to the provinces. An exogenous shock that called for an increase in expenditures on education might or might not call for a change in the constitution. If the increase in expenditures was large, the need for more revenues could lead to a further concentration of revenue collection and to a larger flow of revenue grants to the provinces — two adjustments which, in all likelihood, would be possible within the framework of the existing second period constitution. However, if the greater concentration of revenue collection generated very much larger welfare costs, the greater concentration of expenditures on education that would be needed to keep these costs in check may not be feasible within the existing constitution.

The necessary constitutional change or re-interpretation of the relevant constitutional clauses is likely to require considerable time and to be marked by debate, struggle, experimentation and mistakes. Constitutional experts in governments, in courts and in the public will be involved. During the period over which what is, in effect, an evolutionary process, the constitution drafted in period two will have a real constraining effect on changes in the degree of concentration. Eventually, however, one expects the constitution to be amended or re-interpreted and, in period four (say), a new equilibrium degree of concentration and centralization to be reached which incorporates the adjustments demanded by the external shock of the third period and by the second period constitution. A new shock in a fourth period would start the process anew.¹⁴ If this is true, it follows that the division of powers is determined, at one remove, by the "blind" force of intergovernmental competition. No teleological goals guide the process and no "veil of ignorance" or other similar essentially arbitrary constructions are needed to insure that the system responds to changing circumstances.

Lord Bryce and the others who use the distinction between flexible and rigid constitutions have argued that adjustment to external events is more rapid in unitary than in federal states. I suggest that this is not always the case. Instead, I would conjecture that the constitutions of unitary states are more flexible — adjustment more rapid — when external disturbances call for more centralization, but that when external shocks require less centralization it is the constitutions of federal states that are more flexible.

CONCLUSION

By way of conclusion, let me return to the Tocqueville-Bryce-Popitz-Laski view which predicts ever greater centralization of governmental systems and the eventual disappearance of federalism. In inviting me to present this 1989

MacGregor Lecture, Principal Smith suggested that I could reflect on the challenge posed to intergovernmental relations by "the increasingly globally interdependent economy". What can the model adumbrated earlier say on this enormously broad subject?

A globalization of economic, political and social activities and relations has, without doubt, been taking place. Indeed, this phenomenon which began during the Renaissance and has consequently been in operation for more than half a millennium, has, everyone seems to think, been accelerating during the last decades. However that may be, we will all agree, I am sure, that there are many more multinational enterprises today than there were a quarter of a century ago, that international trade in final and especially in intermediate commodities is freer and the flows larger than they were, that the international mobility of capital is much greater than it was, and that competition between the national governments of "advanced" countries is not only intense, but more pronounced than it was.

Whether one applauds this trend or not, it must be recognized that one of its consequences is a secular *ceteris paribus* reduction in the cost of free-riding and, therefore, an increase in its incidence. The evidence seems to support that this is effectively what is happening (Bird, 1988). The *ceteris paribus* is important because the trend has led to developments that, though modest (again Bird, 1988), are designed to counter its effects. Furthermore, the large array of reform proposals which currently nourish national and international debate on the subject may, one day, lead to greater international coordination of tax policy. However, experience tells us that such coordination is costly. The increasing pressures of globalization may, therefore, lead competitive governments to search for alternative instruments.

The model I have proposed earlier tells us that revenue concentration is one such instrument. Is it possible that one of the real pressures toward the formation of entities like the European Community and other similar blocks is the need to forestall free-riding? In other words, given that the demand for goods and services as a whole is income elastic and given that the comparative advantage of the private sector — of families, not-for-profit bodies, cooperatives and businesses — in supplying the goods and services that induce free-riding is not likely to improve dramatically in the near future, is it possible that the need for revenues will drive the governments of Europe (for example) to create a higher revenue collecting tier of jurisdiction? One, of course, cannot be absolutely certain, but I would suggest that if genuine coordination cannot be achieved, the pressures to federalize will increase.

In any case, I would suggest that the necessity of controlling free-riding and, therefore, the need for revenues is a more powerful explanation of the current drive toward the New Europe of 1992 and beyond than is the explanation based on the gains from increased trade. One of the reasons for thinking this is that

President François Mitterand, a certified socialist and a son of the same France which proclaimed that Europe would only be a "Europe des patries" is now one of the moving forces behind the new Europe of 1992, while Prime Minister Margaret Thatcher, who is not a socialist and who heads the party that dragged the United Kingdom into Europe is, to put it mildly, a reluctant participant in the enterprise. Mitterand would not, I suggest, be inclined to fight very hard for incremental trade gains, while Thatcher would, but he would for larger public revenues, while she would not.

