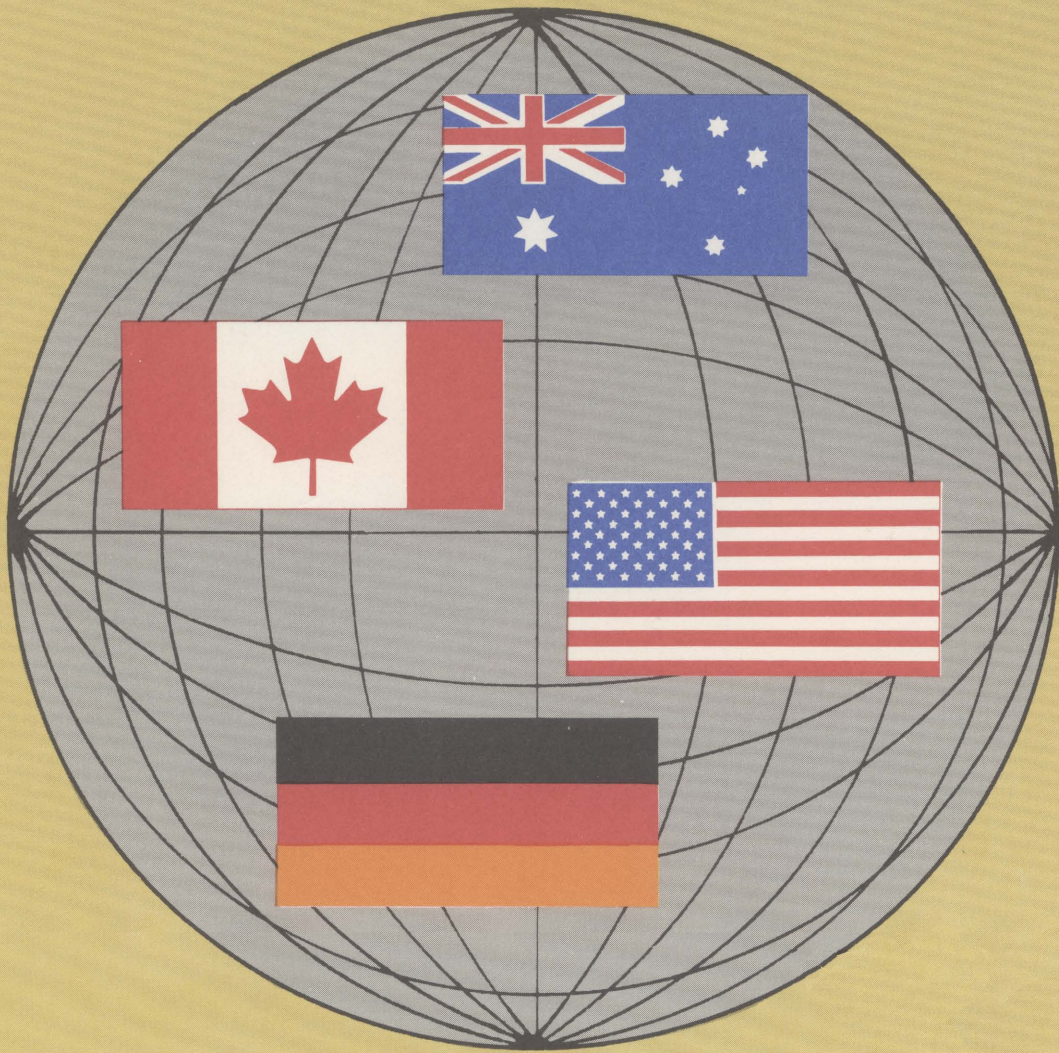


AN INFORMATION REPORT

Studies in Comparative Federalism: Australia, Canada, the United States and West Germany



**ADVISORY
COMMISSION ON
INTERGOVERNMENTAL
RELATIONS**

Washington, D.C. 20575
November 1981



M-130

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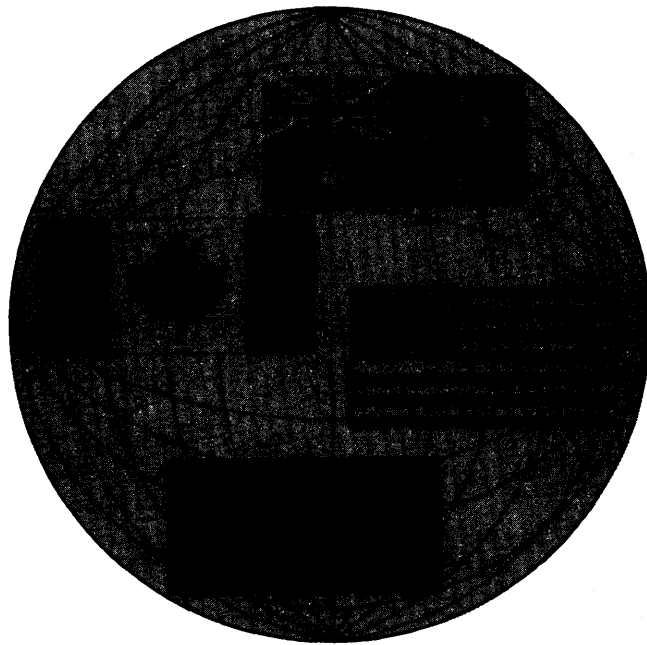
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Preface

In the *State and Local Fiscal Assistance Amendments of 1976* (P.L. 94-488), Congress asked the Advisory Commission on Intergovernmental Relations to study and evaluate "the allocation and coordination of taxing and spending authority between levels of government, including a comparison of other federal government systems." The objective of this research is to determine how federal systems in other industrialized nations have dealt with some of the issues of fiscal federalism that are of current concern in the United States.

To carry out this assignment, four reports have been prepared: individual studies of Canada and West Germany, a selection of readings on the federal system of Australia, and this comparative analysis of fiscal federalism in the U.S. and the other three countries. The comparative analysis of the U.S. and the three other countries draws on the individual studies and examines the relevance of the experience of the other countries for fiscal federalism in the U.S.

One of the conclusions reached is that fiscal federalism in the U.S. is less formally structured, more fragmented, and consequently less neat and orderly than in any of the other three countries. However, the disorderly appearance of the U.S. federal system is a reflection of the heterogeneous and diverse nature of society and government in this country. The study also concludes that while the U.S. could probably profit from adopting some of the more orderly fiscal patterns of Australia, Canada, and West Germany, these three federations might also learn from some of the achievements of the U.S., such as its recent success in strengthening the tax position of the states and the greater fiscal viability and political influence of local governments.

Abraham D. Beame
Chairman

Acknowledgments

The author of this study is Professor Richard H. Leach, Department of Political Science and Director of the Canadian Studies Center at Duke University. L. Richard Gabler is the coauthor of the final chapter. A special debt of gratitude is owed to Douglas H. Clark, Assistant Director of the Federal-Provincial Relations Division, Department of Finance, Government of Canada, and Russell Mathews, Director of the Centre for Research on Federal Financial Relations of the Australian National University, for their careful review of much of the Canadian and Australian content of the study. Of course, what appears here is the responsibility of the author. A debt, too, is owed to the staff of the Perkins and Law School Libraries at Duke University and to numerous colleagues of Prof. Leach who advised and corrected as the study moved along.

At the Advisory Commission on Intergovernmental Relations, the studies of comparative federalism were under the general direction of John Shannon, Assistant Director for Taxation and Finance. Gabler and Susannah E. Calkins were responsible for reviewing and preparing the manuscript for publication. Secretarial tasks were shared by Ruth Philips and Shari Quick.

Wayne F. Anderson
Executive Director

John Shannon
Assistant Director
Taxation and Finance

Contents

Chapter 1 Introduction	1
Chapter 2 The Four Federal Nations in Profile	3
Australia	3
Canada	7
The United States	12
West Germany	19
Chapter 3 Conducting Intergovernmental Relations	25
The United States	25
Intergovernmental Relations and Policymaking	27
Australia	29
Premiers' Conferences	30
Loan Council	31
Grants Commission	32
Canada	33
West Germany	35
The Basic Law	35
The Bundesrat	36
The German Bureaucracy	36
Summary	37
Chapter 4 Tax Revenues	39
The Power to Tax	39
Australia	39
Canada	40
West Germany	40
The United States	42
Revenues	43
National Governments	43
States, Provinces, Laender	44
Local Governments	44
Summary	45
Chapter 5 Intergovernmental Transfers	47
Australia	48
Special Assistance Grants	49
Capital Grants and Approved Borrowing	50
General Revenue Grants	50
Specific Purpose Grants	52
Payments to Local Governments	53
Canada	54
Equalization	56

Stabilizing Provincial Revenues	58
Established Programs Financing	59
Canada Assistance Plan	60
Other Shared-Cost Programs	61
Special Financial Arrangements Between the National Government and Quebec	61
Provincial-Municipal Grants	62
The United States	63
Transfer Grants	64
West Germany	69
Vertical Equalization	69
Horizontal Equalization	70
The Position of Local Governments in German Fiscal Federalism	70
Specific Purpose Grants	71
Chapter 6 Problems and Issues in Fiscal Federalism	75
Australia	75
Canada	78
The United States	83
West Germany	87
Chapter 7 Four Federal Systems in Comparative Perspective	91
Selection of Countries	92
Lessons and Limits of Foreign Experience	92
Major Conclusions	93
Structural Aspects: Processes, Procedures, and Arrangements of Fiscal Federalism	93
Federal Grants-in-Aid	96
Fiscal Equalization	97
Current Issues	98

Chart

1. Canadian Equalization Entitlements per Capita, 1980-81	55
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Tables

1. Australia: States and Territories and Relevant Data	5
2. Canada: Selected Economic Indicators, by Province	10
3. Canada: Provinces and Territories and Relevant Data, 1980	10
4. United States: Division by Regions	14
5. Federal Republic of Germany: States and Relevant Data, 1979	21
6. Tax Sharing in West Germany, 1978	42
7. Payments to Local Governing Authorities in Australia, 1977-78	53
8. Canadian Equalization Entitlements by Revenue Source and Province, Federal-Provincial Fiscal Arrangements, 1977-82, for the Year 1979-80	57
9. The Government of Canada's Equalization Payments, 1977-78	58
10. United States: Categorical Grant Program, Fiscal Year 1978	64
11. Rating Four Federal Systems—An "Impressionistic" Evaluation	94
12. Categorical Grant Programs, by Grant Type, Existence of Nonfederal Match, and Eligible Recipients, 1978	97

Introduction

This is a study of fiscal federalism in four countries—Australia, Canada, the United States, and West Germany. It recognizes as fundamental the complex relationships which inevitably exist within multilevel systems of government, none of which is more important than the fiscal relationship. Each of the four countries reviewed in this study has developed that relationship independently and, over time, with quite different results. Although no one pattern is better than the others, it may be that each country can learn something from the experience of the others.

As with all other aspects of each nation's existence, fiscal federalism stems in essence from the peculiarities of the country involved. *Chapter 2* of the study, therefore, presents a profile of the four nations, including an indication of the disparities among sections and groups which are the target of much of the fiscal policy developed in all four. And because fiscal policies are made—not born fully developed and in place—*Chapter 3* explores the processes by which they are brought into being.

Chapter 4 examines the taxing power—the sources and yield available to the different levels of government in the four countries. Although governments derive revenues from other sources, taxes constitute by far the major portion of each nation's fisc; therefore, except for brief mention, other types of revenue—rents, charges, fees, income from government enterprises—are not dealt with here. Nor is borrowing, even though it is relied on heavily by both national and subnational governments in all four countries. Statistics on taxes are hard enough to ob-

tain on a comparative basis; those on the other components of the fisc are even more difficult. It is important to acknowledge at the outset, however, that the overall fiscal picture is broader than that which is treated in these pages. Since the tone and trend of fiscal federalism in the four countries are set by the tax component, this report attempts to present an accurate feel of the fiscal elephant in all four.

The fifth—and by far the longest—chapter of this study looks first at expenditures by level of government in all four systems and then in detail at the intergovernmental transfers used in all of them to get the money where the need is. Presumably it is possible to reallocate functions among levels and units of governments so that a better match would exist between revenues available and expenditures required. Although some thought has been devoted to the reallocation problem in all four countries, it is extremely unlikely that reallocation will occur soon. Until it actually takes place, intergovernmental transfers will remain a primary element of fiscal federalism.

Chapter 6 reviews reactions to, and criticisms of the existing pattern of fiscal federalism in all four countries and looks at recent and current happenings on the four federal stages which impact the fiscal relationship. From such a review, it is possible to suggest impending changes in the four patterns of fiscal federalism. It is remarkable that in all four countries the amount of attention devoted to devising possible ways to alter those patterns has been growing in re-

cent years, despite the relative success of the existing patterns.

Finally, as already suggested, an attempt is made in *Chapter 7* to draw lessons for the U.S. from the experience of the other three countries which might be heeded, as thought is given in the future to revamping our own pattern of fiscal federalism.

The information presented in this study is drawn chiefly, but not entirely, from the studies conducted for the ACIR: on Canada (by Richard H. Leach), and West Germany (by Horst Zimmermann), the selection of readings on Australia included in this series, as well as from other studies and publications of the Commission and other relevant works, which are duly cited in footnotes. Finally, it should be noted that no single comprehensive source for the statistics used in this report could be found. Thus, the statistics used here vary a good deal by date from country to country and even within a single country. In every case, an attempt has been made to utilize the most recent statistical data available.

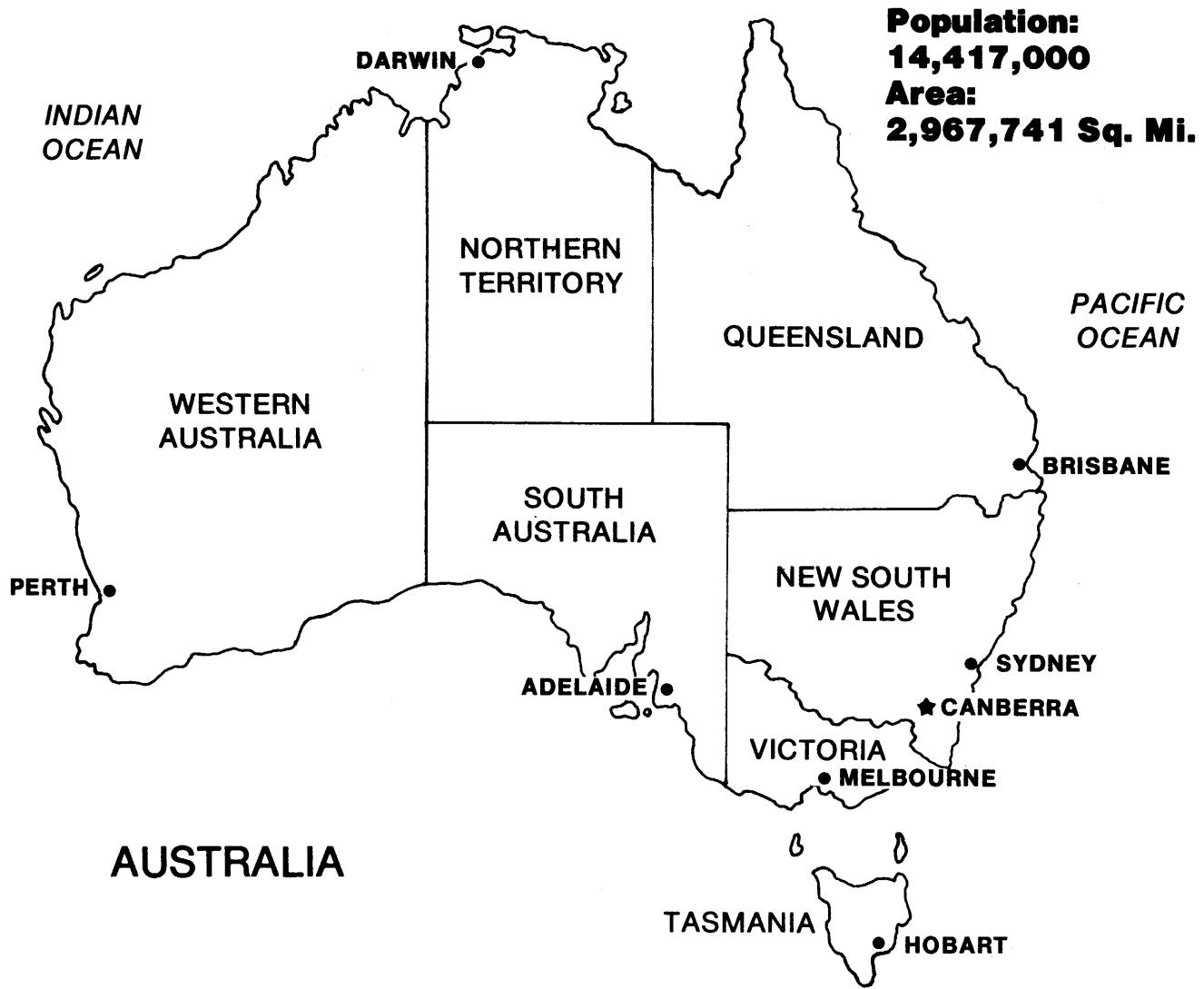
This study is not intended to be a detailed analysis of fiscal federalism in the four countries. Rather, it is intended to provide a broad-brush description. *Table 11*, page 94 attempts to portray in brief compass an overall comparative analysis of the main points of difference in the structure of federalism and of its fiscal component in the four countries (although the study itself does not try to follow the chart as an outline or to discuss every point made thereon directly).

The Four Federal Nations in Profile

AUSTRALIA

Australia consists of a continental landmass and the island of Tasmania plus territory in the Antarctic and in several Pacific and Indian Ocean islands—constituting an area of almost 3 million square miles, almost as large as the 48 coterminous American states. Established by Great Britain as a convict settlement in the late 18th century, the next 100 years saw Australia develop into six self-governing colonies, which joined together under a federal constitution in 1901. As of June 1979, its population was 14,418,200, a figure that is projected to rise to about 16.5 million by the year 2000. Both its population and its institutions have remained predominantly British in origin, although in recent years the number of immigrants from other parts of Europe and Asia has increased sharply. Australia has admitted over 350,000 refugees, mostly from Eastern Europe and Southeast Asia, since 1945. About 20% of Australians living today were born overseas and another 20% have at least one parent who was born overseas. There are only about 160,000 Aborigines and Torres Strait Islanders remaining in Australia.

Most of the Australian people live in urban areas on the eastern, southeastern, and southwestern coastal rims. The great center of the continent is arid and forbidding and is only slowly being developed. Australians are highly literate and their educational system is widely available to the entire population. Though there are some regional variations, the population is remarkably homogeneous.



Economically, Australia is highly developed and quite well balanced. Its labor force in 1977 was chiefly employed, in descending order of importance, in manufacturing, wholesale and retail trade, community services, public administration (including electricity, gas and water production and distribution, and communications), defense, entertainment, and agriculture. Tourism is of increasing importance. The government sector of the economy occupies somewhat less than one-quarter of the labor force.¹

Australia is a leading exporter of wool, meat, wheat, sugar, and fruit. During 1979-80, agricultural exports amounted to over 40% of export earnings.² Its broad industrial base draws from its rich natural resources. Australia is approximately 70% self-sufficient in crude oil and has immense natural gas reserves and large deposits of oil shale; she has abundant and easily accessible coal reserves; about 18% of the Western world's demonstrated low-cost uranium reserves lie within her boundaries; and she is the world's largest exporter of iron ore, alumina, mineral sands and lead; the second or third largest exporter of bauxite, coal, nickel and zinc; and an important supplier of manganese, copper, tin, tungsten, silver, and salt. Increasingly, the products of Australia's agricultural and mineral industries are being processed in Australia prior to export.³

Australia's recent economic performance has been

relatively good, with inflation running at about 10%, the balance of payments in a strong position because of both burgeoning exports and a substantial capital inflow, and unemployment at an overall level of about 6% (but concentrated mainly on the young). Moreover, "Australia is on the threshold of an era of major project investment in the manufacturing and mining industries," if adequate investment from abroad becomes available. Initially, investment will be concentrated in four main sectors: oil and gas; coal; aluminum/alumina/bauxite; and other base metals. Both the federal and the state governments are acting to support and stimulate economic growth.⁴ In addition, Australia has recently been expanding the amount of public and private funds devoted to research and development.⁵

"Inequalities of wealth, though considerable, are . . . less than in most countries. Outside Aboriginal communities, there are few territorial zones of blatant underprivilege; differences of income per head between the states are remarkably small . . ."⁶ Although per capita gross domestic product (GDP) is the lowest of the four countries under review, it is an inadequate measure of the quality of life in Australia. Australian living standards are very high by world standards.

As shown in *Table 1*, governmentally Australia is divided into six states and two mainland territories

Table 1
AUSTRALIA: STATES AND TERRITORIES AND RELEVANT DATA

State	Capital City	Area (in square kilometers)	Population ^a	Percent Urban (cities over 100,000) (1976)
New South Wales	Sydney	801,420	4,945,200	75.0%
Victoria	Melbourne	227,600	3,773,700	75.0
Queensland	Brisbane	1,727,000	2,130,700	52.5
South Australia	Adelaide	984,377	1,273,700	72.3
Western Australia	Perth	2,525,500	1,190,300	70.1
Tasmania	Hobart	68,330	410,000	40.4
Northern Territory	Darwin	1,346,200	104,900	—
Australian Capital Territory	Canberra	2,432	215,870 ^b	^c

^aAs of March 1977.

^bAs of June 1978.

^cAlmost wholly urban.

SOURCE: Population figures: *The World Almanac and Book of Facts, 1980*, New York, Newspaper Enterprise Association, Inc., 1979, p. 516.

Urban percentages: Supplied by the Australian Information Service.

(one of which—the Northern Territory—became self-governing in 1979).

The table suggests what is in fact true: the two states of New South Wales and Victoria are, and have long been predominant in Australian life. Not only do they contain over 60% of Australia's total population (their two capital cities together account for roughly 40% of the total), but they provide over half of the total value of Australian production. The other four states and their urban centers have grown considerably in recent years (the greatest population growth in the 1970s was in Western Australia and the two territories), but to varying degrees they remain the poor cousins in the Australian family—much more dependent on federal aid than on their own more limited resources.