Revenue concentration may not, of course, do anything more than produce larger revenues. However, recall that an increase in that variable would, for unchanging degrees of expenditure concentration, increase the welfare costs of public supply. One way of countering this effect is to concentrate expenditures. If this were to happen, one should expect to observe within a relatively short time — a generation perhaps — an assignment of expenditure powers to the "new" central tier of government in Strasbourg, together with revenue collection powers and, of course, payments of revenue grants by Strasbourg to London, Paris, Rome and to the other "state" governments of the Community. However that may be, it is hard for me to believe, as did Laski, that federalism is obsolete.

Notes

1. These are Birmingham, Leeds, Liverpool, Manchester, Newcastle and Sheffield.
2. Prior to 1986, the year Prime Minister Thatcher's government suppressed the Greater London Council and the six Metropolitan county governments, these seven areas had three levels of elected governments. (The G.L.C. and the Metropolitan county councils, were, indeed, liquidated because the population kept returning Labour Party members to the governing councils at each election). Since 1986, London and the other six metropolitan areas have had only two levels of government.
3. Popitz's writings are in German and, as far as I know, untranslated. I have, therefore, only had indirect access to his thoughts through Emilio Gerelli's (1966) and Horst Hanusch's (1978) papers.
4. Elsewhere Bird (1985) writes: "One reason I do not find centralization, dependence, or balance, however defined, to be useful in dealing with federal finance is because these concepts do not distinguish among federal countries in accord with my *intuitive notion* of their degree of federalism" (p. 158, italics added).
5. The expression is from Donald Smiley (1967, p. 47).
6. Funds expended on unemployment insurance, old age pensions, day care, convalescent hospitals, single mothers, families with dependent children

- and the host of other programs of that sort which are often called transfers are, here, treated as expenditures on services.
7. See Breton (1989).
 8. See Cross and Shaw (1981) for a suggestive discussion of the adjustments that are possible when evasion and avoidance are treated as substitutes and complements.
 9. I need not insist that the degree of mobility, the problems of correctly assessing bases and the susceptibility to political pressures will vary from tax base to tax base.
 10. Even if political influence is assumed to be proportional to the volume of resources invested in political pressure, it is still true that the exchange must be enforced. That is the role of trust and of interpersonal relations.
 11. Governments do not only compete with each other. In my Presidential Address, I have argued that as regards the supply of goods and services which induce free-riding they also compete with families, churches, not-for-profit organizations and business corporations. Because of the necessity to control free-riding, the supply which originates with these "private" bodies is also characterized by welfare costs. Equilibrium obtains when these are equalized at the margin.
 12. In a competitive system of government, intergovernmental grants for strictly redistributive purposes cannot exist for the simple reason that these grants are dominated, in terms of redistributive efficiency, by interpersonal grants.
 13. I am now focusing only on the division of powers and on the degree of centralization. Property rights "regulating" intergovernmental competition go much beyond these phenomena. The literature on "intrastate" federalism is particularly relevant here. See, for example, Smiley and Watts (1985).
 14. The changing interpretation placed on section 91(2) of the Canadian Constitution, as described in Whyte (1985), for example, could be analysed, I suggest, within an evolutionary process such as the one alluded to in the text.

References

- Allingham, M.G. and A. Sandmo (1972) "Income Tax Evasion: A Theoretical Analysis", *Journal of Public Economics*, 1, no. 3/4 (November) 323-338.
- Barzel, Y. (1969) "Two Propositions on the Optimum Level of Producing Collective Loads", *Public Choice*, 6 (Spring), 31-37.
- Bélanger, G. (1985) "The Division of Powers in a Federal System: A Review of the Economic Literature, with Applications to Canada" in R. Simeon (ed.),