The federal and state governments operate under the parliamentary-cabinet system. The political party system is well developed and party discipline is enforced. In the election of October 1980, the Liberal-National Country Party coalition, which took over the national government in 1975, was kept in office. The same coalition of parties is in power in Western Australia and Queensland. The Labor Party, which derives much of its strength from the fact that the labor force in Australia is about 57% unionized, was in power in 1980 in New South Wales and Tasmania. In Victoria and South Australia, the Liberal Party was in power.

Administratively, Australian government at both the national and the state level is marked by a very large number of so-called "statutory authorities," whose number far exceeds the number of regular ministerial departments. ". . . [S]uch bodies conform to no single pattern and their functions are diverse. Indeed, the only feature common to them all is that they are created by special statute. Many are . . . expected to behave with somewhat more independence from political control than a normal ministerial department, though the degree of this varies considerably. They frequently have their own governing board. [Some of them] . . . have the legal status of corporate bodies with independent legal personality, which enables them to own property and to sue and be sued in their own name."

All of the legislatures in Australia, save that of Queensland, are bicameral; but it is the "lower" house (the House of Representatives in Canberra, generally the Legislative Assembly in the states) which exercises major responsibility for governing. In all eight governments, the executive—headed by the Prime Minister in Canberra and by the premier in

the states and the Northern Territory, and including the bureaucracy—is the dominant force in policymaking. R.N. Spann described the Australian political system as "executive-biased."⁸

The Australian Constitution, like that of the United States, enumerates the powers of the federal government, leaving the residual powers with the states. A good many powers are left concurrent with both the federal and state governments. Again, like the U.S., the High Court of Australia, through its power of judicial review, has more often permitted the expansion of federal powers than those of the states, and the federal government's superior revenue position has further cut into areas formally belonging to the states. The federal government has constitutional power in such areas as defense, overseas trade and trade between the states, foreign affairs, the government of territories, and migration into, and out of the country, as well as sharing with the states power in such areas as banking and insurance, industrial disputes, and transport. The states have retained responsibility for the preservation of law and order, have engaged in a wide variety of regulatory and service functions, and exercise primary responsibility for education, the provision of health, cultural and recreational services, and developmental activities in connection with land and resources.

There are fewer than 900 general purpose local governments in Australia, and they do not play a very important role in the overall scheme of things. Many services considered to be local in the U.S. are provided in Australia by states—education, housing, hospitals, transport facilities, water and electricity, etc. As R.N. Spann has noted, the states provide remarkably "uniform service to rich and poor areas, town and country On the other hand . . . one of the continuing problems of Australian administration is to create viable units of decentralization, regional or local, able in some degree to stand on their own feet and flexibly adapt their methods to the communities they serve."⁹ In 1979 both Victoria and Western Australia passed laws specifically recognizing local governments in their state constitutions; but, as Spann suggested, neither act went very far toward strengthening them.

From the beginning, governments in Australia have been actively and deeply involved in internal development. In addition to building and operating railways and other transportation and communications facilities, Australian governments have provided much of the nation's "social overhead capital." This has resulted in making "the profes-

sional expert and the manager" play a relatively more important role in Australian government than the politician. Because of the bureaucracy's largely successful involvement in Australian development and because the spoils system never caught on to any extent there, there is not the legacy of political suspicion or public hostility directed toward the bureaucracy in Australia that is found in the U.S., for example.¹⁰ The federal system itself helped advance the role of the bureaucracy in Australia. The constitution is hard to amend, and "much of the burden of adapting it to changing needs has fallen to the administrator, devising and operating schemes of federal assistance to the states [and] negotiating other forms of intergovernmental cooperation . . ."¹¹ Finally, pressure groups have "contributed to bureaucratization; governments have responded [to them] by making regulations or setting up a board to protect the group concerned or to settle group differences." Examples of the latter are the Commonwealth and state arbitration courts, which generally set wages and working conditions for Australian workers.¹²

Since the 1950s, the federal government has effectively controlled the Loan Council, the federal-state body which must approve the level of borrowing by all governments in Australia; and since 1942, the federal government has had a monopoly over the levying and collection of the most productive source of revenue—the income tax. Thus, the centrality of Canberra in government finances is assured. All of the states depend to a greater or lesser degree on federal grants, though New South Wales and Victoria, with their richer tax bases, are the least reliant on federal transfers and the Northern Territory and Tasmania the most. On the other hand, residents of the two larger states bear a far heavier burden of state taxation than do those of the other four states. In terms of government expenditures, there are wide interstate variations, reflecting varying state functions and priorities, as well as differences in the cost of providing services depending on population size, natural resource base, etc.

In sum, Australia is a remarkably homogeneous, politically advanced, and stable industrialized country.

CANADA

Canada is the largest of the four countries considered in this report, the second largest country in the world. It extends from the U.S. border to the North Pole and includes a total area of almost 4 million

square miles (10,400,000 square kilometers). Because much of her land area lies so far north, however, her vast size has not been as much of an advantage to date as it might seem to be.

Settled originally by the French and later by English and by American Loyalists, Eastern Canada developed virtually as two nations in one, brought together in part by the union of Upper Canada (Ontario) and Lower Canada (Quebec) in 1840. The country remained merely a string of colonies in the east and the vast domain of Hudson's Bay Co., stretching all the way to British Columbia, in the west, until 1867, when they were brought together in confederation. Later, provinces were carved out of the great prairie section, and Newfoundland rounded out present-day Canada when it joined confederation in 1949.

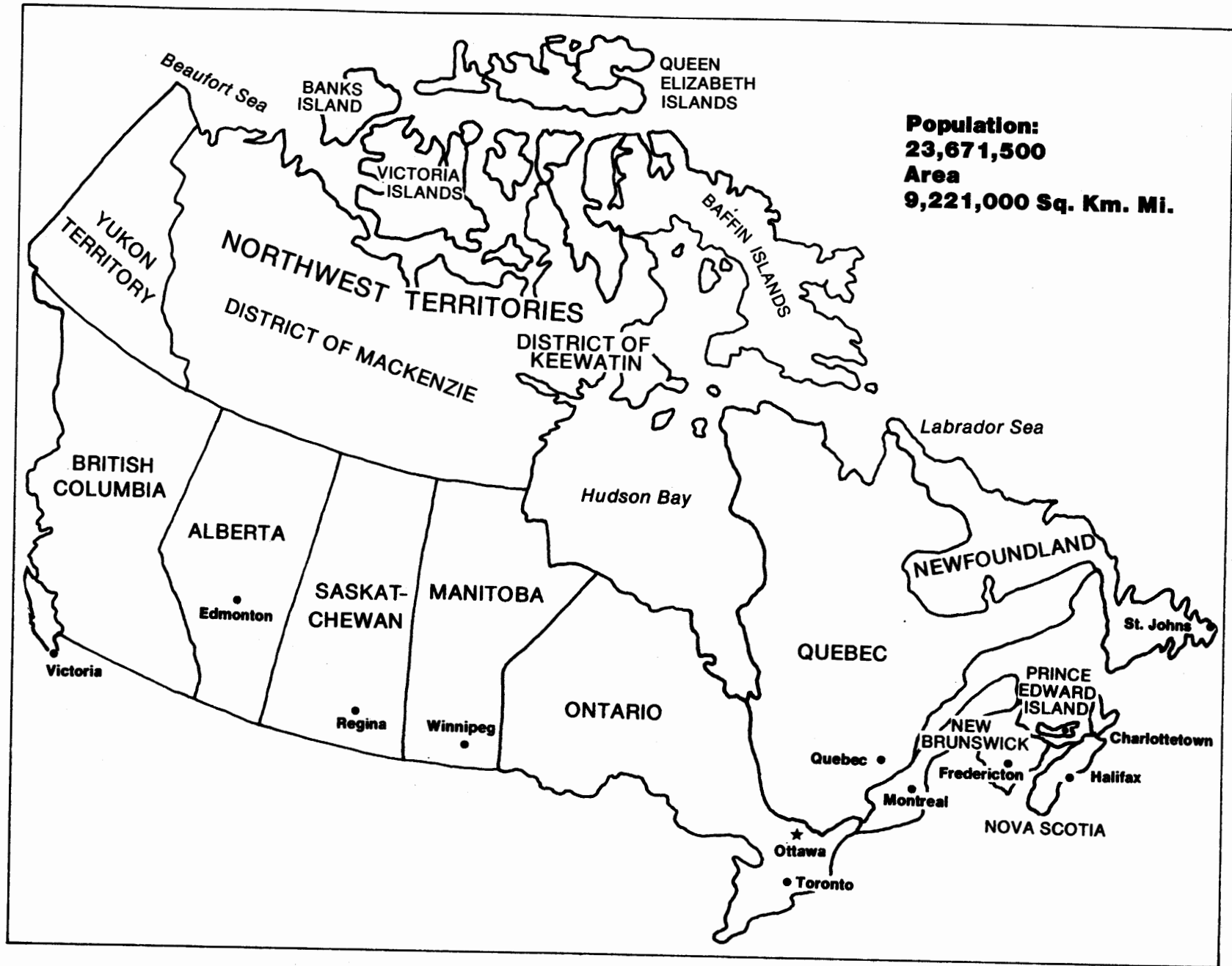
The population of Canada, as of October 1, 1980, was 24,009,600. The annual average growth rate of population was about 1.2% in the 1970s, which, if sustained, would bring the total to about 28 million by the year 2000. The areas of fastest population growth in the 1970s were in the western provinces.

The predominantly French-speaking province of Quebec contains about 27% of Canada's total population, and there are somewhere near 900,000 French-speaking people outside of Quebec. Over 460,000 of them are in Ontario and 224,000 in New Brunswick (where they form the core of an Acadian culture of their own, which extends also into Nova Scotia and Prince Edward Island). This presence of a self-conscious French-speaking minority has been a distinguishing feature of Canadian life over the years.

In addition, there are three groups of "native" peoples in Canada: status Indians (who live on Indian reserves, lands held by the federal government in trust for Indians), the Metis and nonstatus Indians (who live off reserves), and the Inuit or Eskimos. These groups have not been well assimilated into Canadian life and, especially recently, have asserted themselves and demanded recognition of their rights. They live primarily in the northern stretches of the four western provinces and in northern Ontario, as well as in Canada's two territories.

The overall population is thus not as homogeneous as that of Australia, and there is little indication that the linguistic, ethnic, religious, and social differences among the three primary groups—English, French-speaking, and native—will be easily reconciled.

Canadians are a very urban people, most of whom live in a thin strip along the American border. Like



Population:
23,671,500
Area
9,221,000 Sq. Km. Mi.

other Western nations, Canadians are highly literate and have access to a large and varied educational establishment.

Economically, Canada as a whole is an advanced, industrialized nation. The industrial and service sectors of her economy occupy the bulk of the labor force, with less than 20% of the labor force being employed by governments and only about 5% of the gross national product (GNP) being derived from the agricultural sector. With a rich natural resource base, Canadian industry focuses on the production of goods such as steel, motor vehicles, other machinery and equipment, pulp and paper and other wood products, petroleum, natural gas, meat, wheat and other food products, textiles, clothing, and the mining and smelting of a wide range of minerals and base metals. Canadian energy resources are tremendous: not only does she have huge renewable energy from water power, but her coal, oil, gas, and uranium reserves are very large. She has been largely self-sufficient in oil up to now and promises to remain so if less easily exploitable crude oil reserves can be developed. The vast northern area of Canada offers great potential strength for the future Canadian economy. There is currently active exploration for what could turn out to be very large-scale oil and gas reserves, and the exploitation of several large mineral deposits is in prospect. Current government policy encourages northern development.

The Canadian economy, one wag has said, catches cold when the American economy sneezes. In any case, although its performance in the 1970s tended to parallel that of the U.S., it was slightly stronger. Both the inflation and unemployment rates have been high, and her trade balance unfavorable. For despite a highly developed manufacturing sector, Canada remains dependent on many imported products. Many of the imports are high-technology goods, and complaints have been voiced recently about the low percentage of public and private funds being put into research and development.

What is most striking about Canada economically is the substantial variation between, and within regions across the country. In 1980, for example, there was also a 10% spread between the highest and lowest provincial unemployment rates in Canada, with Newfoundland dragging bottom at a 13% rate, and the Maritime Provinces not far ahead, while Alberta and the western provinces were flying high—Alberta with a 3.5% unemployment rate and the other western provinces only a little higher. *Table 2* suggests other ways to illustrate the divergence

among provinces. To a large extent, the difference between the “have” and the “have not” provinces (provinces that are above average and below average in capacity to derive revenues from taxation) is based (1) on the presence and rapidly developing exploitation of natural resources (particularly oil and gas) and the expansion of agriculture in the western provinces, and (2) on the lack of a large enough resource base and agricultural potential in the eastern provinces. Indeed, “the economic center of gravity is moving away from central Canada,” and the prospects are that that trend will be sustained.¹³

Governmentally, Canada is divided into provinces and territories (see *Table 3*). The provinces are uneven both in area and population, and in their influence on the national government. Three of the ten provinces appear to have been particularly important in federal governmental policymaking in recent years. Quebec has not only forced the issue of Canadian unity to the forefront of public and political discussion; it also has provided an example to the other provinces in terms of the potential of provincial power. Because of its dominant economic position over time and because of its centrality in the cultural and communications sectors of English-speaking Canada, Ontario has long played a major role. And Alberta's new economic power and assertive leadership have made it currently the focal point of national attention. The Atlantic provinces (Newfoundland, Nova Scotia, New Brunswick, and Prince Edward Island), on the other hand, have small economies and considerable dependency upon transfers from the government in Ottawa, and thus have been much less aggressive in seeking change from the status quo (although Newfoundland recently seems to have become restless in that role). The Yukon and Northwest Territories are not provinces, but both have acquired a considerable degree of self-government and residents of both are articulating some desire to move toward provincial status.

The 11 governments of Canada operate under the parliamentary-cabinet system. Political parties are well developed and disciplined. However, they have tended to become regional rather than national parties in the sense that none of the three major parties in the House of Commons has representatives from all regions of the country. A Liberal Party government was returned to Ottawa in the election of 1980. In the same year, seven of the provinces had Progressive Conservative Governments. The Social Credit Party was in power in British Columbia, the New Democratic Party in Saskatchewan, and the

Table 2

CANADA: SELECTED ECONOMIC INDICATORS, BY PROVINCE

Province	Gross Domestic Product			Per Capita Income		Unemployment Rate (October 1979)
	Gross Domestic Product 1978 ^a	Percent Total 1978 GNP	Percent Increase Predicted for 1980	Amount 1978	Percent of Canada Average	
Alberta	\$24.9 ^b	11.8%	5.2%	\$8,407	104%	3.5% ^c
British Columbia	25.6	12.2	2.6	8,784	109	7.1
Manitoba	8.5	4.0	1.7	7,456	92.6	5.0
Newfoundland	2.7	1.3	*	5,313	66	13.3 ^c
New Brunswick	4.2	2.0	1.4	5,984	74	10.7
Nova Scotia	5.2	2.5	1.0	6,447	80	10.2
Ontario	80.9	38.5	*	8,735	109	6.9 ^c
Prince Edward Island	0.6	0.3	3.7	5,574	69	10.6
Quebec	49.0	23.3	*	7,628	95	9.1
Saskatchewan	8.6	4.1	4.1	7,432	92.3	4.1

*Less than 1%.

^aTotal GNP Canada, 1978: \$210.2 billion.

^bIn billions of Canadian dollars.

^cSeasonally adjusted unemployment rate as of March 1980.

SOURCE: Advisory Commission on Intergovernmental Relations, *Studies in Comparative Federalism: Canada*, M-127, Washington, DC, U.S. Government Printing Office, 1981, pp. 10-11.

Table 3

CANADA: PROVINCES AND TERRITORIES AND RELEVANT DATA, 1980

Province	Capital	Area (in square kilometers)	Population (October 1, 1980)	Percent of Canadian 1980 Population	Percent Urban
Alberta	Edmonton	661,188	2,113,300	9%	75.0%
British Columbia	Victoria	948,596	2,662,000	11	76.9
Manitoba	Winnipeg	652,218	1,028,000	4	69.9
Newfoundland/ Labrador	St. John's	383,300	582,900	2*	58.9
New Brunswick	Fredericton	72,000	708,700	3*	52.3
Nova Scotia	Halifax	55,000	855,000	4*	55.8
Ontario	Toronto	1,072,713	8,587,300	36	81.2
Prince Edward Island	Charlottetown	5,656	124,000	1*	37.1
Quebec	Quebec City	1,540,668	6,310,800	26	79.1
Saskatchewan	Regina	652,000	973,000	4	55.5
The Yukon Territory	Whitehorse	331,321	21,600	°	61.0
Northwest Territories	Yellowknife	3,379,700	43,000	°	49.7

*The Atlantic provinces together, 10%.

°Insignificant percentage.

SOURCE: Population figures: derived from issues of *Canada Weekly*, a publication of the External Information Programs Division, Department of External Affairs, Ottawa.

Urban percentage figures: *World Almanac and Book of Facts*, 1980, New York, Newspaper Enterprise Association, Inc., 1979, pp. 499-502.

Parti Quebecois in Quebec.

Although the Liberals were not in power in any province, they formed the official opposition party in all of the provinces from Ontario east. And although 31% of the Canadian labor force is unionized, a labor party, based on union membership, has not developed in Canada (though the Canadian Labor Congress does have a close relationship with the New Democratic Party). The regional divergence in party dominance obviously greatly impacts policymaking by the several governments.

The major political parties—the Liberal and Progressive Conservative Parties—are not particularly ideologically oriented, so that policymaking under their auspices tends to respond more to sectoral and regional pressure groups than to the dictates of party ideology.

The major legislative role in Ottawa is played by the lower house of the Canadian Parliament, the House of Commons. All of the provinces have single-chamber legislatures. But, as is generally true of parliamentary systems, it is the members of the cabinet—the Prime Minister and provincial premiers and their ministers—who exercise effective leadership. For many years governments in Canada have played a more important role in national and regional economic development than they have in the U.S. One result of this is that the bureaucracy's role in policymaking is critically important.

The Canadian Constitution—the British North America Act of 1867, as amended—details a good many exclusive powers for both the national government and the provinces and leaves most of the residual power (power to “make laws for the peace, order, and good government of Canada”) with the national government. While federal residual power relates to matters of national importance, the provinces have residual powers with respect to matters of a “merely local or private nature.” Included among the national government's powers are the usual ones necessary for a nation to live in the world of nations and of international trade; but jurisdiction over important areas such as education, health and welfare, property and civil rights, and the ownership of natural resources is largely entrusted to the provinces. The national government can reach into those areas through transfer payments, taxation, its powers over interprovincial trade, etc. Similarly, the provinces exert some control over primarily federal matters because their areas of jurisdictional competence under the Constitution interact with federal powers.

Historically, the provinces have jealously guarded

their constitutional powers. They have felt threatened in the past, particularly by international disorders such as the Great Depression, World War II, and the international oil disturbance of the 1970s—and also by matters such as the prevalence of Keynesian economic thinking in the postwar generation. The provinces appear to have been relatively successful in asserting their rights and indeed have done so to the point where Canada is one of the most decentralized federations in the world. However, in a constantly changing world, the power balance between the two levels of government is ever shifting.

As noted earlier, Canada is a heavily urban nation. Municipal government is fully under provincial control. Moreover, on the average, half or more of the funding for municipal governments comes from the provincial treasuries. Municipalities and school districts are important suppliers of government services and are supported by a strong property tax system of their own. Relations between municipal and provincial governments are close and continuous, while relations between local governments and the national government are limited and frequently handled through the provinces.

The Canadian fiscal system is distinctive in that the national government maintains tax collection agreements with most of the provinces and because, during the postwar period, the national government has yielded to the provinces a great deal of the tax room which it had acquired during World War II. In addition, it continues to make substantial transfers to the provinces. Because ownership of the most valuable natural resources is actually held by the provinces, those provinces with sizable resources are able to derive large revenues for themselves from royalties and exploitation and development leases. The three westernmost provinces, which have very large natural resources, have in recent years moved far ahead of the rest of the provinces in revenue-raising capacity, and the result has been the creation of a serious fiscal imbalance among provincial governments. In an attempt to modify this imbalance, a major program known as fiscal equalization—under which transfers are made to provinces with below-average capacity to raise revenue by taxation—has been undertaken by the national government.

In sum, Canada is a highly developed country with a stable, highly skilled population, marked by a considerable amount of regional disparity and by a considerable degree of governmental decentralization. Throughout its history, there has been friction between the two dominant languages and cultural

groups and between governments over economic issues—in particular those relating to natural resources and industry. Efforts have been made to resolve these issues by intergovernmental arrangements and agreements and also by constitutional amendment. As is the case with other federations, the constitutional route to change has proved very difficult and frustrating. After a long try at federal-provincial negotiations on constitutional reform, the federal government initiated steps in the fall of 1980 to achieve reform unilaterally. Its attempt was immediately attacked from a number of quarters, and the outcome is still in doubt. Whatever it turns out to be, the respective roles of the federal government and the governments of the provinces are likely to undergo change.

THE UNITED STATES

The United States owes its origin to the British mercantilist thrust of the 17th century and to the coincidental religious unhappiness of several groups of British citizens. Although settlement of the New World began early in the 16th century, it was not until the latter part of that century that extensive settlement was undertaken. Eventually a total of 16 colonies, later consolidated into 13, was established along the Atlantic seaboard of the American continent. Because most of the colonists were from England, the institutions of colonial society were similar up and down the coast. When the colonies achieved their independence in 1776, many of those institutions remained unaltered. The Revolution is generally conceded to have been more a matter of America's restlessness as a part of the Empire than it was of Americans' desire wholly to reshape their society.

The nation was marked in its early years by rapid but sectionally uneven development. By 1860, the original 13 states had been joined by 20 new ones. Widening sectional differences in economic endeavors and social outlook led to the Civil War of 1861-65, the effects of which are still evident in some ways in American government and politics. After the Civil War—with the advent of extensive industrialization, improved transportation and communication facilities, and heavy immigration—a long period of national development began, leading to the advanced industrial state the U.S. had become in the 20th century. The last states—Hawaii and Alaska—were added to the Union in 1959, and with the possible conversion of the Commonwealth of Puerto Rico

and the District of Columbia—the nation's capital area—into states, the American nation has reached its full territorial potential.

The United States today is a large—some 3,600,000 square miles (9,360,000 square kilometers)—and complex country, most of which is habitable and productive. It is divided by nature into a number of geographic regions, which varying lifestyles, population characteristics, and economic factors have generally served to perpetuate over time. Those regions (see *Table 4*) are still to a large degree distinct, socially and culturally; but as the Advisory Commission on Intergovernmental Relations concluded in a recent report,

As we look at the trends in regional economic development over the last 25, 50, 75 years, we conclude that the nation . . . [has evolved] from a country of very substantial disparities in regional economic development and per capita incomes to one in which economic activity has dispersed across the nation, with its benefits relatively evenly spread . . .¹⁴

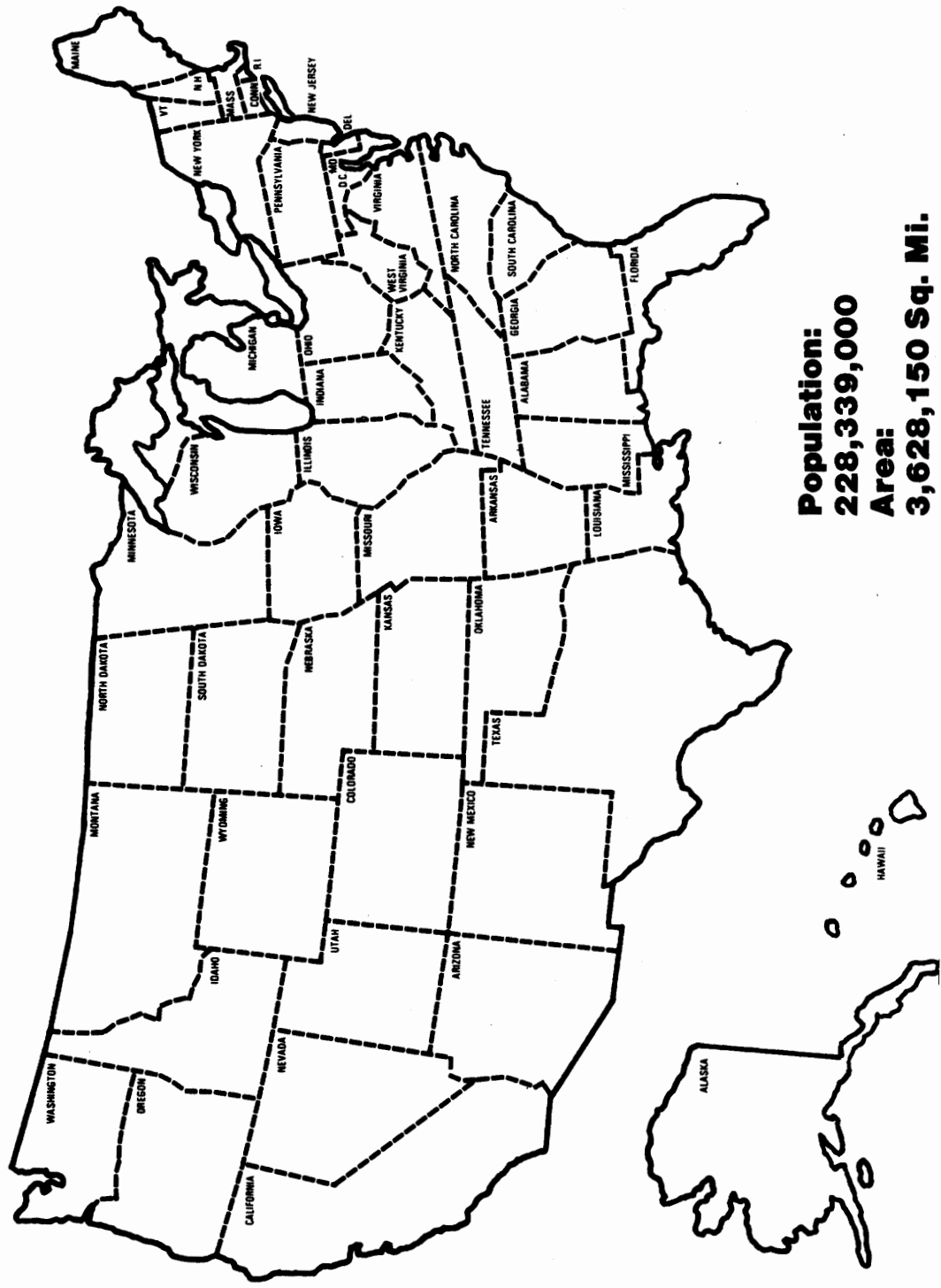
Even so, the older industrial regions, and particularly their center cities—mostly in New England, the Mideast, and the Great Lakes—recently have been declining economically and in terms of population growth, while parts of the Southeast, the Southwest, and the Far West have been spurting ahead, leading to what many are coming to call the Frostbelt-Sunbelt confrontation.

Moreover, there are significant differences by state within the same region, and the spread between urban (central city) and suburban economic status has been widening.

The 1980 Census showed that the U.S. is a nation of about 226,500,000 people, and though the birth-rate has fallen off in recent years and immigration has greatly slowed down, a still larger population is projected for the year 2000. (Present law places an annual ceiling of 290,000 immigrants a year—170,000 from outside of the Western Hemisphere—exclusive of immediate relatives of American citizens.) Population growth in the 1970s, as already suggested, was uneven, with the greatest growth in the Western states (Alaska, California, Nevada, Arizona, Wyoming, Idaho, and Utah) and in Florida and Texas, and in suburban and nonmetropolitan areas.

The vast majority of Americans—over 75% of them—has chosen to live in urban places, most of

UNITED STATES



Population:
228,339,000
Area:
3,628,150 Sq. Mi.

Table 4

UNITED STATES: DIVISION BY REGIONS
(as defined by the Advisory Commission
on Intergovernmental Relations)

Region and State	State Capital	Area in^a Square Kilometers	Population^b (1978) (in thousands)	Percent^c Urban (1970)
New England				
Connecticut	Hartford	12,973	3,116	77.4%
Maine	Augusta	86,027	1,092	50.8
Massachusetts	Boston	21,386	5,771	84.6
New Hampshire	Concord	24,097	869	56.4
Rhode Island	Providence	3,144	932	87.1
Vermont	Montpelier	24,887	487	32.2
Mideast				
Delaware	Dover	5,328	584	72.2
District of Columbia	Washington	174	671	100.0
Maryland	Annapolis	27,394	4,148	76.6
New Jersey	Trenton	20,295	7,315	88.9
New York	Albany	128,402	17,746	85.6
Pennsylvania	Harrisburg	117,412	11,763	71.5
Great Lakes				
Illinois	Springfield	146,076	11,238	83.0
Indiana	Indianapolis	93,994	5,386	64.9
Michigan	Lansing	150,779	9,181	73.8
Ohio	Columbus	106,765	10,732	75.3
Wisconsin	Madison	145,439	4,683	65.9
Plains				
Iowa	Des Moines	145,791	2,906	57.2
Kansas	Topeka	213,064	2,374	66.1
Minnesota	St. Paul	217,736	4,024	66.4
Missouri	Jefferson City	180,487	4,847	70.1
Nebraska	Lincoln	200,018	1,569	61.5
North Dakota	Bismarck	183,022	653	44.3
South Dakota	Pierre	199,552	690	44.6

Table 4 (continued)

UNITED STATES: DIVISION BY REGIONS
(as defined by the Advisory Commission
on Intergovernmental Relations)

Region and State	State Capital	Area in ^a Square Kilometers	Population ^b (1978) (in thousands)	Percent ^c Urban (1970)
Southeast				
Alabama	Montgomery	133,667	3,728	58.4
Arkansas	Little Rock	137,539	2,167	50.0
Florida	Tallahassee	151,670	8,661	80.5
Georgia	Atlanta	152,489	5,075	60.3
Kentucky	Frankfort	104,623	3,490	52.3
Louisiana	Baton Rouge	125,675	3,986	66.1
Mississippi	Jackson	123,584	2,400	44.5
North Carolina	Raleigh	136,198	5,571	45.0
South Carolina	Columbia	80,432	2,902	47.6
Tennessee	Nashville	109,412	4,333	58.7
Virginia	Richmond	105,716	5,177	63.1
West Virginia	Charleston	62,629	1,861	39.0
Southwest				
Arizona	Phoenix	295,024	2,373	79.6
New Mexico	Santa Fe	315,115	1,215	69.8
Oklahoma	Oklahoma City	181,090	2,842	68.0
Texas	Austin	692,405	13,050	79.7
Rocky Mountain				
Colorado	Denver	270,000	2,706	78.5
Idaho	Boise	216,413	882	54.1
Montana	Helena	381,087	780	53.4
Utah	Salt Lake City	219,932	1,316	80.4
Wyoming	Cheyenne	253,597	425	60.5
Far West				
California	Sacramento	411,015	22,314	90.9
Nevada	Carson City	286,299	666	80.9
Oregon	Salem	251,181	2,452	67.1
Washington	Olympia	176,617	3,793	72.6
Alaska	Juneau	1,527,470	411	48.4
Hawaii	Honolulu	16,706	902	83.1

^aSOURCE: U.S. Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States*, Washington, DC, U.S. Government Printing Office, 1979, p. 204.

^bSOURCE: U.S. Department of Commerce, Bureau of the Census, *Current Population Reports: Population Estimates and Projections*, Washington, DC, U.S. Government Printing Office, November 1979.

^cSOURCE: *The World Almanac and Book of Facts 1979*, New York, Newspaper Enterprise Association, Inc., 1978, p. 206.

them in one of 273 large metropolitan areas. The median age of the American people reached 29 years in 1976, and the 1980 census will probably show it has risen still further. Public policy will have to be adjusted to that change as it already has been to dealing more fairly with the ethnic minorities in the nation—the blacks (about 12% of the total population), the native American Indians (mostly concentrated on reservations in the Western states), and the Latinos.

Americans are a very mobile people, about 20% of them changing residences every year. This, too, has an impact on public policymaking. The overall literacy rate in the U.S. is high, being lowest among the minorities. Since World War II, the educational system—both public and private—has been greatly expanded, so that some form of education beyond basic levels is available to most American citizens.

It is difficult in short compass to describe the U.S. economically. In general, it can be said that the U.S. is marked by the largest total GNP and one of the highest average material standards of living in the world. Yet, at the same time, pockets of substandard subsistence and of ecological spoilage exist. The economic sun does not shine evenly across the country: as already noted, there is considerable regional variation, and the minority groups just mentioned are generally found at the bottom of the economic ladder. Nor has the U.S. been able to maintain a steady level of economic well-being. Depression and recession have marked American history, and the nation currently finds itself in a period of economic slump. Inflation and a decrease in the productivity rate are the nation's most pressing economic problems as the nation moves into the 1980s.

Total government expenditures as a percentage of GNP in the U.S. rose from 26.9% in 1959 to 32.5% in 1978; domestic governmental expenditures (including intergovernmental programs) rose from 7.7% of GNP in 1959 to 15.1% in 1978. Public sector employment has remained fairly stable at the national level, while it has risen sharply at state and local levels.

Located as it is in the temperate zone and covering as large an area as it does, the nation's agricultural potential is great and is, for the most part, fully realized. In most food areas, the U.S. is self-sufficient and is an exporting country.

The natural resource base of the U.S. is extensive and rich, some of it still untapped. At least as far as presently exploited reserves are concerned, the major deficiency, as is well known, is crude oil. Other deficiencies, which must be made up for by import, are

rubber, pulpwood, and a great many minerals, including chromium, cobalt, nickel, tin, and tungsten; and although the U.S. is the world's largest producer of electricity, sizable amounts of electric power are imported from Canada. Despite the fact that the U.S. is among the world's greatest producers of manufactured products, the costs of production in the U.S. and the desires and tastes of the American people have been such that the nation is a heavy importer of such products. That, and the nation's dependency on foreign oil, have been primarily responsible for the negative trade balance that plagued the country throughout the 1970s.

Governmentally, the American system is an extremely complex organism. Most Americans are

Governments in the United States, 1977 Census of Governments*

Type of Government	Number
National Government	1
State Governments	50
County Governments	3,042
Municipal Governments	18,862
Township Governments	16,822
School Districts	15,174
Special Districts	25,962
Total	79,913

*The U.S. Census Bureau conducts a Census of Governments every five years.

SOURCE: *U.S. Census of Governments, 1977, Government Organization*, vol. 1, no. 1, Washington, DC, U.S. Department of Commerce, July 1978.

served not only by a national government and a state government, but by at least four—and often more—units of local government as well. Indeed, multiple layering is the dominant feature of American government.

Both the states and the many local governments exhibit significant differences in terms of population, resources and economic potential (and thus of tax revenue), degree of urbanity, etc., and these differences produce wide disparities in political power and influence. Merely to analyze the areas where the 1980 presidential candidates focused their energies demonstrates pretty accurately those areas which are

politically most important: the "Big Nine" states of California, New York, Pennsylvania, Texas, Illinois, Ohio, Michigan, New Jersey, and Florida (given here in descending order of the number of electoral college votes each state possesses), and particularly the cities in their great metropolitan areas. That is not to rule out the "lesser" states: the membership of the U.S. House of Representatives in the national Congress is based on single-member districts, so that there continues to be a strong small state, small town, and rural presence in national policymaking.

The American governmental system is built, at least at the national and state levels, on the concept of separation of powers. Thus, in Washington, power is divided Constitutionally among a two-house legislature (the Senate and the House), a President and the executive establishment over which he presides, and the judiciary (a Supreme Court and a system of courts of appeal and district courts). The Constitutional division of powers is never ignored in practice, although which part of the system may dominate government at any time varies. Woodrow Wilson described *Congressional Government* when he wrote in 1885; Robert Jackson thought it was a *Struggle for Judicial Supremacy* when he wrote in 1941; and most students of post-World War II America conclude that Presidential government has come to the fore.¹⁵

In all of the states, save Nebraska (which has a unicameral legislature), the same constitutional division of powers occurs and the same pattern of alternation between legislative and executive dominance prevails. In the states, however, the courts are generally not as influential in policymaking as they are at the national level.

If there has been competition for power between the branches, however, since the days of President Franklin Roosevelt, the tendency at both national and state levels has been for the initiative in policymaking to be assumed by the executive.

Political parties have been central to the American political process almost since the beginning; and since the Civil War, the two major parties have been the Republican and the Democratic Parties. Third parties have occasionally won in state and local elections and have exerted influence on both elections and policy at the national level. Usually, however, they have been temporary or most of their tenets have been absorbed by one of the major parties.

At both levels, it often happens that the majority party in one or both houses of the legislature is not the same as that of the President or Governor and his

administration, which sometimes makes agreement on policy difficult. On the other hand, party discipline in the parliamentary sense is not observed in the U.S., so that control by one party of both legislative and executive branches is no guarantee of a harmonious working relationship between them. In recent years, the acceptance of parties among the electorate has fallen off, and policy increasingly is made on an issue-by-issue basis instead of on the basis of party.

Pressure groups are extremely important in American government policymaking, perhaps even more so at the state level than at the national level. Policy in many states is extensively influenced by one or two dominant internal interests. Especially important at the national level are groups representing the interests of the other levels of government—the National Governors' Association, the National Conference of State Legislatures, the National League of Cities, the U.S. Conference of Mayors, and the National Association of Counties.

Moreover, at both state and national levels the bureaucracies themselves constitute powerful pressure groups and respond to the pressures of the other groups which constitute their clientele. Because so much legislation at the national and state levels leaves many of the operating details of programs to be set by administrative agencies through regulations, the bureaucracy is often considered to be a fourth branch of government. Americans, however, tend to be disdainful of bureaucrats—and the 1970s were particularly marked by protest at overregulation and by attempts to curb the power of the bureaucracy.

The U.S. Constitution is a venerable document, kept up-to-date more by interpretation (ultimately by the U.S. Supreme Court) and by custom than by amendment. It delegates most of the expected powers of a national government to the Congress (article I, section 8); and through the presence of an "implied powers" clause, legislative, executive, and judicial actions have considerably expanded the range of the national government's powers. The states have "reserved" powers (through amendment ten explicitly and from the tenor of the whole Constitution), which ensure that they can organize their own governments without national interference, legislate for the health, welfare, safety, and morals of their residents (through the exercise of the so-called "police power"), assume responsibility for, and control of local governments, and play an important role in the electoral processes of the national government. As former North Carolina Governor Terry Sanford ob-

served in his classic book, *Storm over the States*, the problem at the state level is not that their power base is too small but that the states have not drawn upon it as extensively as they might have. As the national government extended its role in the 1960s and 1970s, returning power to the states became a political issue and was such in the 1980 election campaign.

Many governmental programs in the U.S. involve the joint or cooperative action of the national, state, and local governments in the system, so that competition for power in fact has become less central in intergovernmental relations than has the search for improved ways of cooperative action.

Local government in the U.S. is not only multi-form and numerous, it plays a very important role in service delivery to the citizens of the nation. Municipalities and counties (and to a lesser extent townships) are general purpose units of government. They have, under state authorization, responsibility for the implementation of a number of state and federal programs, as well as for providing a range of services on their own—from police and fire protection to the provision of cultural and recreational facilities, from street and road maintenance to water supply, and from refuse collection and sewage disposal to library services. School districts are single purpose, as are most special purpose districts, supplying service needs for a group of residents not provided by the general purpose units of government. Local governments put a great deal of pressure on both state and national governments which, in turn, direct financial aid to the local government for carrying out many functions.

Having said all of this, it is necessary to heed the caution of David R. Beam in a 1980 analysis of American federalism:

Textbook descriptions of the Congress, the Presidency, interest groups, the political parties, the states, the judiciary, and others, circa 1960, are badly dated. For example, during the past 20 years, power in the Congress has been radically diffused, and members have seized the initiative in many aspects of domestic, budgetary, and even foreign policy. The federal courts, once regarded as neutral “umpires” of federalism—or even a highly conservative force—have played an aggressive and activist role in dealing with social issues. The political parties, always highly decentralized, have been substantially reorganized on a national basis, and reduced

in influence. Over these years, too, state and local governmental jurisdictions have “come to Washington” on a full-time basis, establishing new lobbying offices and strengthening their national associations. The changes in each institution have necessarily impacted the others. To cite one obvious case, the Presidency has lost a great deal of its influence and prestige as Congress has asserted itself, interest groups have proliferated, and the political parties have declined.

Compared to 20 years ago . . . it is a “whole new ball game,” with new team lineups and many new rules as well . . . a thoroughly atomized system for decision-making [has sprung up].¹⁶

The fiscal system under which the U.S. operates is as complex as the nation itself. The national government relies chiefly on the income tax (both individual and corporate), on excise taxes, and on the payroll tax, as well as on borrowing, for its revenue. The states rely chiefly on retail and selective sales taxes (which are not imposed by the national government), on excise taxes of their own, and on the individual and corporate income taxes they levy independently of the national government. (Oil and gas producing states, notably Alaska, are able to draw increasing amounts of revenue from severance taxes and rents and royalties). Local governments rely heavily on the general property tax. An important ingredient of all state and local budgets is intergovernmental aid. For example, in 1976, not an untypical year, federal grants—most of them conditional—were 27% of state receipts. At the same time, federal and state grants together—again most of them conditional—accounted for 46% of local revenues. As the ACIR put it in a 1980 report,

The 1960s and 1970s saw particularly rapid growth in federal government use of loans and grants, transfer payments to individuals, off-budget loan guarantees, tax expenditures, and regulation. This growth moved the federal government predominantly away from activities in which it is the principal service provider, toward activities in which it shares responsibilities with the state and local governments and the private sector. . . .

As a result of these recent trends, in-

tergovernmental relationships have become increasingly important. Interdependencies between the federal government and the other sectors of the economy (both public and private) have intensified.¹⁷

Note should be made of the rise of citizen resistance to taxes in the 1970s, most notably exemplified by the acceptance of Proposition 13 in California and Proposition 2-1/2 in Massachusetts. Such antitax sentiments and the squeeze of inflation have further intensified the problems encountered in the nonrationalized, diffused, intergovernmental fiscal system in the U.S.

In sum, the American system is undergoing change. Though its Constitutional base remains virtually unchanged, the dynamics of national life have altered the role the government plays a good deal in recent years. As a result, the U.S. federal system—particularly its fiscal aspects—is under greater scrutiny than it ever has been.

WEST GERMANY

West Germany (the Federal Republic of Germany) is in essence the American, British, and French zones of military occupation converted into a new state. It consists of the western remainder of the Third Reich after vast eastern and northeastern parts of the country had been “provisionally” ceded to the Soviet Union and Poland after World War II and after the lands seized by the Nazis—from countries such as Czechoslovakia and Austria—had been returned to their prewar owners. It was actually proclaimed as a republic in 1949, after a constitution had been drawn up by a consultative assembly from all parts of the country and had been approved by the state (laender) parliaments and the French, British, and American governments.

“During the war the Allies had agreed on the general lines of postwar policy toward Germany.” Not only was it to be denazified and demilitarized, it was “to be a *democratic* society,” with a drastically reformed education system, and a *decentralized* state, “with important political responsibilities delegated to states (laender) and local governments.”¹⁸ Thus federalism was required of West Germany—although it had a long tradition and powerful support within the country—as a part of the overall effort to reconstruct German society.

The Federal Republic has a total area, including the enclave of West Berlin, of some 96,000 square

miles (about 250,000 square kilometers); it is about the size of the state of Oregon. The population of that area of prewar Germany was about 43 million. Its population in the late 1970s was nearing 62 million. The increase was early accounted for by the influx of millions of Germans fleeing, or actually expelled, from the German territories occupied after the war by Poland and the Soviet Union and later (before 1961) from East Germany. Altogether some 20% of the present German population is classified as refugees or expellees. Later there was another influx of some 3-1/2 million foreign workers and their families, primarily from Italy, Turkey, and Yugoslavia. Finally, population growth has reflected a healthy birthrate in the last three decades.