- Division of Powers and Public Policy*, University of Toronto Press, Toronto, 1-27.
- Bella, L. (1979) "The Provincial Role in the Canadian Welfare State: The Influence of Provincial Social Policy Initiatives on the Design of the Canada Assistance Plan", *Canadian Public Administration*, 22, no. 3 (Fall), 439-452.
- Bird, R.M. (1979) *Financing Canadian Government: A Quantitative Overview*, Canadian Tax Foundation, Toronto.
- _____ (1984) "Tax Harmonization and Federal Finance: A Perspective on Recent Canadian Discussion", *Canadian Public Policy*, 10, no. 3 (September) 253-266.
- _____ (1985) "Federal Finance in Comparative Perspective" in T.J. Courchene, D.W. Conklin and G.C.A. Cook (eds.), *Ottawa and the Provinces*, Ontario Economic Council, Toronto, I, 137-177.
- _____ (1986) *Federal Finance in Comparative Perspective*, Canadian Tax Foundation, Toronto.
- _____ (July 1988) "Shaping a New International Tax Order", *Bulletin of the International Bureau of Fiscal Documentation*, 292-303.
- Brennan, G. and J.M. Buchanan (1980) *The Power to Tax. Analytical Foundations of a Fiscal Constitution*, Cambridge University Press, New York.
- Breton, A. (1989) "The Growth of Competitive Governments", *Canadian Journal of Economics*, 22, no. 4 (November), 717-749.
- Breton, A. and A. Scott (1978) *The Economic Constitution of Federal States*, University of Toronto Press, Toronto.
- Bryce, J. (1911) *The American Commonwealth*, Macmillan, New York.
- Buchanan, J.M. (1964) "Fiscal Institutions and Efficiency in Collective Outlays", *American Economic Review*, 54, no. 3 (May), 227-235.
- _____ (1967) *Public Finance in Democratic Process. Fiscal Institutions and Individual Choice*, University of North Carolina Press, Chapel Hill.
- Buchanan, J.M. and G. Tullock (1962) *The Calculus of Consent*, University of Michigan Press, Ann Arbor.
- Chernick, H. (1979) "The Economics of Bureaucratic Behavior: An Application to the Allocation of Federal Project Grants" in P.M. Mieszkowski and W.H. Oakland (eds.), *Fiscal Federalism and Grants-in-Aid*, Urban Institute, Washington.
- Cross, R.B. and G.K. Shaw (1981) "The Evasion-Avoidance Choice: A Suggested Approach", *National Tax Journal*, 34, no. 4 (December), 489-491.
- Davies, D.G. (1970) "The Concentration Process and the Growing Importance of Noncentral Governments in Federal States", *Public Policy*, 18 (Fall), 649-657.
- de Tocqueville, A. (1969) *Democracy in America*, Translated by George Laurence, Doubleday, Garden City, N.Y.

- Dicey, A.V. (1962) *Introduction to the Study of the Law of the Constitution* (10th edition), St. Martin's Press, New York.
- Elazar, D.J. (1987) *Exploring Federalism*, University of Alabama Press, Tuscaloosa, AL.
- Gerelli, E. (1966) "Intergovernmental Financial Relations: The Case of the German Federal Republic", *Weltwirtschaftliches Archiv*, 97, no. 2, 273-302.
- Gordon, R.H. (1983) "An Optimal Taxation Approach to Fiscal Federalism", *Quarterly Journal of Economics*, 98, no. 4 (November), 567-586.
- Hanusch, H. (1978) "Tendencies in Fiscal Federalism" in H.C. Recktenwald, *Secular Trends of the Public Sector*, IIPF, Cujas, Paris, 129-149.
- Kolm, S.-Ch. (1973) "A Note on Optimum Tax Evasion", *Journal of Public Economics*, 2, no. 3 (July), 265-270.
- Kolstad, C.D. and F.A. Wolak, Jr. (1983) "Competition in Interregional Taxation: The Case of Western Coal", *Journal of Political Economy*, 91, no. 3 (June), 443-460.
- Laski, H.J. (1939) "The Obsolescence of Federalism", *The New Republic*, 98 (May). Reprinted in A.N. Christensen and E.M. Kirkpatrick (eds.) (1941) *The People, Politics and Politicians*, Holt, New York, 111-117.
- Lazear, E.P. and S. Rosen (1981) "Rank-Order Tournaments as Optimum Labor Contracts", *Journal of Political Economy*, 89, no. 5 (October), 841-864.
- McWhinney, E. (1965) *Comparative Federalism. States' Rights and National Power* (2d edition), University of Toronto Press, Toronto.
- Mintz, J. and H. Tulkens (1984) "Commodity Tax Competition Between Member States of a Federation: Equilibrium and Efficiency", *Louvain-la-Neuve CORE Discussion Paper no. 8427*
- Musgrave, R.A. (1959) *The Theory of Public Finance*, McGraw-Hill, New York.
- _____ (1969) *Fiscal Systems*, Yale University Press, New Haven.
- Oates, W.E. (1972) *Fiscal Federalism*, Harcourt Brace Jovanovich, New York.
- _____ (1978) "The Changing Structure of Intergovernmental Fiscal Relations" in H.C. Recktenwald, (ed.), *Secular Trends of the Public Sector*, Cujas, Paris, 151-160.
- Ostrom, V. (1969) "Operational Federalism: Organization for the Provision of Public Services in the American Federal System", *Public Choice*, 6 (Spring), 1-17.
- Ostrom, V., C.M. Tiebout and R. Warren (1961) "The Organization of Government in Metropolitan Areas: A Theoretical Inquiry", *American Political Science Review*, 55, no. 4 (December), 831-842.
- Peacock, A.T. and J. Wiseman (1967) *The Growth of Public Expenditure in the United Kingdom* (2d edition), Allen and Unwin, London.