With the exception of the foreign workers, the German population is remarkably homogeneous, except for a lingering class division embedded in the country’s work pattern and its social and educational systems.

West Germany became an urbanized country in the late 19th century, and today the bulk of the population lives in communities of 10,000 or more, much of it in cities of over 100,000. With as large a population and as small a land area as it has, it is densely populated. About a sixth of the total population lives in the Rhine-Ruhr region between Dusseldorf and Dortmund, although “large urban areas . . . are distributed throughout the country and make for considerable diversity.”¹⁹

The German educational system has long made a basic education available to all, but advanced academic training remains designed to educate a small elite from the middle and upper classes. “. . . [L]ess than 10% of all university students in 1974 came from working-class families,”²⁰ and that proportion has not changed greatly since; but, as compared with 2% or 3% in the prewar and early postwar years, even this represents a substantial advance.

Economically, West Germany is dependent on international trade. Inevitably, with its large population and small area (Germany has 0.3 acres per capita of arable land, as compared to 8.1 acres per capita in Australia and 4.7 acres in Canada), it is required to import food supplies. Although West Germany does have significant reserves of coal, iron ore (mostly low grade), several base metals, and even of crude oil and natural gas, they are not sufficient to meet the country’s needs. Therefore, lacking an extensive natural resource base, she must import raw materials in large quantities, as well as many semi-finished products.



What the country depends on is manufacturing and the sale of its manufactured goods abroad. The chief exportables are automobile, steel, chemicals and chemical products, oil products, heavy machinery and machine tools, textiles, and electrical and electronic equipment.

West Germany has had phenomenal success in the world market since World War II. She has become the example par excellence of an advanced industrial society. Through most of the 1970s she consistently maintained a positive trade balance, though in 1980 it appeared that it would virtually disappear. Her success, David Conradt concluded, has reflected "the ability of German industry to sell its manufactured goods at a price greater than the costs of raw materials and production. Successful production is in turn strongly related to an adequate supply of skilled, disciplined industrial labor, management expertise, and scientific know-how."²¹

Although Germany has managed to keep both her overall inflation and unemployment rates at very low levels (6% for the former, 3.4% for the latter, as of mid-1980), there are nevertheless disparities among the various regions of the country, depending on varying geographic, demographic, and economic factors. The unique equalization and redistribution features of German fiscal federalism, however, largely overcome these disparities, so that regional differences are relatively small. Neither gross post-tax and post-transfer earnings per capita nor unemploy-

ment rates vary significantly across the country.

Governmentally, West Germany is now divided into 11 laender (see *Table 5*), two of which—Hamburg and Bremen—are cities with historic land status. West Berlin's status has been indeterminate since 1949; it still exists as a de facto land. Only Hamburg and Bremen and the land of Bavaria (Bayern) existed as political entities prior to 1945. "The remaining laender were created by Allied occupiers, in many cases to the consternation of tradition-conscious Germans."²² That being the case, there are few traditional loyalties to bolster the individual land, and though three or four of the laender—North Rhine-Westphalia, Baden-Württemberg, Hesse, and Hamburg—are economically in a class above the others, none of the laender plays a much more important role than the others in national policymaking, with the possible exception of North Rhine-Westphalia. As noted already, and as will be discussed later in this report, the equalization and redistribution methods utilized in German fiscal federalism go far toward reducing the importance of income and other differences among the laender.

The German governmental system itself is still in its developmental stages. None of Germany's experiences with government in the past provided much guidance for a democratic system. The Weimar attempt had ended in failure. Really representative institutions of government had to be grafted onto an authoritarian root, and the emergence of effective

Table 5
FEDERAL REPUBLIC OF GERMANY: STATES (LAND) AND RELEVANT DATA, 1979

States (laender)	Capital City	Area (in square kilometers)	Population (1979)
Baden-Württemberg	Stuttgart	35,751	9,130,000
Bavaria	Munich	70,546	10,819,000
Berlin (West)	—	480	1,918,000
Bremen	—	404	701,000
Hamburg	—	747	1,672,000
Hesse	Wiesbaden	21,113	5,546,000
Lower Saxony	Hannover	47,415	7,225,000
North Rhine-Westphalia	Dusseldorf	34,069	17,015,000
Rhineland-Palatinate	Mainz	19,839	3,634,000
Saarland	Saarbrücken	2,568	1,077,000
Schleswig-Holstein	Kiel	15,696	2,589,000

SOURCE: *Statistisches Jahrbuch 1979 für die Bundesrepublik Deutschland*, Wiesbaden, Statistisches Bundesamt, 1979, pp. 50-51.

and reciprocal working relations between the executive and those institutions had to wait until the passage from the scene of Chancellor Konrad Adenauer in 1963. The pre-Hitler party system—six major parties, with at times as many as 25 parties contending for power—has been replaced with a strong three-party (or perhaps “two-and-a-half” party) system around which policymaking in Germany now revolves. (Article 21 of the Basic Law, West Germany’s Constitution, specifically states that “the political parties shall take part in forming the political will of the people.” It also goes on to say that parties “may be freely established. Their internal organization must conform to democratic principles. They must publicly account for the sources of their funds.” It also prohibits the existence of parties which do not accept the “free democratic basic order” of the Federal Republic.)

The three main parties today are the Christian Democratic Union (in Bavaria the Christian Social Union)—CDU/CSU; the Social Democratic Party (SPD); and the Free Democratic Party (FDP). The SPD alone enjoys direct descent from the Weimar Republic (1919-33)—indeed, from the old Empire (1871-1918). On a spectrum of conservative to socialist, the CDU/CSU would fall on the conservative side, the SPD on the socialist side, and the FDP would fall somewhere in the middle: leftish on foreign policy, quite conservative domestically. Governments both in Bonn and in the laender have been formed only by the CDU/CSU and the SPD, but more often than not in coalition with the FDP. Occasionally CDU/CSU and SPD at both levels have formed “grand” coalitions, excluding the FDP. Currently, and since 1969, the SPD and the FDP constitute the government in Bonn, with the CDU in opposition.

Elections for the Bundestag, the representative body of the German Parliament, are run along both preferential and proportional lines. Half of the members of the Bundestag are elected on an individual basis by plurality vote from single-member districts; the other half are elected by proportional representation. In effect, each voter votes twice—once for a candidate from a district, once from a party list. Only parties which win 5% of the vote for their list, or which elect three candidates in districts, may take advantage of proportional representation. The second vote has been instrumental in keeping the FDP in a powerful position for participating in coalition governments.

The laender, whose elections fall at different times,

are under the following party leadership:

CDU: Baden-Württemberg, Lower Saxony, Rhineland-Palatinate and Schleswig-Holstein

CSU: Bavaria

SPD: Bremen, Hamburg

CDU/FDP coalition: Saarland

SPD/FDP coalition: Berlin, Hesse, North Rhine-Westphalia

Executive authority in the federal government (Bonn) is centered in the chancellor and cabinet, and in the laender in a ministerpraesident and cabinet. The legislature in Bonn is bicameral. The central policymaking chamber—and the body to which the chancellor is responsible—is the Bundestag, which is directly representative of the people. The other chamber, the Bundesrat, will be described below. With the exception of Bavaria, all the laender have single-chamber legislatures. The bureaucracy at both levels has remained remarkably stable over time, but it occupies a less than central place in policymaking—though, as Almond and Verba found, the German public seems to have more confidence in the bureaucracy than in the political branches of government.²³

Pressure groups continue to play a very important representative role in West German government, and they are both numerous and widely varied. A surprisingly large proportion of members of legislative bodies are themselves pressure group representatives, making for “a high degree of consensus and cooperation between major interest alignments and all three system parties.” Even more important “is the access of interest groups to the ministerial bureaucracy . . . major interest organizations are consulted, as a matter of administrative procedure, in the drafting of laws affecting them.”²⁴

The important feature of German government as far as this study is concerned is the way in which the powers of the central government are balanced by the power of the laender. (Recall that a purpose of the Allied powers was to decentralize the new German state.) Thus the Basic Law provides for laender power in four main ways:

1. It establishes the Bundesrat, which represents the laender as laender in Parliament. Land governments appoint and may recall Bundesrat members. Through the Bundesrat, the laender are guaranteed an important role in the passage of federal legislation. Most federal laws require its consent,

and in other cases the Bundesrat has the right to enter an objection to legislation proposed by the Bundestag. "The Bundesrat is in effect an organ of control which 'corrects' legislation in the interest of the laender. Serious difficulties can arise if the federal government does not have a safe majority in the Bundesrat."²⁵

2. Although the Basic Law gives extensive exclusive and other powers to the federal government (power, e.g., over foreign affairs and treaties, defense, federal citizenship, freedom of movement, passports, immigration and emigration, extradition, currency and coinage, weights and measures, time standards, federal railroads and airports, posts and telecommunications, and industrial property rights), it also accepts in principle the competence of the laender in "all governmental matters that do not explicitly fall within the ambit of federal authority"²⁶—i.e., the laender have residual powers under the constitution. Those matters are chiefly in the areas of cultural affairs, education, health and public welfare, the maintenance of law and order, and roads.
3. "The implementation of legislation, and especially federal laws, by the administrative bodies, is . . . mainly the responsibility of the laender. The federal government exercises only very limited administrative powers."²⁷ Correspondingly, the federal bureaucracy and judiciary are quite small; most civil servants—over 90% in 1977—are state and local employees.
4. The Federal Constitutional Court was created as a separate branch of the German judiciary to decide, among other things, disputes between the federal government and the laender and over whether federal and land laws are compatible with each other.

The German Constitution also specifically recognizes and protects units of local government, which for the most part were left unaltered or were restored to their pre-Hitler form. Article 28 of the Basic Law essentially assures that local authorities will be self-governing as far as local affairs are con-

cerned. As has been traditional in Germany since the beginning of the 19th century, local governments play an important service role in German society and are well funded to do so. In many cases the laender delegate functions to local authorities; by tradition local governments have been involved in the provision of such public utilities as water, gas, electricity, and public transport. The main units of German local government are the communes (Gemeinden), the area associations of communes (Gemeindenverbände), and counties (Kreise).

The Basic Law of the Federal Republic was regarded at the outset as provisional—not in terms of what it provided for the government of West Germany, but in terms of the eventual desirability and necessity of unifying West and East Germany. As one observer noted, this has left "the country in a condition that, in terms of both foreign and home affairs, can only be described as constitutional unfulfillment."²⁸ Whether or not German unity can ever be achieved, there is concern in Germany that the constitutional fabric woven by the Basic Law may itself be transitional. Pressure for the development and promulgation of a permanent and possibly recast constitution is present today on the German scene.

In fiscal terms, the outstanding feature of German federalism is tax sharing. Only a few types of taxes are levied exclusively by one level of government, and those totaled only about 22% of total tax revenue shared between two or three levels of government. The Basic Law (article 106) specifically provides for the tax-sharing system and for the division of certain taxes among the levels of government. The taxes shared are the most lucrative of any country: the personal income tax, the value-added tax, the business tax, and the tax on corporation profits. Some of the taxes are required by the Basic Law to be shared equally between the federal government and the laender; the share of others is decided by annual negotiation. The Constitution provides that a share of the revenue from the income tax be passed on to the communes by the laender.

Moreover, German fiscal policy is directed by the Basic Law (article 72.2) to make "economic unity, especially the maintenance of uniformity of living conditions beyond the territory of any one land," an objective of state policy. Thus, German fiscal policy has been developed with equalization in mind. (Article 107 of the Basic Law specifically calls for an equalization program.) This is achieved mainly in two ways: redistribution by the national government to the economically less well off laender, and pay-

ments by the better off laender directly to those which are less well off. In addition, both federal and laender governments have consciously directed public expenditures toward the removal of regional disparities.

In sum, the Federal Republic of Germany operates under a new and still developing governmental and fiscal system. It contains a number of unique

features, which are more apt to be set in constitutional requirement than to be the product of intergovernmental negotiation and consultation. The system has worked well enough to undergird a remarkable economic recovery for Germany and is regarded by most observers as stable and generally accepted by the German people (this despite the fact that the Basic Law was conceived to be provisional only).

FOOTNOTES

¹Year Book Australia, 1977-78, Canberra, Australian Bureau of Statistics, 1978.

²Australia Bulletin, a publication of the Australian Information Service, Embassy of Australia in the U.S., No. 83, February 28, 1980, p. 5.

³Phillip Lynch, Australian Minister for Industry and Commerce, "Australia in the '80s: The Development Frontier," a speech delivered to the New York Chamber of Commerce, July 30, 1980, Australian Information Service Media Release 44/80, pp. 1-2.

⁴Ibid., p. 5.

⁵Australia Bulletin, No. 91, June 19, 1980, p. 5.

⁶R.N. Spann, *Government Administration in Australia*, Sydney, George Allen and Unwin, 1979, p. 35.

⁷Ibid., p. 113.

⁸Ibid., p. 36.

⁹Ibid., pp. 38-39.

¹⁰Ibid., pp. 33-34.

¹¹Ibid., p. 37.

¹²J.D.B. Miller and Brian Jinks, *Australia Government and Politics*, 4th ed., London, Duckworth, 1970, p. 15.

¹³Peter Cook, *The Financial Post*, Toronto, January 5, 1980, p. 2.

¹⁴Advisory Commission on Intergovernmental Relations, *Regional Growth: Historic Perspective*, A-74, Washington, DC, U.S. Government Printing Office, 1980, pp. 89-90.

¹⁵See especially James McGregor Burns, *Presidential Government:*

The Crucible of Leadership, Boston, MA, Houghton-Mifflin Co., 1966.

¹⁶David R. Beam, "Forecasting the Future of Federalism," *Intergovernmental Perspective*, vol. 6, no. 3, Summer 1980, p. 7.

¹⁷Advisory Commission on Intergovernmental Relations, *The Federal Role in the Federal System: The Dynamics of Growth*, A-86, Washington, DC, U.S. Government Printing Office, 1981, p. 102.

¹⁸David P. Conradt, *The German Polity*, New York and London, Longman Inc., 1978, p. 15.

¹⁹Ibid., p. 19.

²⁰Ibid., pp. 38, 25.

²¹Ibid., p. 19.

²²Ibid.

²³Gabriel A. Almond and Sidney Verba, *The Civic Culture*, Princeton, NJ, Princeton University Press, 1963, pp. 189 ff.

²⁴Conradt, *The German Polity*, pp. 101, 92.

²⁵*Basic Law of the Federal Republic of Germany*, Promulgated by the Parliamentary Council on May 23, 1949 (as amended up to and including August 23, 1976), translation published by the Press and Information Office of the Government of the Federal Republic of Germany, Introduction, p. 6.

²⁶Ibid., p. 9.

²⁷Ibid.

²⁸Michael Hereth, "Bonn's Basic Law: A Fresh Start," *Die Zeit*, June 8, 1979, reproduced in *The German Tribune, Public Affairs Review*, No. 34, July 15, 1979, p. 15.

Conducting Intergovernmental Relations

Of the four countries under consideration here, the process by which intergovernmental relations is carried out is least well structured and coordinated in the United States; most structured in Canada and West Germany; and most centralized in Australia. In the sections that follow, the process in each of the four countries will be looked at in turn, particularly as it relates to fiscal matters.

THE UNITED STATES

This section was written in late 1980 and reflects the situation in the United States before the inauguration of President Reagan.

With only a few exceptions, the U.S. Constitution leaves the matter of raising revenue as a concurrent power of both the national and state governments. Local governments have only those revenue powers allowed them by their parent states. As for expenditures, the domestic functions of government in the U.S. are spread among the three levels with no very clear or absolute delineation of responsibility to guide them. Thus, fiscal policymaking—government taxation and expenditure decisions—is shared among a great many diverse units of government.

The result is that it is not possible to speak of a “process” for developing fiscal policy in the United States. Some fiscal policies are made on an ad hoc basis; some are planned in advance. In both cases, development is diffused and fractionated so that no

single policy or agreed-upon group of policies to which all levels and units of government adhere can be said to exist.

Although the President and his advisers are generally considered to be responsible for formulating national domestic policy, including fiscal policy (the President has specific authority to develop and present the budget to Congress), in recent times they have not been notable for their leadership. And while the federal Office of Management and Budget has a major role to play, it is necessarily more concerned with the short term—with the federal budget in preparation and the one in being—than it is with long-term overall policy development. The jurisdiction of the Council of Economic Advisers is limited to study and recommendatory purposes, and its recommendations may or may not be accepted by the President.

It may well be that recent Presidents have not distinguished themselves as fiscal and economic policy-makers because they know that, in the face of the way Congress generally conducts its business, those recommendations often are not highly regarded. Over time, Congress—operating through committees, subcommittees, and committee chairmen as it does, its members subject neither to prior party agreement on policies and issues nor to subsequent party discipline—has been prone to treat economic and fiscal issues in bits and pieces, often in isolation from each other. Thus, while some bills passed may respect a commitment to restrain spending, others, enacted by the same Congress, may serve to expand it.

By and large Congress responds to organized pressures in American society and to local demands, rather than to a concept of the broader national interest. It spreads itself thinly over a multiplicity of small issues and problems and often largely ignores demonstrable economic trends and movements. And it makes decisions largely on political grounds, rather than being guided by the dictates of economic and fiscal analyses. Especially in the House of Representatives (where members serve two-year terms), another election is always just ahead, and members of Congress never forget it.

Nor does Congress as a whole evince much understanding of the intergovernmental dependencies and linkages so characteristic of the American federal system. Though each house has a subcommittee on intergovernmental relations (in the House, of its Committee on Government Operations; in the Senate, of its Committee on Governmental Affairs),

there is no clear evidence either that these subcommittees have directed themselves in the main to the fiscal side of intergovernmental relations or that their studies and recommendations are given very high priority by members of Congress in making fiscal decisions. On the contrary, through the many different and sometimes opposing requirements Congress places on programs affecting state and local governments, it has come very near to overloading the federal system itself. On the other hand, Congress did pay some attention to the overall status of state and local finances and to its role in contributing to them when it enacted the original General Revenue Sharing Program in 1972 and in 1977 and 1980 when it extended the program, and there is considerable ex post administrative evaluation of programs operating under the various grants.

Federal courts have also come to play an increasingly active role in the fiscal policy arena. Although each court decision impacts only one or a few situations, what the courts say has a large potential audience. As the ACIR noted, in “the 1970s, the highly intergovernmental area of litigation relating to federal grants-in-aid mushroomed . . . there [were] more than 550 decisions relating to receipt and use of federal assistance.”¹

Neither the atomized approach taken by Congress nor the case basis of American judicial decisions lends itself to the formulation of broad goals or to an established and respected procedure to attain those goals. Nor does the vast bureaucratic structure of the federal administrative establishment aid in that direction. Bureaucrats in a multitude of agencies, bureaus, offices, and commissions of the national government help shape fiscal policy as they develop regulations for the particular grant program for which they have been assigned responsibility. But each group of bureaucrats concentrates on a particular clientele and the particular interests, demands, and problems stemming from that clientele, so that bureaucratic regulations and procedures only add to the complexity and dispersion of intergovernmental policymaking.

Lacking any direct input into national policymaking (except through their own lobbyists in Washington and such joint organizations as the National Governors' Association and the Council of State Governments), the states have had an increasingly hard time in recent years in winning as many fiscal and economic points in Washington as do local governments. Both the weight of the voters in large metropolitan areas and the Capitol Hill activities of

local government pressure groups—the U.S. Conference of Mayors, the National League of Cities, and the National Association of Counties—serve to assure Congressional attention to local rather than to state demands. An excellent recent example of the point is the decision of Congress, evidently supported by the President, to leave the states out of the popular General Revenue Sharing Program for one year (FY 1981). Moreover, overlooking the intimate parental relationship between states and their local subdivisions, after 1960, Congress developed the habit of making direct grants to local governments, bypassing the states in the process. By 1980, some 30% of total federal assistance to state and local governments went directly to local governments. Such grants do nothing to rationalize and simplify the intergovernmental policy “process.”

Further fractionation takes place at the substate level, as is evident from the number of governments involved (see figures given in *Chapter 1* of this report). It is avowedly more difficult for substate units of government to make policy independently, inasmuch as they derive their fiscal power from their parent states, even as they do their other powers. But local governments are not political neuters: the revenue and expenditure policies they adopt in accordance with pressures exerted at the local level impact not only state but federal finances and economics as well.

At both subnational levels, input into fiscal policy is made both by elected officials—members of state legislatures, city councils, county commissions—and by bureaucrats in state departments and agencies and at the local level. The Governor in most states and Mayors and city and county managers have special responsibility for the preparation of budgets to be enacted by the appropriate legislative body; but once again, that responsibility is shared with state and local bureaucracies, who also make their own input into the implementation of budgets through their own rules and regulations. Very little coordination takes place either within a single government or between governments at any point in the budget process.

In short, the American federal system consists of a great many independent fiefdoms, under a multiplicity of elected and appointed officials, many going in different directions, few of them taking into account the impact of their federal and economic actions on the others in the system.

Even so, the American system is not without linkages in the policy process. Intergovernmental nego-

tiations—in which public officials, often at all three levels of government, bargain “in dead earnest for power, money, and problemsolving responsibility”²—are continually being conducted. At all three levels, more attention is now paid institutionally to the intergovernmental bargaining process and its management than previously. Even so, each bargaining session is unique in time and circumstances, with no central policy framework which guides those negotiations. Negotiations among various levels of government usually result in an agreement, “but they are agreements restricted to the confines of programmatic requirements and they are isolated from agreements reached in other areas. The result of this fragmented system of negotiations is frequently conflicting, sometimes duplicative, and often ineffective.”³

Lacking as well is a structure for coordinating fiscal policy among levels of government. If Governors meet with the President, they do not really *confer* with him. In any case, given separation of powers, they are in no position to make commitments for their states. And when they meet with each other, they may well confer, but the same limitation binds them. Local governments are not always included in high-level meetings with national and state leaders, or they are invited to different meetings, so that the possibilities for trilevel discussion and policy consideration are not many.

Intergovernmental Relations and Policymaking

As already suggested, at the level of departmental and agency officials, a great deal of intergovernmental contact and consultation is present. The expected outcome of negotiations among them is intergovernmental cooperation, although that expectation is not always met in practice. The cooperation worked out does not follow any universal formula. Indeed, working within the federal framework, the possibilities for cooperative action are innumerable. Many of the ways devised by public officials to link their governments to attack common problems are informal: public officials working on the same problem share their knowledge and their strengths and work out commonsense policy approaches. A good example is police work across state and local boundaries. Other examples involve formal actions: an agreement signed between officials of two units of local government concerning water supply or sewage

treatment, for example, or a compact between two or more states concerning pest control or higher education. A great many kinds of cooperative fiscal arrangements have been developed among the various units and levels of government (see *Chapter 5*, "Intergovernmental Transfers"). For the most part, however, the vast amount of intergovernmental consultation in the U.S. today results from the "continuous, day-to-day. . . contacts, knowledge, and evaluations of government officials."⁴

In recent years especially, cooperative consultation has become institutionalized. Important examples at the national level have included the following:

- the inclusion on White House staffs of the Presidents since Eisenhower of someone of expertise in, and responsibility for intergovernmental relations in the policymaking process;
- the promulgation by the Office of Management and Budget of the Executive Office of the President of several directives designed to improve the management and facilitate the policymaking process. OMB Circular A-85 "provides an assured mechanism for state and local government review of draft federal regulations having substantial intergovernmental implications,"⁵ and OMB Circular A-95 sets forth regulations for cooperative planning, programming, and coordinating activities at the substate level of government when funding from the national government is sought;
- the creation by both Houses of Congress of subcommittees on intergovernmental relations of their committees on government operations;
- the enactment by Congress of the *Intergovernmental Cooperation Act of 1968* and the *Intergovernmental Personnel Act of 1970* to provide better administrative procedures and improve personnel administration in intergovernmental programs, and of the *Joint Funding Simplification Act of 1974* to make it easier for subnational units to apply for more than one kind of assistance from the national government; and
- the establishment of councils of represen-

tatives of agencies of the national government on a regional basis to make possible better and quicker policy coordination and response to state and local needs.

Examples at the state level include:

- the creation of "federal relations units" within the office of the Governor, or elsewhere in state administration, to provide a focal point for contacts with the national government and the executive departments and agencies of state government;
- the establishment of commissions (or some similar body) on interstate cooperation to keep state legislatures informed about developments in national-state and interstate policy issues;
- the creation in more and more states (18 by 1980) of state advisory panels or commissions on intergovernmental relations to focus on policy issues and problems involving another level of government; and
- the creation of state and regional clearinghouses in accordance with OMB Circular A-95, to facilitate coordination in policy development, avoid unnecessary duplication, and assure consistency of plans and projects among state and substate units of government applying for funding from the national government.

And a good many of the larger cities and counties, school districts, and special districts in the country have established within their governmental structure an office, or designated an official, to serve in a liaison and informational role with state and national offices and officers. Moreover, a number of states have granted local governments the power to negotiate interlocal agreements and to establish programs across jurisdictional lines, and those governments are making increasing use of the power.

Intergovernmental policymaking is further facilitated by a number of nationwide associations bringing groups of public officials together regularly for consultation and discussion of policy problems. Reference has been made to the Council of State Governments in another connection. Founded in 1933, it was given a mandate by the contributing

states (all 50 states belong to, and support it) "to conduct research on state programs and problems; maintain an information service available to state agencies, officials, and legislators; issue publications; assist in state-federal liaison, [and] promote regional and state-local cooperation. . . ." Associated with the council are 32 other associations of state officials, ranging from the National Conference of State Legislatures, the Conference of Chief Justices, and the Conference of State Court Administrators, to the National Association of Attorneys General, the National Association of Tax Administrators, and the Conference of State Sanitary Engineers.⁷ Each of these groups, within its own area of interest, seeks ways to join hands in policy development and implementation. Other organizations serve to link local officials across the country for the same purpose. The U.S. Conference of Mayors and the National League of Cities provide a forum for municipal officials, while the National Association of Counties does the same for county officials. In addition to these national groups, each state has its own associations of public officials where ideas can be exchanged, help given, and problems in a wide range of policy areas discussed.

Mention must also be made of the U.S. Advisory Commission on Intergovernmental Relations, created by Congress in 1959. Known informally as the ACIR, the Commission functions as a special arm of the national government to offer continuing study, information, and recommendations for the improvement of the federal system in operation. The Commission is a bipartisan body of 26 members, representing all levels of government and the general public. It has a small Washington-based research staff, and it attempts to find the most serious practical problems emerging in federalism and intergovernmental relations, to study them, and to make recommendations to the governments concerned.

Since it was established, ACIR has studied and recommended action in policy areas such as the development of equitable state and local tax systems, making cities and municipalities fiscally sound, outlining a reasonable system of grants-in-aid to be followed by the national government (part of which has been adopted), improving the effectiveness of the grant system, and improving overall governmental performance in such functional areas as transportation, law enforcement, health, and urban growth and development. Through a variety of means, ACIR works to get its recommendations adopted: it prepares and keeps up to date suggested state legislation,

cast in legislative language for consideration by state legislatures, and it makes its staff available to work with elected and appointed public officials to tailor suggested actions to the particular needs and circumstances of the moment. In the years since 1959, a good many of its recommendations have been adopted by the appropriate governments.

Thus, if the American federal system has not evolved an overall set of procedures for intergovernmental policymaking, at least it has the advantage of a great many points of input into the process. There is strong bureaucratic involvement in the allocation of project grants and in program evaluation, but always within the confines of individual grant programs—the parameters of which are set by Congress and/or state legislatures in the usual ad hoc way of such bodies. Fiscal and economic policy is thus built up incrementally, accidentally, and incidentally, rather than being the product of a rational process in which the needs of all levels of government are considered and ways are sought to fit them into some kind of integrated revenue and expenditure pattern.

AUSTRALIA

Domestic policymaking in Australia is affected in the first place by the nature of the division of powers between the states and the national government in the Australian Constitution. Like the U.S. Constitution, it leaves the power to raise revenues, with few exceptions, as a concurrent power to be shared by the national and state governments. Thus, in the fiscal area as in others, "Instead of coherent action, the [Australian] system is designed to encourage the representation of diverse interests within the government by establishing competing centres of power. . . ." Local governments are so circumscribed in Australia that for the most part they are not involved effectively in that competition except through representation of their interests by their parent state governments.

In practice, that concurrency has not produced an equivalency of revenue. Though state governments are responsible "for providing the infrastructure of public services in education, health, public utilities, public transport, and so on. . . the central government controls the major sources of public funds through taxation revenue and loan raising, and transfers these to the states to fund their activities."

Thus, fiscal considerations are ever present in the relations between the seven major governments of Australia. Distribution of public money "is a matter

for political decision through the legislatures [and] financial bargaining takes place between the federal parliamentary leaders who head the [national] government of the day, and their state counterparts,"¹⁰ primarily through the agency of the Premiers' Conferences, to which we will shortly return.

Not all of the bargaining takes place at the prime minister/premier and ministerial levels. Much of it has been transferred from the political to the administrative arena at both levels of government. Somewhere around half of all federal government programs in the late 1970s involved interaction with state governments, and bureaucracies charged with their implementation are constantly concerned with intergovernmental consultation and negotiation with their state counterparts. The Department of the Treasury plays a leading role in setting the parameters of bureaucratic bargaining over fiscal policy with the states.

Much of the bargaining among bureaucrats is informal and unrecorded and also unsystematic and ad hoc, as is the case in the U.S. For the most part it revolves around adjustment by the states to the policy priorities already adopted by the national government, and involves little ex post program evaluation. If this bureaucratic bargaining is hard to generalize about, it nevertheless constitutes an important part of the Australian domestic policy process.

The Australian system differs from other federal systems, however, in that it has had built into it, over time, a number of institutional bodies where some of the most important intergovernmental bargaining about policy takes place. Among the most important of those bodies are the Australian Agricultural Council, the Australian Transport Advisory Council, the Australian Water Resources Council, the Australian Forestry Council, the Australian Minerals and Energy Council, the Australian Education Council, the Schools Commission, and the Tertiary Education Commission. All of these bodies formulate and recommend policy in their areas of concern, the latter two being specifically directed to make recommendations concerning funding. More important than the bodies confined to a single policy area, however, are the Premiers' Conference, the Loan Council, the Grants Commission, and the Advisory Council for Intergovernment Relations. Each of these deserves brief comment.

Premiers' Conferences

The habit of state premiers meeting together occa-

sionally to discuss matters of mutual interest is an old one in Australia. Premiers' meetings were originally confined to agendas dealing with purely state (and sometimes interstate) interests, but eventually representation from the national government—and thus consideration of broader intergovernmental topics—was added. Today, the holding of Premiers' Conferences (Conference of First Ministers) has become a regular—about annually—and expected event in Australian government and politics. It provides a regular occasion for intergovernmental issues to be aired prior to submission of specific policy recommendations to the respective parliaments.

Of particular interest in the context of this report is that Premiers' Conferences provide the setting in which the overall financial relationship among the seven major governments of Australia is determined. Over time, however, the initiative in the fiscal, as well as in other areas has shifted to the national participants. The conferences are ordinarily convened by the Prime Minister of Australia, to deal first and foremost with topics of concern to the national government and to present the national government's fiscal plans and adopted policies. To a great degree the Treasury determines the agenda of Premiers' Conferences. It is its view that those conferences "are meetings whose preeminent concern is finance,"¹¹ and at every conference fiscal policy is the leading agenda item. Other items on the agenda are supplied by the Department of the Prime Minister and cabinet and by state premiers themselves. Almost always on fiscal items, the Prime Minister will have secured national departmental and cabinet approval before he and the state premiers sit down together. Since the premiers are more dominant in state government than the Prime Minister is in the national government, state cabinet approval is not so often sought. And given the importance of securing approval in the end by the premiers, the Prime Minister will have already met with each of them individually in an attempt to win them over to the national government's point of view.

The conferences begin with a formal statement by the Prime Minister on the state of the economy and a general outline and justification of the federal attitude to the agenda items in general and financial relations with the states in particular. . . . The conference then adjourns for the state delegations to assess the implications of the federal statement of policy, to do their financial

calculations, and to plan their strategy for the the rest of the conference.¹²

Once back in session, and the premiers each having said their piece in reaction to the national government's position (they seldom wish to take a unanimous position but prefer to make individual responses), the conferees settle down to discussion of who should get how much of the proposed federal fiscal pie and in what form and under what conditions delivery should be made. Though meetings are usually closed sessions, there is general consensus among informed students of the conferences at work that discussions there are dominated by political factors. Indeed, it is "the state's ability to deploy political resources that offsets whatever bureaucratic and financial advantage the federal government has at premiers' conferences."¹³ Thus Holmes and Sharman insist that instead of viewing premiers' conferences as true bargaining forums, they should be regarded as opportunities "for a breath of reality to blow through the. . . discussions of federal and state politicians." They force the national government to consider (or reconsider) the political implications of its proposed fiscal policies and particularly to be reminded of the "large state/small state dichotomy, the diversity of administrative resources between the states, the federal government's superior access to funding, and the states' superior access to jurisdiction in such fields as health, education, housing, transport, and regional planning. . . ." The result of Premiers' Conferences may not always (or even often) be modifications in the national government's proposed policy, but they do serve "to preserve a rough political equilibrium in intergovernmental relations by sensitizing governments to each other's problems and by preventing department policy goals from becoming major confrontations between rival government constituencies."¹⁴

Loan Council

The depression of the 1920s in Australia forced consideration of the responsibilities of governments relating to borrowing and debt redemption. A voluntary intergovernmental loan council came into being in 1924, and the Financial Agreement of 1927 between the national government and the states provided for the formal setting up of the Australian Loan Council to regulate borrowing by all seven major governments and to decide how the states would contribute to a national debt sinking fund from

which to redeem existing state indebtedness. By 1928, all seven governments had accepted the concept, and it was subsequently embedded in the Australian Constitution through a referendum.

The personnel of the Loan Council and the Premiers' Conference are usually the same: the state premiers and the Prime Minister, with the Prime Minister convening and presiding over the meetings (although three states can join in requesting a meeting). The June Premiers' Conference is traditionally linked with a meeting of the Loan Council. When the two meet together, Russell Mathews notes, an opportunity is provided "for the Commonwealth and state leaders to review the state of the economy and to examine their governments' budgetary prospects for the forthcoming year in the light of the tax-sharing, grants, and borrowing arrangements in which they are mutually interested."¹⁵ In reaching Loan Council decisions after discussion, each state has one vote, but the national government has two plus a casting vote. Thus Canberra need only carry two states with it to produce a 4-4 tie, which, by using its casting vote, it can break and carry the day.

The basic functions of the council are to decide the total amount of government borrowing for the next financial year and to apportion that amount between governments wishing to borrow. Federal defense borrowing and short-term government borrowing do not have to be submitted to the council, nor does borrowing to convert, renew, or redeem existing loans. Should agreement on apportionment not be reached by the council (which in fact has never happened), the Financial Agreement of 1927 provides a formula for apportionment.

As Mathews and Jay observe:

The formation of the Loan Council was a most significant move in the direction of cooperative federalism, whereby the Commonwealth and each of the states give up their right to determine independently the level of their loan raisings. . . . The Loan Council has the sole constitutional authority to make this decision and to determine the rates of interest to be offered and other terms and conditions of the loans. It remains a unique institution among federations to this day.¹⁶

In contrast to the Premiers' Conferences, whose decisions have ultimately to be ratified by national and state parliamentary action, those of the council require no ratification at all: What it says goes. Nor is

the council accountable to any other body or to the public for what it decides. It meets *in camera* and does not publish a report of its proceedings. Through it, fiscal uniformity is imposed on a very important area of Australian government.

Although the Premiers' Conference and the Loan Council are central to intergovernmental policymaking in Australia, they operate at some distance from the public. As Russell Mathews has observed, neither the Commonwealth nor the state governments provide much information "about the issues discussed and decisions reached. . . . While there are no doubt good reasons why the discussions themselves should be confidential, there can be no justification for the cryptic, haphazard, and usually incomplete record of the issues which are examined at these conferences and the intergovernmental agreements—or lack of agreement—which represent their outcome."¹⁷

Grants Commission

Parliament began making special grants to the less well-off states (under Section 96 of the Australian Constitution, which permits the national government to do so under any conditions it wishes to impose) as early as 1910. However, they were usually determined in an ad hoc and essentially political manner, often without any "clear understanding as to what criteria should be adopted for purposes of determining [the amount] of assistance to be given."¹⁸ During the 1920s, the poorer states began to make regular claims for special assistance, claims to which the national government did not respond to their satisfaction. Western Australia even passed a secession referendum in 1933. In that same year, the national government established the Commonwealth Grants Commission and charged it with responsibility for inquiring into and reporting on applications by claimant states for special financial assistance. The three part-time lay members of the commission, appointed for five-year terms by the national government, have continued to this day to consider requests from claimant states. Special assistance grants (equalization) are defined in the act (as amended) establishing the commission as those necessary to make it possible for a state, "by reasonable effort, to function at a standard not appreciably below the standards of other states." The commission uses sophisticated methods of needs assessment in considering state claims and makes its own calculations on which to base the actual grant to be recommended to the national government.¹⁹ Although the commission does

not have any power to make the grants itself, almost without exception its recommendations are accepted by the government of the day and become part of the national budget.

Thus, fiscal policy determination in Australia is made partly through the separate institutions of the seven major governments, but much of it worked out in discussion with the states through the Premiers' Conferences and set in formal financial agreements developed at those conferences. Specific areas of fiscal policy are confided to such statutory bodies as the Grants Commission and the Loan Council. As Holmes and Sharman conclude,

Each of these sets of transactions. . . is accompanied by its own characteristic intergovernmental bargaining strategies to make the horizontal allocation of resources in the Australian federal system an original and complex process.²⁰

One body of growing importance in the intergovernmental policy process in Australia is the Advisory Council for Intergovernment Relations. It is a relative newcomer to the intergovernmental process in Australia, having been established by intergovernmental agreement embodied in an act of Parliament in 1976. Modeled on the U.S. Advisory Commission on Intergovernmental Relations, the Australian Advisory Council was designed as a device to improve intergovernmental consultation and cooperation. Supported by the national and state governments and, through the Australian Council of Local Government Associations, by local governments, the advisory council brings together representatives from all three levels of government and private citizens to consider problems referred to it by the Premiers' Conference (which may also pass on to the advisory council matters suggested by local government authorities, through their state organizations). Unlike the U.S. Advisory Commission on Intergovernmental Relations—which operates independently but subject to direction from Congress—the advisory council operates in accordance with directions from the premiers' conference. However, section 1 of the advisory council's charter permits "the council itself to request that matters be referred to it for advice." The council was thus visualized as having "both a continuing role in relation to information-gathering, analysis of issues and dissemination of ideas, and a specific role in relation to the [matters referred to it] from the Premiers'

Conference (and on which it will be required to make specific recommendations and furnish reports)."²¹ Working from its agenda, the council, with initial staff work by a small secretariat (located in Hobart, Tasmania), studies the issues involved in the matters before it, considers ways and means of resolving them, and makes recommendations for action to the Prime Minister and the premiers for tabling in Parliament and in the state legislatures. Pertinent recommendations may also be made to local governments through the Council of Local Government Associations. In addition, the Australian advisory council makes an annual report of its activities to both the Prime Minister and the premiers, which is published and made available to a broad governmental and lay readership. Like its American counterpart, the 22-person council is a bipartisan multimember body and possesses advisory powers only. (Both the Prime Minister and the leader of the opposition appoint three members of the federal Parliament; state premiers appoint a member each from their state legislatures; the Australian Council of Local Government Associations appoints six members; and five public members are appointed by the Prime Minister after consultation with the state premiers.) Although its mission is much broader than fiscal relations—indeed, it may cover pretty much the whole spectrum of governmental activity in Australia—one of the specific concerns may be financial relationships. To date, however, the council has not had the occasion to concern itself much with that area. During 1979, however, the advisory council conducted an inquiry into the role of local government in Australia and its relations with the Commonwealth and state governments. It is possible when the report on that inquiry is released that it will contain a discussion of—and perhaps recommendations concerning—local government financing.

CANADA

The Canadian Constitution (the British North America Act of 1867, as amended) seems to distinguish between the power of the national government and that of the provinces in regard to taxing. In fact, however, both levels of government utilize many of the same taxes. Though the power to enact revenue legislation lies of course with the 11 legislatures, as put before them by the cabinets, to a large extent fiscal policy—as domestic policy in general—is hammered out within an elaborate structure of intergovernmental consultation. Cabinets and

legislatures have been rendered largely incapable of making effective domestic policy decisions (1) by increasing complexity of many of the issues involved—which inhibits their solution through political means—and (2) by the fact that Canadian political parties, which are supposedly the moving force in achieving cohesion and agreement on policy in parliamentary systems, do not in fact any longer perform that function. Canada has basically regional—that is, provincial—rather than national parties, so that a variety of approaches toward domestic policy, rather than a single unified approach, is the norm among cabinets and legislatures in Canada.

Inevitably, then, the development of fiscal and other areas of domestic policy has largely slipped over to the bureaucracies. As Richard Simeon has noted, “the executive and administrative process of federal-provincial conferences”²² has become the main area for domestic policymaking—a fact which distinguishes the Canadian policy process from that in the other countries considered in this report.

The intergovernmental consultation process is carried on at virtually every level of federal and provincial administration, from nearly annual meetings of the first ministers (the Prime Minister and the ten provincial premiers) and regular—often annual—meetings of ministers in the many areas of domestic governmental concern, to frequent meetings of deputy ministers and senior departmental (and occasionally agency) officers. In 1975, a typical recent year, a total of 782 federal-provincial meetings and conferences was held, divided among areas of Canadian governmental activity as follows:

General Government	18
Finances	18
Agriculture	23
Transportation	57
Education	9
Energy and Resources	51
Environment	93
Manpower-Labor	44
Statistics	37
Welfare	22
Health	38
Industry and Trade	157
Urban Affairs	78
Justice and Laws	22
Consumer Affairs	15
Communications	9

Native Affairs	38
Miscellaneous	53
Total	782

SOURCE: Kenneth Kernaghan, "Federal-Provincial Administrative Liaison in Canada," in Kernaghan, ed., *Public Administration in Canada*, Toronto, Methuen, 1977, pp. 80-81. (The areas of activity are given in the order presented in the source.)

With so many meetings, involving obviously so many government officials, and representing as many different subject matter areas as they do, it is not possible to draw a single picture which would accurately represent the entire framework of intergovernmental consultation in Canada. Some of the meetings and conferences have been taking place for a long time and have fallen into an established way of proceeding; others have not been meeting long and are still feeling their way toward a consensus on procedure. Some meet more often than others; and to some extent, how the meeting is conducted and what outcome is expected vary among meetings and over time. Moreover, there are variations by subject matter area—what applies in health does not necessarily apply in energy, for example.

What does characterize the process as a whole (with the exception, to some extent, of first ministers' conferences) is the central role played in the process by bureaucrats—in recent years especially bureaucrats from provincial governments often dominating their federal counterparts, and members of the so-called "superbureaucracy"²³ dominating those in-line agencies. The superbureaucrats at the national level are to be found primarily in the Privy Council Office, the Department of Finance, the Prime Minister's Office, the Treasury Board Secretariat, the Federal-Provincial Relations Office, and, just recently, the Ministries of State for Economic Development and Social Development.

Insofar as fiscal policy is concerned, the most important roles in national government are played by the Federal-Provincial Relations Office (FPRO) and the Department of Finance. FPRO is responsible for the important meetings of first ministers, and, together with the Department of Justice, for matters relating to the Canadian Constitution. The Department of Finance, through its Federal Relations Division and Social Policy Branch, is responsible for the fiscal arrangements agreed to finally by the national government and the provinces. The department is

also concerned with fiscal harmonization and a wide range of economic matters.

For their part, most of the provinces have similar superbureaucratic institutions. The FPRO is commonly duplicated at the provincial level either by a free-standing office or ministry of intergovernmental affairs or by the assignment to someone at a high level in provincial government of responsibility for intergovernmental relations as a whole. Premiers frequently fill that role themselves. In addition, the Council of Maritime Premiers and the Western Premiers Conference and their staffs and working groups serve as multiprovincial recommending bodies.