- Pommerehne, W.W. (1977) "Quantitative Aspects of Federalism: A Study of Six Countries" in W.E. Oates (ed.), *The Political Economy of Fiscal Federalism*, Heath, Lexington, MA, 275-346.
- Pommerehne, W.W. et B.S. Frey (1981) "Les modes d'évaluation de l'économie occulte", *Futuribles*, 50 (December), 3-32.
- Popitz, J. (1927) "Der Finanzausgleich" in *Handbuch der Finanzwissenschaft*, Tübingen.
- Pryor, F.L. (1968) *Public Expenditures in Communist and Capitalist Nations*, Allen and Unwin, London.
- Rawls, J. (1971) *A Theory of Justice*, Harvard University Press, Cambridge, MA.
- Rosen, H.S. (1985) *Public Finance*, Irwin, Homewood.
- Salmon, P. (1987) "Decentralization as an Incentive Scheme", *Oxford Review of Economic Policy*, 3, no. 2 (Summer), 24-43.
- Sandmo, A. (1981) "Income Tax Evasion, Labour Supply, and the Equity-Efficiency Tradeoff", *Journal of Public Economics*, 16, no. 3 (December), 265-288.
- Schwartz, R. and S. Orleans (1967) "On Legal Sanctions", *University of Chicago Law Review*, 34, no. 2, 274-300.
- Shoup, C.S. (1969) *Public Finance*, Aldine Publishing, Chicago.
- Sidgwick, H. (1919) *The Elements of Politics*, Macmillan, London.
- Simeon, R. (1986) "Considerations on Centralization and Decentralization", *Canadian Public Administration*, 29, no. 3 (Fall), Reprinted in R.D. Olling and M.V. Westmacott (1988) *Perspectives on Canadian Federalism*, Prentice-Hall, Scarborough, Ont, 367-379.
- Smiley, D.V. (1967) *The Canadian Political Nationality*, Methuen, Toronto.
- Smiley, D.V. and R.L. Watts (1985) *Intrastate Federalism in Canada*, University of Toronto Press, Toronto.
- Smith, A. (1937) *An Inquiry into the Nature and Causes of the Wealth of Nations*, Random House, New York.
- Spicer, M.W. and S.B. Lundstedt (1976) "Understanding Tax Evasion", *Public Finance*, 31, no. 2, 295-304.
- Srinivasan, T.N. (1973) "Tax Evasion: A Model", *Journal of Public Economics*, 2, no. 4 (November), 339-346.
- Strick, J.C. (1971) "Conditional Grants and Provincial Government Budgeting", *Canadian Public Administration*, 14, no. 2 (Summer), 217-235.
- Thirsk, W.R. (1980) "Tax Harmonization and its Importance in the Canadian Federation" in R.M. Bird (ed.), *Fiscal Dimensions of Canadian Federalism*, Canadian Tax Foundation, Toronto.
- Tiebout, C.M. (1956) "A Pure Theory of Local Expenditures", *Journal of Political Economy*, 64, no. 5 (October), 416-424.

- Tullock, G. (1969a) "Social Cost and Government Action", *American Economic Review*, 59, no. 2 (May), 189-197.
- _____ (1969b) "Federalism: Problems of Scale", *Public Choice*, 6 (Spring), 19-29.
- Vogel, J. (1974) "Taxation and Public Opinion in Sweden: An Interpretation of Recent Survey Data", *National Tax Journal* 27, no. 4 (December), 499-513.
- Wheare, K.C. (1963) *Federal Government* (4th edition), Oxford University Press, London.
- Whyte, J.D. (1985) "Constitutional Aspects of Economic Development Policy" in R. Simeon (ed.), *Division of Powers and Public Policy*, University of Toronto Press, Toronto, 29-69.
- Wicksell, K. (1896) "A New Principle of Just Taxation", *Finanztheoretische Untersuchungen*, Reprinted in R.A. Musgrave and A.T. Peacock (eds.) (1964) *Classics in the Theory of Public Finance*, Macmillan, London, 72-118.