Considering all such agencies, Richard Simeon concluded that their members had come to constitute "an internal diplomatic corps" to which domestic policymaking is largely confined.²⁴

Other inputs into the intergovernmental consultation process are made by the Economic Council of Canada through its studies and annual reports; officials of many of the line departments involved in domestic areas of concern (especially of the Department of Regional Economic Expansion, established in 1969 with comprehensive responsibility for planning and coordinating action between the national and provincial governments to reduce regional disparities); and the many crown corporations (e.g., the Canadian Development Corporation and Petro-Canada) and nonbudgetary funds (e.g., the Canada Pension Plan and Quebec's Caisse de Depot et de Placement du Quebec and the Alberta and Saskatchewan Heritage Funds), of which Canada makes such great use.

Interest groups, both from the private and the governmental sectors, focus their attention on the bureaucracies as they consult together concerning domestic policy.

In the end, the intergovernmental process culminates in a federal-provincial conference. Armed with parliamentary and legislative mandates and/or cabinet directives, and probably aware of Economic Council and research studies conducted by provincial bodies and of the fiscal impact of crown corporation and fund actions, informed of group desires and interests, and supported by their own "homework," the consulting team of bureaucrats go to work. As noted, the process is not a monolithic one, but one going on in many parts, at different times, at several levels, on many different subjects and issues, and employing a variety of procedures. Over time this intergovernmental machinery has demonstrated its

ability to go "into operation on very short notice and [to] deal with matters of enormous complexity. . . ."25

What the Ottawa Bureau of Toronto's *Globe and Mail* had to say about the role of the bureaucracy in the constitutional talks between first ministers in the summer of 1980 applies equally well to their role in general in domestic policymaking: Though their "names and faces are barely known outside the closed world of federal-provincial diplomacy," its report observed, "within that world they are the master fixers. . . . Although all of them insisted that their political masters make the final decisions, they nevertheless provided their leaders with the ideas and options from which they made their choices."26

What has been said up to this point has concerned only federal-provincial relations in policymaking. However, the same process is utilized in interprovincial relations and, somewhat differently cast, in provincial-local relations as well. Indeed, what distinguishes Canada in the domestic policy field is the omnipresence of bureaucratic consultation throughout.

All of this has not developed without criticism in Canada. Critics have coined the term "executive federalism" to describe the process of reaching decisions without debate or scrutiny by legislatures.

The critics. . . argue that "executive federalism" places too much power in the hands of civil servants. . . [and] that the expansion of provincial bureaucracies has prompted provincial governments to challenge the federal government too frequently, thus diminishing rather than increasing federal-provincial harmony. In short, the. . . bureaucracies designed to sort out problems are themselves part of the problem itself.27

Moreover, with so many conferences and meetings going on and different bureaucracies involved, critics allege that there are apt to be a good many left hands not knowing what the right hands are doing. Some feel that the intergovernmental process consists of a "rather nebulous clutter of committees. . . often without consistent objectives" and that too little attention is paid to coordinating "the activities of the vast network of. . . meetings and conferences that takes place each year. . . ." Finally, it is argued that domestic policy, as a result of being formed in this way, tends to be made piecemeal and on a short-term

basis, "with little regard for long-term objectives and priorities."28

Such criticism and fears notwithstanding, the intergovernmental consultation conference process has been chiefly the architect of the fiscal arrangements and equalization programs currently in effect in Canada (to be described in a later section of this report) and of "some consensus on basic directions" for Canadian economic policy as well.29 There is nearly unanimous opinion in Canada, among both practitioners and scholars of government, that intergovernmental consultation is so solidly entrenched in Canadian government practice that it will continue into the indefinite future as the central device for making domestic policy in general and fiscal and economic policy in particular.

WEST GERMANY

Intergovernmental relations are more formalized and at the same time less central to domestic policymaking in West Germany than they are in the other countries considered in this report. For one thing, the Basic Law of the Federal Republic goes into great detail about how the fiscal pie will be divided among governments (including local governments), so that there is less to negotiate about. For another thing, the establishment by the Basic Law of the Bundesrat (which represents the states, or *laender*) as the second house of the national legislature and the requirement of its consent to most intergovernmental financial arrangements have made it the main forum for whatever negotiations are carried on. And for a third thing, the bureaucracies in West Germany have remained more isolated by level and less inclined to tackle big issues than they have in the other three countries, so that the bureaucratic arena for domestic policymaking has been slow to develop. All of these points deserve brief comment.

The Basic Law

After some years of functioning under the Basic Law as it was promulgated in 1949, it was realized that the fiscal responsibilities of the national government and the *laender* had not been adequately dealt with in the original version. In a series of amendments added between 1955 and 1969, the defects were remedied. These amendments dealt with specific provisions concerning the apportionment of expenditures among governments; the granting of financial assistance by the federation to the *laender* and local

governments; the levying of certain kinds of taxes by the several levels of government; the apportionment of tax revenue among levels of government and the procedures for arranging the details thereof; the national government's responsibility for providing equalization payments to "financially weak laender" (article 107, (2)); and the procedures for fiscal administration. Moreover, by the terms of article 109, as amended, while "The federation and the laender shall be autonomous and independent of each other in their fiscal administration," both "shall take due account in their fiscal administration of the requirements of overall economic equilibrium. . . ."

In operating under the amendments, the laender have been zealous in maintaining their independence and the results of their consideration of the "requirements of overall economic equilibrium" have varied a good deal. Even though the national government is authorized (again by article 109) to set forth in legislation the "principles applicable to both the federation and the laender. . . governing budgetary law, responsiveness of the fiscal administration to economic trends, and financial planning to cover several years ahead," the consent of the Bundesrat is required for such legislation to become effective, thus placing it in the central negotiating spot.

The Bundesrat

The Bundesrat was intended by the framers of the Basic Law to give to the laender a strong place in overall domestic policymaking. It consists of 41 delegates sent and instructed by the laender governments (the delegates must vote as a unit per those instructions). The most populous laender (North Rhine-Westphalia, Bavaria, Baden-Württemberg, and Lower Saxony) are entitled to five delegates, the middle-range laender (Hesse, Rhineland-Palatinate, Schleswig-Holstein) to four, and the others to three. The original intention was to have the laender represented by elected state officials; but by now, the actual membership of the Bundesrat during most sessions has come to consist of bureaucrats, most of whom come from the ministries of the formally designated members. "In practice. . . in the Bundesrat's committees, where most of the work takes place, bureaucrats from state administrations outnumber politicians. . . by about a 15-1 ratio."³⁰ The Bundesrat meets about monthly in plenary session. Although these sessions are attended by the elected officials, they usually approve, pretty much pro forma, the results of the committees' work.

The Bundesrat does not initiate legislation very often (though the Basic Law permits it to do so); rather, it plays the role of reviewing Bundestag-initiated laws with an eye both to their possible impact and effect on the laender and to securing necessary alterations or vetoing what appears to it to be objectionable. For even in areas which seem clearly within the power of the national government to act, much legislation contains provisions dealing with how the laender are to administer and implement the programs established thereby. And since "any Bundesrat veto, regardless of whether the proposed legislation is in the states' area of competence or not," can be overridden by the national government of the day only by a two-thirds majority of the Bundestag, the Bundesrat has come to occupy a major role in most domestic areas of action.³¹ Nowhere is its role more jealously guarded than in the area of fiscal policy.

The German Bureaucracy

Although the roots of the bureaucracy in Germany run deep, and bureaucrats are generally held in high esteem by the public, the overall institution of the German bureaucracy cannot be regarded as a monolithic unit, working in cooperation or coordination on the development of public policy. Rather, the German bureaucracy tends to be confined to jurisdictional groups—federal, laender, local—whose actions are only occasionally coordinated and integrated. Moreover, as David Conradt points out, within individual bureaucracies there is not much centralization or overall direction from the top, so that national policy tends to be the sum of what the many parts produce.³² As one study of the bureaucracy's fragmented role in policymaking concluded, comprehensive policy planning or major reform initiatives that require much interdepartmental, interministerial, or intergovernmental cooperation are discouraged. The bureaucracies deal best with single small problems, not with complex large ones.³³ "The system cannot tackle big problems or foresee upcoming problems because its planning capability is inadequate. Reacting to problems is. . . [in]sufficient. . . in education, the environment, health care, and urban development,"³⁴ and this includes the fiscal side as well as the substance of programs in those and other areas.

Some attempts have been made to remedy the situation by the establishment in recent years of a num-

ber of planning bodies to look ahead and develop long-range programs. The CDU/SPD coalition government (1966-69) was particularly concerned about the lack of coordination in national, laender, and local government spending and laid emphasis on economic and financial planning. In 1967 a federal law was enacted requiring national and laender governments to plan their budgets, and particularly their expenditures, in closer cooperation with each other, taking into account anticipated trends in economic development and the impact of expenditures on economic growth and stability. To implement the law, two joint federal-laender planning bodies were created—the Trade Cycle Council and the Financial Planning Council.

Neither of these bodies has in practice become very important. The national government found out very quickly that the felt autonomy of the laender in the fiscal arena makes the enforcement of such a law difficult, if not impossible.

In the 1970s, specific joint planning committees were created to deal with programs in education and land use and regional development (as authorized by Article 91 of the Basic Law, amended by federal legislation in 1969). For example, the planning committee on regional economic policy consists of the federal minister of finance and one minister from each land. More relevant to this report are the 1969 changes in the Basic Law relating to government finances, which provided in detail for the distribution of most tax revenues among levels of government. As a result, governments were made more dependent on the whole tax system and hence have a greater mutual

interest in common financial planning.³⁵ To date, however, that interest has not led to the development of any coordinated, systematic way of “ordering the policy programs of state and national governments.”

There are few clear-cut policy goals or priorities in the financial planning system. For the most part. . . policy goals continue to be formulated in the usual fragmented, incremental manner through the interaction between parties, interest groups, government, administration, and Parliament.³⁶

SUMMARY

Thus the arrangements for dealing with economic and fiscal policy planning and development which were developed over time vary considerably in the four countries under review here. The process is most fragmented and uncoordinated in the U.S. In West Germany the functioning of the Bundesrat provides the possibility of ultimate correlation and required change. In Canada fiscal policy is largely the product of a highly developed, closely knit system of bureaucratic intergovernmental consultation. And in Australia, major parts of it are consigned to separate governmental bodies whose recommendations and actions necessarily fit neither each other's nor those of the other parts of the process. Each set of arrangements derives from endemic sources and seems well entrenched in the respective country. However, possible constitutional changes in Canada, and perhaps in West Germany, may be forthcoming.

FOOTNOTES

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³*Public Administration Times*, vol. 2, no. 24, Washington, DC, American Society for Public Administration, December 15, 1979, pp. 1, 3.

⁴Deil S. Wright, “Intergovernmental Relations: An Analytical Overview,” *Annals of the American Academy of Political and Social Science*, Philadelphia, PA, November 1974, p. 7.

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⁶Council of State Governments, *The Book of the States 1976-77*, Lexington, KY, The Council, 1976, p. 559.

⁷Council of State Governments, *State Government News*, Lexington, KY, October 1979, pp. A1-A16.

⁸Jean Holmes and Campbell Sharman, *The Australian Federal System*, Sydney, George Allen and Unwin, 1977, p. 21.

⁹*Ibid.*, p. 136.

¹⁰*Ibid.*, p. 138.

¹¹*Ibid.*, p. 121.

¹²*Ibid.*, p. 128.

¹³*Ibid.*, pp. 131-32.

¹⁴*Ibid.*, p. 133.

¹⁵R.L. Mathews, *Australian Federation 1979*, Canberra, Australian National University, Centre for Research on Federal Financial Relations, 1980, p. 162.

¹⁶R.L. Mathews and W.R.C. Jay, *Federal Finance: Intergovernmental Financial Relations in Australia Since Federation*, Sydney, Thomas Nelson Ltd., 1972, p. 153.

¹⁷Mathews, *Australian Federation 1979*.

¹⁸See Commonwealth Grants Commission, *45th Report (1978) on Special Assistance for States*, Canberra, Australian Government Publishing Service, 1978, pp. 31-32.

¹⁹*Ibid.*, p. 109.

²⁰Holmes and Sharman, *The Australian Federal System*, p. 138.

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²²Richard Simeon, *Intergovernmental Relations and the Challenges to Canadian Federalism*, Discussion Paper No. 7, Institute of Intergovernmental Relations, Queen's University,

Kingston, Ontario, The Institute, 1979, p. 1.

²³Colin Campbell and George J. Szablowski, *The Super-bureaucrats: Structure and Behavior in Central Agencies*, Toronto, MacMillan, 1979.

²⁴Simeon, *Intergovernmental Relations and the Challenge to Canadian Federalism*, p. 11.

²⁵Gerard Veilleux, "Intergovernmental Canada: Government by Conference?" *Canadian Public Administration*, Spring 1980, Toronto, Canadian Society for Public Administration, p. 38.

²⁶*The Globe and Mail*, Toronto, September 13, 1980, p. 13.

²⁷*Ibid.*

²⁸These objections came from Province of British Columbia, *British Columbia's Constitutional Proposals*, "Paper No. 5: Improved Instruments for Federal-Provincial Relations,"

September 1978, pp. 7-8, 10-11.

²⁹Simeon, *Intergovernmental Relations and the Challenge to Canadian Federalism*, p. 57.

³⁰David P. Conradt, *The German Polity*, New York and London, Longman Inc., 1978, p. 137.

³¹*Ibid.*, p. 139.

³²*Ibid.*, p. 164.

³³See Renate Maynitz and Fritz W. Scharpf, *Policymaking in the German Federal Bureaucracy*, New York and Amsterdam, Elsevier-North Holland Publishing Co., 1975, pp. 69-76.

³⁴Conradt, *The German Polity*, p. 169.

³⁵Robert L. Rothweiler, "Revenue Sharing in the Federal Republic of Germany," *Publius*, Philadelphia, PA, Spring 1972, pp. 4-25.

³⁶Conradt, *The German Polity*, p. 174.

Tax Revenues

As noted in the *Introduction*, the focus of this study is on the tax component of the government's revenue dollar. All governments, federal or not, must have an adequate tax base on which to build their operations. So important, indeed, is the power to tax that it is almost invariably imbedded in the nation's basic law or constitution. Federal governments must divide the power to tax among the various levels. The four countries under review here differ considerably in how that power is divided.

THE POWER TO TAX

Australia

Except for the assignment of customs and excise duties to the national government, the Australian Constitution of 1901 leaves taxation as a concurrent power of both the national and state governments. Concurrence in this connection means that both levels of government are free to draw from whatever revenue sources they choose to finance their peculiar functional responsibilities. While this would seem to suggest that both levels might draw from all revenue sources, in fact in Australia there has been little tax overlapping, with only about 2% of all Australian government revenues raised from overlapping taxes. The only notable field of overlapping between the national government and the states has been that of estate, gift, and succession duties; but at both levels there has been a trend toward abolishing such taxes,

so that the amounts involved are not significant. States impose license and registration fees and land taxes which overlap similar levies by local governments, but again the amounts are not significant.

Instead of overlapping, the traditional pattern in Australia has been tax separation, and it continues to be so today. The national government uses its exclusive constitutional authority to levy customs and excise duties and relies on rulings by the High Court of Australia to exclusively levy sales taxes. By virtue of an agreement reached at the 1970 Premiers' Conference, the states have exclusive access to the payroll tax. However, the High Court subsequently ruled that the payroll tax could be imposed only by the national government. Currently, that tax is levied at a uniform rate of 5% across the nation, and the proceeds are handed over to the states. The states are the only units of government to levy entertainment taxes, and they impose stamp duties on vehicles, mortgages, property and securities conveyancing, as well as taxes on such items as liquor, horse racing, lotteries, and gambling. Several states also impose franchise license taxes. And by long custom, local governments exercise exclusive rights in relation to property taxation.

In terms of total tax revenue, the two most important taxes, of course, are those on personal and corporate income. Before World War II, both the national and the state governments levied income taxes. Since 1942, however, the national government alone has tilled those fields, but the states are reimbursed for not levying those taxes themselves. Each state does retain the option of imposing a surcharge or of giving a rebate on personal income tax collected in the state and deriving the benefits or costs thereof.

However uniform the overall Australian tax system is, by virtue of the national government's exclusive control over income and sales taxes and the overwhelming importance of those taxes in terms of total tax receipts, the same uniformity does not spread all the way across the tax spectrum. Individual fees, taxes, and duties vary considerably from state to state, and there is no uniformity in the property taxes used by local authorities (or in the method of evaluation). Even so, Australia has what amounts to a "financially unitary" federal system.'

Canada

Both levels of government in Canada are empowered by the British North America Act (Canada's Constitution) to levy taxes, although in somewhat different terms. Whereas the national government is

given authority to raise "money by any mode or system of taxation" (section 91.3), the provinces are given access to all forms of direct taxation "in order to the raising of a revenue for provincial purposes" (section 92.2). In practice, as time went on and the provinces exerted their authority to tax, it became clear that in fact both the national and the provincial governments have constitutional access to all the major forms of taxation, and they both make use of most of them.

Thus, the national government derives part of its revenue from taxes on income and consumption (including customs duties), while obtaining part of it from resource rents—most notably an export tax on oil. The provinces also derive revenues from taxes on income and consumption. Because ownership of the most valuable natural resources is held by the provinces, through their retention of subsurface mineral rights when surface rights are sold, the provinces also derive revenue from resource rents. The latter accrue mostly, however, to the three westernmost provinces of British Columbia, Alberta, and Saskatchewan, enabling those provinces to move far ahead of the rest of the provinces in revenue-raising capacity. The result has been the creation of a serious fiscal imbalance among provincial governments. "In 1979, the capacity of the Alberta government to raise revenues [to cite the most obvious example], using average rates of taxation prevailing across the country, exceeded Prince Edward Island's. . . by four times."² Even the fiscal equalization program carried on by the national government (see discussion in *Chapter 5*) has been unable to keep fiscal disparities between provinces within a moderately narrow range.

Municipalities and other local governments, of course, have only those areas of tax power permitted them by the provinces. For the most part, they have been left the real property tax field—a field which they cultivate extensively. Considerable revenue is also derived from the "business occupancy tax," levied on the occupants of such property.

Tax overlapping thus occurs between national and provincial levels to a considerable extent. On the other hand, one area where Canada has harmonized tax policies is the income tax field. Since 1941, Canada has had arrangements governing the joint occupancy of the personal and corporate income tax fields by the two major levels of government. These revenues accounted for about 38% of total government revenues in Canada in fiscal 1979-80, with slightly over 60% of that amount accruing to the na-

tional government and almost 40% to the provinces. All of the provinces save Quebec currently are party to a tax collection agreement with the national government covering personal income taxes; and all save Quebec, Ontario, and Alberta (beginning in 1981) covering corporate income taxes. Provincial governments that are party to an agreement accept the national government's income tax system as the tax base for their own corporate and personal income taxes. This means that taxpayers need only fill out one tax form. Under the agreements, the national and provincial governments work out a formula for allocating individual and corporate income taxes among the provinces so that no element of income is taxed by more than one province and that income taxed by the national government is taxed by at least one province.

The national government collects the income taxes imposed by the provinces upon their residents at the same time and in the same manner that it collects its own income taxes. The provincial income tax on individuals is expressed as a constant percentage of the federal tax payable by the individual for the year; and the provincial corporation income tax is expressed as a percentage of the taxable income a corporation earns in the province in the year. Each province agrees to impose only one rate of income tax each year. In return for accepting these conditions, the national government incurs the entire cost of collection and remits the amount of tax assessed under each provincial act to that province in full.

Under this arrangement each government levies its taxes on a uniformly defined tax base, and each government is free to establish the rate that is to be applied to that base. Personal income tax rates, expressed as a percentage of the federal income tax, ranged in 1980 from 38.5% in Alberta to 44.0% in Newfoundland. Corporate tax rates, expressed as a percentage of each corporation's taxable income, ranged from 10% in Prince Edward Island and 11% in Alberta to 15% in Newfoundland, Manitoba, and British Columbia. If they wish, provinces may impose special surcharges, grant special tax credits, or give rebates on taxes. If they do so, however, a small fee for administering them is charged by the national government. Even though those possibilities permit a degree of flexibility among the provinces, the system in operation has produced a strikingly uniform income tax system in Canada—the bases used by the national government even being used, with minor variations, by Quebec and Ontario. In addition, there has been virtually no double taxation because

there are uniform residence requirements for persons and uniform rules for allocating the profits of corporations operating in more than one province.

By now tax collection agreements and distribution procedures are taken for granted by most Canadians. However, there are those who argue that the system limits provincial freedom and impairs the flexibility of the national government. In recent years there have been a number of pressures on the agreements, and their continuation may be part of the overall discussion of adjustment which is occurring in Canada today.

West Germany

Among the four countries examined in this report, West Germany is distinctive in that the Basic Law of the Federal Republic assigns a number of tax sources to particular levels of government (article 106). Interestingly enough, those provisions were added between 1955 and 1969, after the Basic Law had been in operation for several years. Under its terms, the national government has exclusive use of customs duties, excise taxes not otherwise assigned (e.g., the beer tax), the road freight tax, certain business taxes, and income and corporation surtaxes (only the federal government being allowed to levy surcharges—or to give rebates on those taxes). All told, exclusively federal taxes do not contribute a very significant amount to the national coffers.

The Basic Law assigns to the *laender* the revenue from the property (net worth) tax, the inheritance tax, the motor vehicle tax, the tax on gambling and beer establishments and on real estate purchases, and certain taxes on business transactions. Taken together, they were contributing about 12% of *laender* revenue in the late 1970s.

At the local level, there are only two exclusive taxes of any importance: the tax on real estate (land and buildings) and the payroll tax, which was scheduled to be abandoned in 1980. Minor local taxes—dog taxes, entertainment taxes, etc.—are permissible.

The vast majority of government tax revenue (around three-quarters of the total) is derived from taxes shared by two or three levels of government. *Table 6* indicates the major shared taxes and the percentage accruing to each level of government.