List of Titles in Print

Institute of Intergovernmental Relations, *Annual Report to the Advisory Council, July, 1989*/Institut des relations intergouvernementales, *Rapport annuel au conseil consultatif, juillet 1989* (charge for postage only).

William M. Chandler and Christian W. Zöllner, *Challenges to Federalism: Policy-Making in Canada and the Federal Republic of Germany*, 1989. (\$25)

Peter M. Leslie, *Rebuilding the Relationship: Quebec and its Confederation Partners*/Une collaboration renouvelée: le Québec et ses partenaires dans la confédération, 1987. (\$8)

A. Paul Pross and Susan McCorquodale, *Economic Resurgence and the Constitutional Agenda: The Case of the East Coast Fisheries*, 1987. (\$10)

Bruce G. Pollard, *Managing the Interface: Intergovernmental Affairs Agencies in Canada*, 1986. (\$12)

Catherine A. Murray, *Managing Diversity: Federal-Provincial Collaboration and the Committee on Extension of Services to Northern and Remote Communities*, 1984. (\$15)

Peter Russell et al, *The Court and the Constitution: Comments on the Supreme Court Reference on Constitutional Amendment*, 1982. (Paper \$5, Cloth \$10)

Allan Tupper, *Public Money in the Private Sector: Industrial Assistance Policy and Canadian Federalism*, 1982. (\$12)

William P. Irvine, *Does Canada Need a New Electoral System?*, 1979. (\$8)

Canada: The State of the Federation

Ronald L. Watts and Douglas M. Brown, editors, *Canada: The State of the Federation*, 1989. (\$16)

Peter M. Leslie and Ronald L. Watts, editors, *Canada: The State of the Federation*, 1987-88. (\$15)

Peter M. Leslie, editor, *Canada: The State of the Federation* 1986. (\$15)

Peter M. Leslie, editor, *Canada: The State of the Federation* 1985. (\$14)

Volumes I, II and III (\$22)

Canada: L'état de la fédération 1985. (\$14)

The Year in Review

Bruce G. Pollard, *The Year in Review 1983: Intergovernmental Relations in Canada*. (\$16)

Revue de l'année 1983: les relations intergouvernementales au Canada. (\$16)
S.M. Dunn, *The Year in Review 1982: Intergovernmental Relations in Canada.* (\$12)

Revue de l'année 1982: les relations intergouvernementales au Canada. (\$12)
S.M. Dunn, *The Year in Review 1981: Intergovernmental Relations in Canada.* (\$10)

R.J. Zukowsky, *Intergovernmental Relations in Canada: The Year in Review 1980, Volume I: Policy and Politics.* (\$8) (Volume II not available)

Research Papers/Notes de Recherche (formerly Discussion Papers)

27. Michael B. Stein, *Canadian Constitutional Renewal, 1968-1981: A Case Study in Integrative Bargaining*, 1989. (\$12.00)
26. Ronald L. Watts, *Executive Federalism: A Comparative Analysis*, 1989. (\$6.00)
25. Denis Robert, *L'ajustement structurel et le fédéralisme canadien: le cas de l'industrie du textile et du vêtement*, 1989. (\$7.50)
24. Peter M. Leslie, *Ethnonationalism in a Federal State: The Case of Canada*, 1988. (\$4)
23. Peter M. Leslie, *National Citizenship and Provincial Communities: A Review of Canadian Fiscal Federalism*, 1988. (\$4)
22. Robert L. Stanfield, *National Political Parties and Regional Diversity*, 1985. (Postage Only)
21. Donald Smiley, *An Elected Senate for Canada? Clues from the Australian Experience*, 1985. (\$8)
20. Nicholas R. Sidor, *Consumer Policy in the Canadian Federal State*, 1984. (\$8)
19. Thomas O. Hueglin, *Federalism and Fragmentation: A Comparative View of Political Accommodation in Canada*, 1984. (\$8)
18. Allan Tupper, *Bill S-31 and the Federalism of State Capitalism*, 1983. (\$7)
17. Reginald Whitaker, *Federalism and Democratic Theory*, 1983. (\$7)
16. Roger Gibbins, *Senate Reform: Moving Towards the Slippery Slope*, 1983. (\$7)
14. John Whyte, *The Constitution and Natural Resource Revenues*, 1982. (\$7)

Reflections/Réflexions

3. Peter M. Leslie, *Federal Leadership in Economic and Social Policy*, 1988. (\$3)
2. Clive Thomson, editor, *Navigating Meech Lake: The 1987 Constitutional Accord*, 1988. (\$4)
1. Allan E. Blakeney, *Canada: Its Framework, Its Foibles, Its Future*, 1988. (\$3)

Dean's Conference on Law and Policy

1. John D. Whyte and Ian Peach (eds.), *Re-forming Canada? The Meaning of the Meech Lake Accord and the Free Trade Agreement for the Canadian State*, 1989. (\$6.00)

Bibliographies

- Bibliography of Canadian and Comparative Federalism*, 1986. (\$20)
- Bibliography of Canadian and Comparative Federalism, 1980-1985*. (\$39)
- Aboriginal Self-Government in Canada: A Bibliography 1986*. (\$7)
- A Supplementary Bibliography*, 1979. (\$5)
- A Supplementary Bibliography*, 1975. (\$10)
- Federalism and Intergovernmental Relations in Australia, Canada, the United States and Other Countries: A Bibliography*, 1967. (\$9)

Aboriginal Peoples and Constitutional Reform

Background Papers

16. Bradford W. Morse, *Providing Land and Resources for Aboriginal Peoples*, 1987. (\$10)
15. Evelyn J. Peters, *Aboriginal Self-Government Arrangements in Canada*, 1987. (\$7)
14. Delia Opekokew, *The Political and Legal Inequities Among Aboriginal Peoples in Canada*, 1987. (\$7)
13. Ian B. Cowie, *Future Issues of Jurisdiction and Coordination Between Aboriginal and Non-Aboriginal Governments*, 1987. (\$7)
12. C.E.S. Franks, *Public Administration Questions Relating to Aboriginal Self-Government*, 1987. (\$10)
11. Richard H. Bartlett, *Subjugation, Self-Management and Self-Government of Aboriginal Lands and Resources in Canada*, 1986. (\$10)
10. Jerry Paquette, *Aboriginal Self-Government and Education in Canada*, 1986. (\$10)
9. Marc Malone, *Financing Aboriginal Self-Government in Canada*, 1986. (\$7)
8. John Weinstein, *Aboriginal Self-Determination Off a Land Base*, 1986. (\$7)
7. David C. Hawkes, *Negotiating Aboriginal Self-Government: Developments Surrounding the 1985 First Ministers' Conference*, 1985. (\$5)
6. Bryan P. Schwartz, *First Principles: Constitutional Reform with Respect to the Aboriginal Peoples of Canada 1982-1984*, 1985. (\$20)
5. Douglas E. Sanders, *Aboriginal Self-Government in the United States*, 1985. (\$12)

4. Bradford Morse, *Aboriginal Self-Government in Australia and Canada*, 1985. (\$12)
3. (not available).
2. David A. Boisvert, *Forms of Aboriginal Self-Government*, 1985. (\$12)
1. Noel Lyon, *Aboriginal Self-Government: Rights of Citizenship and Access to Governmental Services*, 1984. (\$12)

Discussion Papers

David C. Hawkes, *The Search for Accommodation*, 1987. (\$7)

David C. Hawkes, *Aboriginal Self-Government: What Does It Mean?*, 1985. (\$12)

Position Papers

Inuit Committee on National Issues, *Completing Canada: Inuit Approaches to Self-Government*, 1987. (\$7)

Martin Dunn, *Access to Survival, A Perspective on Aboriginal Self-Government for the Constituency of the Native Council of Canada*, 1986. (\$7)

Workshop Reports

David C. Hawkes and Evelyn J. Peters, *Issues in Entrenching Aboriginal Self-Government*, 1987. (\$12)

David C. Hawkes and Evelyn J. Peters, *Implementing Aboriginal Self-Government: Problems and Prospects*, 1986. (\$7)

Bibliography

Evelyn J. Peters, *Aboriginal Self-Government in Canada: A Bibliography 1986*. (\$7)

Final Report

David C. Hawkes, *Aboriginal Peoples and Constitutional Reform: What Have We Learned?*, 1989. (\$7)

Publications may be ordered from:

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