The Basic Law specifies that the national government and the *laender* "shall share equally the revenue from income taxes and corporation taxes," while "the respective shares of the federation and the *laender* in the revenue from turnover [net value

Table 6
TAX SHARING IN WEST GERMANY, 1978

	Percent of Total Tax			
	Federal	State	Local	All Levels
Income Tax	43%	43%	14%	100%
Corporation Profits Tax	50	50	—	100
Net Value-Added (Turnover) Tax	67.5	32.5	—	100
Business Tax	20	20	60	100

SOURCE: Advisory Commission on Intergovernmental Relations, *Studies in Comparative Federalism, Fiscal Federalism in the Federal Republic of Germany*, M-128, Washington, DC, U.S. Government Printing Office, July 1981, p. 10.

added] tax shall be determined by federal legislation requiring the consent of the Bundesrat.” Article 106 goes on to say that,

The respective shares of the federation and the laender in the revenue from the turnover tax shall be apportioned anew whenever the relation of revenues to expenditures in the federation develops substantially differently from that of the laender.

The Basic Law also provides for a share of the revenue from the income tax to be passed on by the laender to local governments—specifically, communes—“on the basis of income taxes paid by the inhabitants of the latter,” e.g., personal income taxes. The exact formula for determining the share for local governments is set in a federal law, which again requires the consent of the Bundesrat, as is the formula for dividing the business tax among the three levels of government.

Thus, although all levels of government in West Germany may draw from a variety of tax sources, a large segment of the total tax system is developed on the basis of coordinated national plan. Indeed, article 106 recognizes “the equal claim to coverage from current revenues of [the] respective necessary expenditures” of both the national government and the laender: “the coverage requirements of the federation and of the laender shall be coordinated in such a way that a fair balance is struck, any overburdening of taxpayers precluded, and uniformity of living standards in the federal territory ensured.”

Although the tax-sharing system in essence gives each level of government a fixed share of national tax revenue, at the same time it makes it impossible for laender or local governments to alter tax rates or tax bases to provide for unforeseen demands. Local governments do retain the right to vary the rates of some

taxes, and they may or may not choose to levy a payroll tax.

The United States

As in Australia, the U.S. Constitution leaves the power to tax as a concurrent power to be exercised by both the national government and the states. Since the addition of the 16th Amendment to the Constitution in 1913, the national government has the power to levy income taxes, and those are the only direct taxes of which it has made use. (Article I, section 9, clause 4 of the Constitution prohibits the levying of “capitation, or other direct [taxes]. . . unless in proportion to the census or enumeration herein before directed to be taken.”) Except for the limitation of the U.S. Constitution on state levying of customs duties, the states are free to tax as they choose. (Article I, section 10, declares that “No state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws. . .” or “lay any duty of tonnage. . . .”) However, state constitutions are generally restrictive about the use of state taxing power, many of them placing “elaborate. . . limitations upon the legislature designed to ensure fiscal prudence. . . .”³ As for local governments, they can levy only such taxes as they are permitted by the states.

The tax “system,” which was developed over the years on this Constitutional and legal base, is uncoordinated and overlapping. All three levels of government utilize many of the same tax sources, though some to a greater degree than others. State governments cast the tax net wider than either of the other two levels—by 1979, 37 states were levying both personal income and retail sales taxes—and local governments are more dependent on a single tax source

than are the other two levels.

In 1976—the latest year for which full data for all three levels of government were available—the national government derived 45.8% of its total tax revenues from the personal income tax and 14.4% from the corporation income tax. (Preliminary data for 1980 suggest that the total yield from the two taxes combined will be 58%, compared to 60.2% in 1976.) The other large source of tax revenue for the national government is the payroll tax, which in 1976 contributed 29.8% of total national tax revenues. The remaining 10% of national tax revenues was derived in 1976 from selective sales taxes (5.9%), primarily on motor fuel, alcoholic beverages, tobacco products, public utilities; custom duties (1.6%); and other—primarily death and gift—taxes (2.3%).

In 1976 state governments derived 17.8% of their total tax revenues from the personal income tax and 6.1% from corporate income taxes. However, since 1976 considerable change has taken place in the state revenue picture: by 1978, it was estimated that the personal income tax provided 26% of total state tax collections, and that percentage may have increased since then. The payroll tax yielded states 25.7% of their total 1976 tax revenues (for the most part, such revenues are earmarked as insurance trust funds in the states). The general (retail) sales tax accounted for 22.7% of 1976 state tax revenues (estimated at 30% in 1978), while selective sales taxes (primarily on motor fuel, alcoholic beverages, tobacco products, public utilities, insurance, parimutuel betting, and amusements) accounted for 16.7% (estimated at 18% in 1978). State governments make little use of the general property tax, yield from it by states in 1979 amounting to about 2% of total state tax revenues. The remaining portion of state tax revenues—about 10%—in 1976 was derived from death and gift taxes, motor vehicle license fees and a variety of other license fees, and severance taxes.

As for local governments taken together, 1976 figures show that the personal income tax contributed only 4.4% of total local government tax revenue (estimated at 5% in 1978), while the yield from corporation income taxes was too small to be calculated in percentage terms. The payroll tax, at 3.5% of total local tax collections in 1976; the general (retail) sales tax, at 6.7%; and selective sales taxes, at 3.4%, were also small contributors. However, 1978 estimates placed the general sales tax contribution to the total at 8% and the contribution of selective sales taxes at 3%. Far and away the most

important tax at the local level is the general property tax—accounting for 78% of total local tax revenues in 1979. The remainder of tax collections at the local level—about 4%—was derived in 1976 from a variety of other taxes and fees.

When local governments are broken down by type, considerable variations in their reliance on taxes shows up. Special districts, school districts, and townships rely almost exclusively on receipts from the general property tax. Municipalities and counties draw from a wider tax base, although they, too, place major reliance on the general property tax.

Thus, in the U.S., the national government eschews the general sales and property tax and the state governments eschew the general property tax, but all levels make use of the other major taxes. No attempt is made to work out an allocation of those taxes among levels, either constitutionally or by intergovernmental negotiation.

REVENUES

In all four countries under review here, the power to tax, as just demonstrated, is available to all levels of government. Some kinds of taxes are constitutionally restricted to one level (e.g., the power to levy customs duties); but for the most part in Australia, Canada, and the United States, which level uses what kind of tax and to what extent has been decided more by custom and negotiation, embodied in statute or agreement, than by constitutional provision. Only West Germany has very specific constitutional provisions concerning the allocation of taxes among levels of government and the sharing of taxes among levels.

What is important in the long run is the yield from the taxes which each level of government is empowered to levy. By level, the revenue picture in each of the four countries as of the late 1970s now will be described.

National Governments

The principal source of revenue for the national governments of all four countries is the personal income tax: it accounted for 49.2% (1975) of the Australian national government's revenue from its own sources, for 38.5% (1977) of Canada's; 35.3% (1974) of West Germany's, and 40.7% (1976) of the United States'.

When the tax on corporate or company income is added to the personal income tax, the proportion of

the national government's total tax revenue from its own sources (which is derived from income taxes) rises to 63.1% in Australia (1975), 52.5% in Canada (1977), 41.6% in West Germany (1974), and 53.5% in the U.S. (1976).

The remaining sources of tax revenue from their own sources for national governments in the four countries vary a good deal. In Australia, excise taxes and sales taxes yield a goodly amount (17.4% of total tax revenue in 1975), with minor amounts deriving from the payroll tax and other taxes.

In Canada, sales taxes are also an important source of national government income (13.8% of total tax revenues in 1977), as is the payroll tax. Customs duties also accrue to the national government, and some revenue is derived from a number of minor taxes.

In West Germany, where tax sharing among levels of government is the practice, the federal government derives the major portion of its tax revenue from its share of personal and corporate income taxes and of the value-added (turnover) tax. Although it has access to customs duties, these are collected for the European Economic Community, and the other taxes which are assigned to it are not only rather unimportant in amount, but their contribution to the total tax take has tended to decline over the years.

And the other major tax contributor to the national revenue pot in the United States is the payroll tax (accounting for 26.5% of total revenues from its own sources in 1976). Small amounts are received from certain selective excise taxes, customs duties, and other taxes.

All told, taxes as a percentage of national government revenues from own sources amounted to 90.4% (1975) in Australia, 87.3% (1974) in Canada, 93.7% (1974) in West Germany, and 88.8% (1976) in the U.S.

Remaining sources of national government revenues from own sources are derived in all four countries from a variety of interests, rents, and royalties, from postal and other charges and fees, from government enterprises, and from borrowing.

States, Provinces, Laender

For the states in Australia and the United States, the provinces in Canada, and the laender in West Germany, again revenue from taxes amounts to the largest portion of own-source revenues—to 82% (1975) in Australia, 72% (1977) in Canada, 82.7% (1978 estimate) in West Germany, and 85.5% (1976) in the U.S.

However, state, provincial, and laender governments are not as dependent on one type of tax for their own-source revenues as are the national governments of the four countries. In Australia, state governments derive a sizable portion of total own-source tax revenues from the payroll tax. Stamp duties and motor taxes account for virtually all of the rest, though a variety of other minor taxes and duties do return a small part of the total tax take. In Canada, the provinces derive more of their own-source tax revenues from personal income taxes and sales taxes than from any other sources, though the corporate income tax and payroll taxes contribute a small portion of the total. There, too, a variety of minor taxes also swells the tax total take a bit.

In West Germany, under the tax-sharing arrangements in force, the laender receive the same proportion of personal and corporate income taxes as does the national government, and that share constitutes the major portion of laender tax revenue. They also receive a set share of the value-added (turnover) tax and the business tax. Other taxes contribute very little to laender total tax revenues.

And in the U.S., the sales tax, income taxes of both kinds, and payroll taxes are the major sources of state own-source tax revenue—other taxes contributing only a small portion of the total.

Taxes do not constitute as great a percentage of total own-source revenue, however, at the state, provincial, and laender levels as they do at the national government level. Some 18.1% of total state own-source revenues in Australia (1975 estimate) came from charges and fees, government enterprises, rents and royalties, and miscellaneous levies. In Canada, 28% (1977) of total own-source revenues came from nontax sources, much of it from the earnings of public (crown) corporations which are in common use by the provinces. In West Germany, charges, fees, rents and royalties, and income from government enterprises, along with some miscellaneous charges, contributed 17.2% of total laender own-source revenues in 1978 (estimate). Such other sources of state nontax revenue are not quite as important in the U.S., amounting to 14.5% in 1976.

Local Governments

As for local governments, in three of the four countries covered in this report, property taxes account for the bulk of own-source revenue: for 80.3% in Australia (1975 estimate), for 67.2% in Canada (1976), and for 50.6% in the U.S. (1976). The local

government share of the individual income tax (1.52%) collected by the national government in Australia and the receipts from certain minor taxes in both Australia and Canada bring the total percentage of local government own-source revenues from taxes to 83.0% in Australia (1975 estimate) and 75.1% in Canada (1976). Local governments in the U.S. have a wider range of own-source taxes to draw income from—the individual income tax, the payroll tax, the sales tax, and a number of minor taxes. In 1976, these additional tax sources yielded 13.9% of own-source revenues, bringing the total percentage of local government own-source revenues from taxes to 64.5%.

The situation of local governments in West Germany is different from that of the other countries. Taxes provided approximately 54.3% of revenues from own-sources (1978 estimate), but 23.2% of those revenues come from local governments' constitutionally mandated share of the individual income tax and 18.5% from local governments' share of business taxes. The other taxes utilized by local

governments are the payroll tax (4.4% of total tax revenues from own sources), property taxes (6.7%), and other taxes (1.5%).

Other revenues from local governments' own sources in all four countries come from various fees and charges, income from government enterprises and miscellaneous income sources, and from borrowing.

SUMMARY

The tax structures developed in the four countries under review fall into quite distinct categories, ranging from the fiscal dominance of the national government in Australia (exerted by uniform income taxation and control of state-local borrowing), to the decentralized and tax-overlapping structure of the U.S. (where state and local governments have access to substantial tax sources under their own control), to the somewhat more centralized but still tax-overlapping structure of Canada, to the predominantly tax-sharing structure of West Germany.

FOOTNOTES

¹Jean Holmes and Campbell Sharman, *The Australian Federal System*, Sydney, George Allen and Unwin, 1977, p. 136.

²Federal Finance Minister Allan MacEachen, quoted in *The Globe and Mail*, Toronto, February 3, 1981, p. B3.

³Commentary on Article VII of the Model State Constitution, National Municipal League, *Model State Constitution*, 6th ed., revised, New York, the League, 1968, p. 91.

Intergovernmental Transfers

In all four of the countries under review in this study, the relative importance of government expenditure in general has risen significantly since World War II.

In part, that increase was due to the war itself. One commentary sets forth several reasons that may account for the higher plateau of government spending as a result of the war:

First, it was only to be expected that after the war, as a consequence of the war, expenditure on war and defense. . . should absorb a larger share of the community's resources than in the 1930s. Secondly, the greater concern for social security, which has been a distinguishing feature of the postwar period, can be traced back to the war years themselves. . . . Those were also disturbing years emotionally and intellectually, producing a strong resolve that the postwar economic world should be a better place for all to live in. Thirdly, [governments] gained considerable administrative experience during the war, thus facilitating and to some extent probably even encouraging a higher peacetime level of government spending. Finally, mention should be made of what two English economists, Peacock and Wiseman, have called the "displacement effect." From a study of British data, they have come up with the hypothesis that government spending is held in check mainly by the com-

munity's reluctance to approve the extra taxes required to finance higher expenditures. However, war forces higher taxes on the community, in the first instance as an emergency measure; but in time people become accustomed to paying more, so that the tolerance limit on government spending is permanently lifted.¹

And another factor, of course, has been the "rapid rise in money incomes" in the four countries: "When money incomes are rising steadily, [governments do not need] to increase income tax rates in order to collect a higher proportion of the national income, as most people have been shifted automatically to a higher tax bracket."²

The increases in government expenditures were especially marked in the 1970s when government action was called for to help relieve the economic distress all four nations faced to a greater or lesser degree. Thus, in Australia, combined public-sector spending as a percentage of GDP (gross domestic product) rose from 18.5% in 1962-63 to 25.7% in 1975-76, and public trading enterprises accounted for approximately 1% more of GDP. In Canada, total public-sector spending rose from 26.3% of gross national product (GNP) in 1955 to 41.6% in 1978, in the U.S. from 26.5% of GNP in 1954 to 32.6% by 1979 (estimated), and in West Germany from 27.0% of GNP in 1955 to 34.5% in 1975.

The bulk of the increased expenditure in all four countries has occurred at the subnational rather than at the national level. In Australia, for example, by 1975-76 state and local government expenditures had come to account for 17.5% of GNP (15.2% state governments, 2.3% local governments), while those of the national government accounted for only 8.2% of GNP.

All four countries being federal systems, with power to deal with many of the service needs of the people vested in subnational governments, it was inevitable that those governments should develop expenditure demands more rapidly than the national governments themselves. It was probably equally inevitable that the subnational governments should turn to their national governments for aid in meeting those rising expenditure demands since at least in three of the countries—Australia, the U.S., and West Germany—the overall structure was such that more revenue accrued to the national government than to the subnational governments. In Australia, approximately 76% of public-sector receipts (including

receipts from taxes, fees, property income, and depreciation allowances) was accruing to the national government at the end of the 1970s; in the U.S. and West Germany, the national governments in the late 1970s were getting about 55% of total public revenues—including, in the case of West Germany, the national government's share of shared taxes. Only in Canada had the national government's total receipts begun to be less than those of the subnational governments: from a 71.5% share of total government revenues in 1945, the national government's share had fallen to about 45% by 1979.

There were other reasons as well that the national governments should have become involved in transfers of funds to subnational governments.

All four national governments wished to push certain policies and programs which they perceived to be for the overall welfare of the nation, but which they were prevented from undertaking—for constitutional, political, or traditional reasons—on their own. In these cases, the transfers in effect convert subnational governments into agents of the national governments. In other situations, there are many things that national governments have no inclination to do themselves, "but which [they are] pressed by the states or private groups to support" and which they find it convenient to encourage subnational governments "to undertake by offering subsidies."³ Moreover, some of the required services of subnational governments were seen to spill over subnational jurisdictional lines. Finally, service delivery by subnational governments involves a good deal of inequality and unevenness of standards, which the national governments felt could be evened out only by policies and financial assistance adopted at the national level. For all of these reasons at least, the transfer of funds from the national government to subnational governments became a common practice in all four countries. Indeed, intergovernmental transfers have come to constitute a significant proportion both of national government expenditures and subnational government revenues in all four. The mechanisms and procedures of such transfers vary a good deal among the four, however, so that a country-by-country analysis is necessary.

AUSTRALIA

Intergovernmental transfers go back to the first days of Australian federation. When the Australian Constitution came into effect in 1901, it made three

provisions for fiscal transfers from the national government to the states:

The first of these involved a pure tax-sharing agreement, whereby the federal government was required to transfer to each state at least three-quarters of the net customs and excise revenues derived from consumption in that state for a minimum period of ten years after federation. Secondly, after a transition period the federal government was required to transfer all its so-called surplus revenue to the states on such basis as . . . Parliament deemed fair. Thirdly, the Federal government was empowered to grant financial assistance to any state on such terms and conditions as . . . Parliament thought fit.⁴

The fiscal transfers authorized by the constitution were intended primarily to redress the vertical fiscal imbalance which resulted from the loss by the states of what until then had been their principal sources of revenue—customs and excise duties and, to a lesser extent, postal and telecommunications revenues—while they continued to be responsible for the provision of most of the costly services of government.⁵

The only restriction on how transfers were to be made to the states was the constitutional provision that each state's share of federal customs and excise duties was to be distributed on "a derivation or consumption basis."⁶ In 1910, the national government replaced the sharing of customs and excise revenues with per capita general revenue grants, which were continued until 1927. By simply paying whatever surpluses accrued into a trust fund, the national government never had to transfer any to the states.

Grants under the third constitutional authorization began to be made very early. "First Western Australia (from 1910-11), then Tasmania (from 1912-13), and later South Australia (from 1929-30) sought and obtained special grants from the federal government to assist them in overcoming budgetary difficulties, which they said were accentuated by the operation of the constitution and by federal tariff, shipping, and other economic policies

But these special grants were made on an unsystematic and ad hoc basis and on a scale which failed to satisfy the aspirations of the

governments and the people in the states concerned."⁷

Following threats of secession by the three claimant states, the national government established the Commonwealth Grants Commission, to which reference has been made in an earlier section of this report. To it was referred the responsibility for inquiring into, and making recommendations to Parliament concerning applications from claimant states for special financial assistance. "The principles and methods developed by the commission," notes Russell Mathews, "provided an innovative and acceptable solution to the problem of horizontal fiscal imbalance in Australia. The commission's approach has been refined over the years, but from the beginning it has represented the most highly developed system of fiscal capacity equalization in any federal country. The recommendations of the commission have always been accepted by federal governments. Because the financially weaker states are also the less populous states, the level of special (equalization) grants recommended has always been low relative to the financial resources of the federal government, New South Wales, and Victoria. No doubt this has contributed to the general acceptance of the equalization arrangements by all Australian governments."⁸

Special Assistance Grants

Special assistance—or equalization—grants are given unconditionally to support the revenue budgets of the four financially weaker states—Queensland (the only state currently receiving special assistance), Tasmania, Western Australia, and South Australia—and of the Northern Territory. The amount recommended by the Grants Commission for a claimant state (or territory) is based on a sophisticated assessment of the differences in state revenue-raising capacity and in the costs to the states of providing government services. The grant will approximate "the financial assistance necessary to give a claimant state the capacity to provide services comparable to those of the standard states [New South Wales and Victoria] without having to impose higher taxes and charges than the standard states." The weights attached to the different revenue and expenditure items used in the commission's calculations of standard per capita revenue and expenditures "depend on the budgetary performance of the two states with the highest fiscal capacity and are not based on an average or representative budget as in Canada and West Ger-

many.”⁹ Like Canada and West Germany, however, the calculations of the commission leading to a grant are not hinged on revenue effort adjustments by the claimant states. In short,

. . . the Australian position reflects a philosophical attachment to federalism which regards any fiscal effort requirement as incompatible with fiscal capacity equalization and as an unwarranted restriction on the ability of state governments to determine their own levels of revenue raising and expenditures.¹⁰

It should be pointed out that the disparities among the six Australian states (each of which to all intents and purposes constitutes a region of its own) do not arise to any great extent out of great disparities in individual incomes and wealth among regions. “By comparison with most other countries, living standards are high in all states and there have been no persistent economically depressed areas in Australia.” Nor is any state—read region—without “at least one manufacturing industry in which [it] record[s] the highest production per head of population of any state.” About the only long-term disparity developing stems from the vast mineral and energy resources of Queensland and Western Australia, which have begun to be developed at a great enough rate to skew population and economic growth rates toward those states and away from the other four.¹¹ (See *Table 1*, page 5.) Thus, equalization in Australia has not taken the direction of development incentives “but has rather been directed towards the equalization of state government administrative, social, and economic services.”¹²

Capital Grants and Approved Borrowing

In addition to the special assistance grants, transfers are made from the national government to the subnational governments of Australia through the medium of the Loan Council in the form of capital grants “to assist the states to finance works of a nonrevenue producing nature”¹³ and others in the form of approved borrowing. The latter is extended to larger semigovernmental and local government authorities as well as to states. The national government also provides assistance to the states outside the Loan Council machinery by way of grants and advances for specific capital purposes. “This has enabled it to play a larger role in determining the direction of state investment; on the other hand, it has had the effect

of multiplying the points of decisionmaking.”¹⁴ These transfers have assisted the states in a wide range of activities, including “land acquisition, [establishment of] growth centres, area improvement, sewerage, urban public transport, hospitals, education, community health, the national estate [the term in Australia for publicly owned land], pre-schools and child care.” After 1974, however, the national government began to assume from the states full responsibility for funding universities and colleges of advanced education, accounting for a drop in the number and amount of such transfers; and from 1976-77 on, there has been a further “significant reduction in many specific purpose capital programs, especially in the field of urban and regional development.”¹⁵

General Revenue Grants

The national government makes payments to subnational governments in the form of general revenue grants. General revenue grants stem from the position of financial superiority which accrued to the national government after it took over all levying of income taxes in 1942. At first the grants were made as tax reimbursement grants; increasing objections to the inadequacy of the formula on which they were based resulted in adoption of a new formula in 1959. That in turn did not prove to be satisfactory in operation, so in 1975 the intergovernmental consultation process came up with a system of personal income tax sharing to replace the financial assistance grants. Under this system, each state is given a designated share of the national government’s personal income tax collections based on the relationship of the earlier grants to such tax collections in 1975-76. The amount received may be used wholly at the discretion of the recipient states. The ratio for a given year was eventually fixed at 39.87% of collections in the previous year. Distribution among the six states is based on the per capita relativities in the financial assistance grants made in 1975-76. Those relativities are currently under review by the Commonwealth Grants Commission. (The states insisted on an enlarged grants commission if such a review were to be made so that the three-member commission has been augmented for that purpose by three associate members nominated by the states.) The overall tax-sharing arrangement itself was to be reviewed by the Commonwealth and the states by the end of 1981.

Under the tax-sharing arrangement, the national government can add personal income surcharges or

offer rebates without affecting state entitlements; but a guarantee provision was included to prevent state entitlements "from falling below the amounts they would have received as financial assistance grants" or from falling below the amount of their share the previous year. The guarantee was altered at the December, 1979, Premiers' Conference so that in 1980-81 each state would receive "no less in real terms than the amount it received in 1979-80 as measured by the consumer price index for the four quarters to March 1981, as compared with the four quarters to March 1980, in the capital city of each state."¹⁶

As Richard Spann has noted, there was "no particular rationale" for the new arrangement, "except as an earnest of good intentions." Thus, if the national government wishes "to raise or lower taxes to stabilize the economy or to meet a greater or smaller defense commitment, or to change the balance between direct and indirect taxation, this creates no automatic case for changing the level of state grants."

In any case, the general purpose grant based on income tax provides under half of total grants to the states, so there is still considerable room for maneuver by the [national government], even without changing the percentage. The [national] treasurer has also made it clear that he may declare any part of the income tax to be a "surcharge" in which case it will not be part of the base that determines the states' share. The states could well end by being more uncertain about what they will get than they were under the old arrangements.¹⁷

On the other hand, the general revenue grant system, which is "designed to do the main job of redistribution between states . . . has made the special [revenue assistance] grants largely redundant. . . ."¹⁸ As noted earlier, Queensland and the Northern Territory are now the only "claimant" governments still receiving such grants.

Since the new arrangements were put into operation, the entitlements "flowing to the states have fallen well below expectations, partly because of the introduction of personal [income] tax indexation and partly because of depressed economic activity and high unemployment, so that the financial assistance formula guarantee has had to operate for most states."¹⁹

Originally, general revenue grants went to state governments only, but under the new arrangements,

from 1975 on, local governments receive a designated share—currently set at 1.75% but designed eventually to rise to 2%—of personal income tax collections. State grants commissions²⁰ were required to be established to advise on the distribution to individual local government authorities within each state of the tax-sharing entitlement, with the proviso only that at least 30% of the total amount be distributed on a population basis. The rest is allocated on a "general equalization basis," with the precise formula left to the state commissions. Local governments altogether received an estimated \$179.4 million (Australian dollars) in 1978-79 under this tax-sharing arrangement.

Reviewing the tax-sharing system in operation, Russell Mathews concluded that if its purpose was "to reduce the states' dependence on Commonwealth financial support, enhance the fiscal responsibility of both Commonwealth and state governments and make the states accountable for their own budgetary decisions, there has so far been little indication that these purposes will be achieved."

The only effective difference between the tax-sharing arrangements and the system of financial assistance grants which they replaced has concerned the method of calculating the state revenue entitlements. Arguments between the Commonwealth and the states have continued to centre on the amounts of revenue the Commonwealth should raise on the states' behalf, and not on the principle of state fiscal autonomy. Not only have the states all indicated their strong opposition to any resumption of state income taxation, but since the introduction of the tax-sharing arrangements they have begun to establish or reduce the incidence of some of the main taxes under their own control, in particular death and gift duties, land tax and payroll tax.

Both the Commonwealth and the states must share the blame for the failure of the tax-sharing arrangements to result in increased fiscal responsibility for the two levels of government. The Commonwealth has demonstrated that it does not intend to make tax room for the states by reducing its own rates of personal income tax and, despite the consultation provisions in the Points of Understanding on the tax-sharing arrangements, continued to make unilateral deci-

sions on taxation policy irrespective of the effects of those decisions on state finances. It has also continued to use its Loan Council domination as a major instrument of fiscal restraint. [The details of the tax-sharing arrangements were set forth in an intergovernmental agreement called "Points of Understanding."]

For their part, the states have demonstrated that they are more concerned with political opportunities than with fiscal autonomy. They have been only too willing to sacrifice the principle of independence in taxing powers on the altar of political expediency, and to consider the main issue in federal financial relations to be the amounts of financial assistance they are able to extract from the Commonwealth

. . . The forthcoming review of the tax-sharing arrangements may determine, once and for all, whether the states are to participate effectively in a coordinated approach to the formulation of taxation policy or whether Australia will remain a federal paradox, with a unitary and highly centralized fiscal system and an aggressively federal political and administrative system.²¹

Specific Purpose Grants

Specific purpose grants still constitute a sizable proportion of national government transfers to Australian subnational governments. As early as 1923, the national government began making such grants. The years after that saw the growth of a limited number of relatively large specific purpose grant programs, usually focusing on expenditures in selected areas of activity but seldom tied closely to state revenue conditions. Indeed, federal grants have tended to substitute for state revenues rather than to stimulate state expenditures. The first grants were for main road construction, and later grants were made in such areas as education, housing, health and welfare services, local government, rural development, and urban public transport. From 1976-77 on, the national government has been "reducing the emphasis on some specific purpose recurrent programs"²² in line with a decision to restrict such grants "to areas of national need and . . . to encourage innovation or to meet special situations Except in the fields of education (where grants have been roughly maintained in real terms) and health and

welfare (where there has been an increase in hospital grants and [where] it seems likely that most other grants will be consolidated into block grants), most specific purpose grant programs have been abolished or severely curtailed. . . . This has been especially the case with grants for urban and regional purposes. The principal reason for this has been the federal government's difficulty in holding down the size of its budget deficit"²³ Not surprisingly, the reduction in specific purpose payments has been resisted by the states because of the loss of revenue involved.

Specific purpose grants are in all cases conditional. All of them commit the subnational government to a particular program. Though many grants have similar characteristics, some of them require matching funds from the subnational government's own resources. Some are short-term, one-time grants; others are expected to be recurring and so to be renegotiated periodically. And the national government may "administer the grant so as to gain some control over both policy formation and implementation within individual departments of the [subnational] government." For these reasons, states have been critical of the restraints imposed on them by specific purpose grants.

However, states receiving new special-purpose grants can partly reassert their own priorities by reallocating those revenues (including general purpose grants) over which they still have full control. For example, when in 1977 the Commonwealth increased its allocation to local roads but reduced funds for urban arterial roads, Victoria compensated by reducing its own funding for local roads. States can also juggle around as between capital and current expenditure or draw on internal reserves. In 1977 the Premier of New South Wales "found" some \$230 million in the reserves of government agencies and statutory authorities . . . and used this to complement funds raised elsewhere.²⁴

The national government makes some specific purpose grants as capital grants, others are for current expenditure. Some are made as a result of the application of a formula, others result from an investigation into a particular need. Often they are the product of the intergovernmental consultation process and are embodied in an intergovernmental agreement, as noted in an earlier section of this study.

Payments to Local Governments

By and large, all the grants discussed in this section are those from the national government in Canberra to the states (except for the local government portion of tax entitlement). Under the Labor Government, in 1974, a nationwide referendum to give Parliament power to finance local governments on such terms and conditions as it might see fit was defeated at the polls. However, that government did begin to make unconditional block grants to local governing authorities, which were replaced after the Liberal-National Country Party government came into office in 1975 with the income tax-sharing arrangements described earlier. The shares to which individual local governing bodies are due are distributed to them by the states on the basis of the recommendations of state grant commissions. In addition, the national government continues to make a limited number of specific purpose payments directly to local governments, and several other specific purpose payments are passed through the states to local governments, as indicated in *Table 7*.

All of the direct grants in 1977-78 totalled \$14.17 million, and the total pass-through grants for that year amounted to \$137.56 million, of which \$116.95 million went for roads (all figures are in Australian dollars).²⁵ All told, grants from the national government do not constitute a major portion of local government revenues.

After the Northern Territory became self-governing on July 1, 1978, and the main functions of government were transferred to the Northern Territory Assembly in 1979, the same financial arrangements that prevail between the Australian states and the national government were applied to it, so that from July 1, 1979, the territory has received "a personal income tax-sharing entitlement, relevant specific purpose payments, and general purpose capital funds on the same basis as state Loan Council programs. The territory . . . [also has] access to the Commonwealth Grants Commission, and [it] applied for a special [purpose] grant through the commission for 1979-80."²⁶

As for local governments, other than the grants from the national government, local councils are on the receiving end of transfers from their parent state governments. Although, as noted earlier, local governments are heavily dependent on the property tax, they have long depended as well on grants from state governments for a number of specific purposes—roads, water and sewerage schemes, libraries—as

Table 7

Payments to Local Governing Authorities in Australia, 1977-78

Direct grants

- Preschools and Child Care
- Nursing Homes
- Home Nursing
- Aged or Disabled Persons Homes
- Aged Persons Hostels
- Delivered Meals Subsidy
- Handicapped Persons Assistance
- Community Youth Support
- Homeless Persons Assistance
- Arts
- Aerodrome Local Ownership Plan

Payments through the States

- Assistance for Exmouth Shire
- Preschools and Child Care
- Homecare Services
- Senior Citizens Centres
- Urban Food Mitigation
- Urban Water Supply
- Capital Assistance for Leisure Facilities
- National Estate
- Urban Public Transport
- Roads

SOURCE: Russell Mathews, *Australian Federalism 1978*, Canberra, The Australian National University, Centre for Research on Federal Financial Relation, 1979, p. 162.

well as on general purpose grants. Unfortunately, there are no published statistics which separate state grants from own sources to local governments, as distinguished from grants from the national government passed through the states to local authorities. Estimates suggest, however, that, taken together, they are far less in dollar amounts than is the total of grants from the national government and that they fell off slightly in the late 1970s.²⁷ There are, of course, variations from state to state; but in general, state distribution of grants is not influenced by the tax efforts of recipient local governments. In any case, as R.N. Spann observes, "there has been no great feeling in state circles that local councils should be encouraged to expand their functions, or to have more public money at their disposal to spend as they pleased."²⁸

In sum, transfers from the national government to state and local governments in Australia have tended to emphasize general purpose/revenue sharing arrangements, though specific purpose project grant programs have been utilized in a number of areas of governmental activity. Little use has been made of block grants or formulas. The fiscal equalization principle has been an important element in grants arrangements, focusing on fiscal capacity equalization and fiscal performance equalization. Noteworthy, too, is the extensive use of independent statutory authorities in the grant process.

CANADA

In Canada, expenditures by the national government have not risen dramatically, but "provincial and local government expenditures rose . . . from less than 10% of GNP (in 1955) to about 25% by 1975. . . . In 1978, provincial, local, and hospital expenditures . . . were about 1-1/2 times those of the federal government."²⁹ This shift in the relative expenditures among governments was basically due to the rapid postwar increase in demand for the services assigned by the British North America Act to the provinces—notably health, education, transportation, and community amenities—and to the stimulation by the national government of provincial and local efforts to meet that demand. In 1979, the provinces and municipalities spent 67.4% of the revenues available to all government levels combined. Although provincial and municipal tax revenues rose along with the demand for expenditures—amounting altogether to 54.4% of total government revenues derived from their own taxes in 1979—a considerable gap between expenditures and revenues remained in many of the provinces and particularly at the local government level.

Obviously, the provinces with great resource reserves, particularly of oil and gas, have been able to reap immense revenue bonuses from 1974 on, while those provinces without such resources have had only traditional tax sources to rely on and so have been badly disadvantaged. Alberta in particular has accumulated huge surpluses, and both Saskatchewan and British Columbia have consistently had surpluses as well. However, the seven Eastern provinces have had deficits of various sizes. Given the Canadian constitutional arrangement, "which vests in the provinces ownership of natural resources, such as oil, that are unequally distributed across the country," nothing much can be done to ameliorate the situation

save by some kind of equalization scheme under the aegis of the national government.³⁰

As for local governments, for the most part their revenue position has been declining steadily over the last decade, but so have the demands for expenditures at that level. Even so, concludes a recent study of local government in Canada, taken as a whole local governments have been meeting less than half of their total expenditures out of own-source revenues. Put another way, Canadian local governments have been becoming steadily more dependent financially on senior levels of government, especially on provincial governments. On the expenditure side, local governments are locked into much of their expenditures (over half of which go for health, social services, and education), which are mandated by the provincial governments and over which localities have very little discretion.³¹

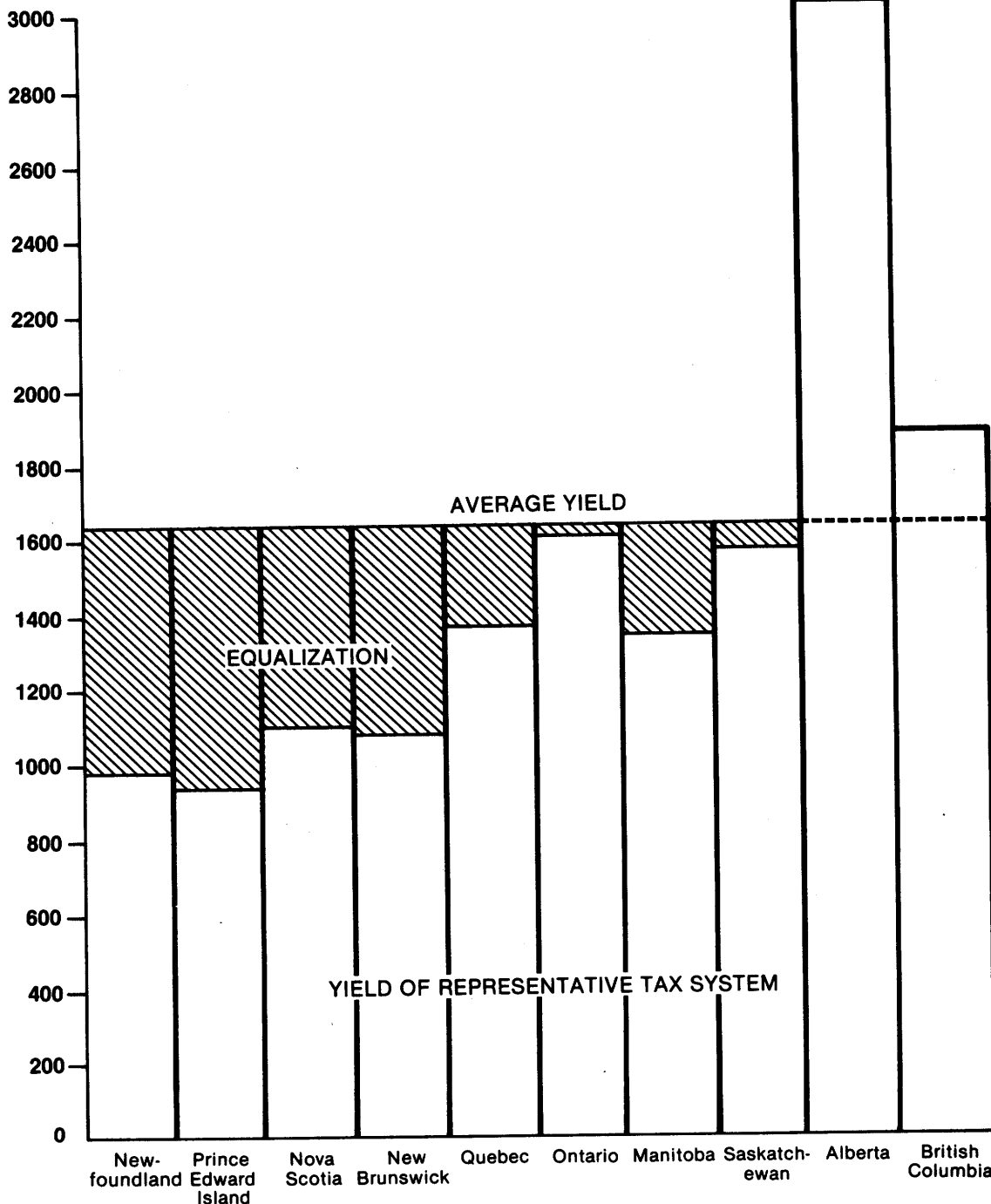
The result of these trends at the subnational level has been the development by the national government of an elaborate and expensive system of intergovernmental fiscal transfers.³² Transfers of funds from the national to the other governments of Canada have been made since the beginning of confederation. The oldest fiscal transfer payments are subsidies paid to each province as part of the terms of confederation. These subsidies were estimated to amount to \$34.1 million (Canadian dollars) in 1980-81. They take several forms, including grants in support of provincial legislatures, per capita grants, debt allowances, and certain special grants. Most of the other transfers are embodied in the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act of 1977, which expires in 1982. Negotiations for its renewal, with a view to having legislation enacted by April 1, 1982, are already well under way. Still other arrangements for the transfer of funds from Ottawa to the subnational governments are embodied elsewhere. When it is realized that total payments by the national government to provincial and municipal governments were estimated to reach \$11.2 billion (Canadian dollars) in fiscal 1979-80 and to constitute about 22% of estimated total national budgetary expenditures in that year, the importance of those transfers can be more realistically understood.

The 1977 act not only continues the basic structure of harmonized tax definitions and collection arrangements discussed earlier in this report, it incorporates a system of equalization payments directed toward the less-favored provinces, incorporates measures to shore up the stability of provincial

Chart 1
CANADIAN

EQUALIZATION ENTITLEMENTS PER CAPITA,
1980-81

Canadian Dollars
per Capita



SOURCE: Department of Finance, Government of Canada, Draft Discussion Paper on Federal-Province Fiscal Arrangements, May 23, 1980, Chart 3, p. 24.

government revenues, and provides for the financing of three major social programs—hospital insurance, medicare, and postsecondary education.

Equalization

The Canadian national government has made equalization payments to provinces with tax yields below a specified standard since 1957. Since 1967, the purpose of the program has been to provide fiscal support to those provincial governments which have demonstrated the inability to raise revenues from their own economies through a broad range of taxes sufficient to maintain an adequate level of public services without having to resort to relatively high rates of taxation. Thus, while the calculation of equalization payments is made with reference to the capacity of the provinces to derive revenue from taxation, its purpose relates equally to provincial expenditures—that purpose being to make it possible for each province to provide its residents with a reasonable level of public services at average rates of taxation.

The system is based on the “representative tax system” pioneered by the U.S. Advisory Commission on Intergovernmental Relations. That system utilizes an “equalization formula” which takes all provincial sources of revenue into account. If the calculation of per capita revenue receipts for any province turns out to be less than the national average per capita yield, the province receives an unconditional, no-strings-attached grant equal to the per capita shortfall multiplied by its population.

The 1977 act identified 29 revenue sources in its construction of a representative provincial revenue structure. *Table 8* lists those sources and the provincial entitlements for fiscal 1979-80 resulting from application of the formula. *Chart 1* shows graphically how that application worked in practice in 1980-81. Equalization payments have been made regularly to seven of the ten provinces (see *Table 9*), which between them account for approximately 45% of the nation’s population. As a consequence of these payments—as well as of the willingness of the receiving provinces to impose a relatively high level of taxes—there appear to have been remarkably small differences between provinces in respect of their public services.

Only Ontario has never received an equalization payment; however, it merited interim entitlements “of \$113 million for 1977-78, \$203 million for 1978-79, and \$255 million for 1979-80.” (The federal fiscal arrangements regulations, which govern equali-

zation payments, provide for interim payments and final adjustment payments which need not be calculated until 35 months after the end of a fiscal year.) The national government presumably took into account the size of the payments due Ontario and its consistently higher-than-the-national-average personal income per capita; and, given the mounting federal deficit in those years, concluded that payments of that magnitude would not be appropriate. “It may also be argued that making payments to Ontario . . . would weaken the overall credibility of the program.”³³ Very likely, the exclusion of Ontario cannot be maintained for very long. It will certainly be one of the principal matters to be examined in the discussions leading up to a revision of the program when the present one expires at the end of the 1981-82 fiscal year.

Requiring equal examination is the matter of unequal provincial revenues from natural resources, most of which accrue to the three western provinces producing oil and gas. Oil and gas revenues have been included in equalization since 1967-68 and give rise to large equalization entitlements because the disparities among provinces in respect of resource revenues are exceptionally large. As a result, an increasingly large proportion of equalization has been paid because of revenues of a kind that are not levied in all provinces and that bear very little relationship to the costs of public services in any province. The federal government recognized that equalization might produce windfalls, even to the poorer provinces, and that the federal capacity to finance equalization might become strained if the formula were not altered to take into account resource revenues. In the 1977 fiscal arrangements, the federal government cut back on the extent to which those revenues would be included in equalization (a 50% maximum was set) and a ceiling on the proportion of total equalization that may relate to resource revenues was superimposed on the equalization formula. That ceiling came into effect for the first time in 1980-81.

The problem is how to compensate the other provinces for the lack of natural resources revenues. It is obvious that if the present equalization formula is kept intact, the bulk of the additional compensatory payments will have to come from the very provinces which lack a lucrative natural resource tax base. The conclusion is inevitable, argues J. F. Helliwell, that an “equalization system financed by federal tax revenue is unsuitable for transferring rapidly rising resource revenue from the richer to the poorer prov-

Table 8

**CANADIAN EQUALIZATION ENTITLEMENTS BY REVENUE SOURCE AND PROVINCE,
FEDERAL-PROVINCIAL FISCAL ARRANGEMENTS, 1977-82,
FOR THE YEAR 1979-80
(in thousands of Canadian dollars)**

Revenue Source	Newfound- land	Prince Edward island	Nova Scotia	New Brunswick	Quebec	Ontario	Manitoba	Saskatch- ewan	Alberta	British Columbia	Seven Recipient Provinces
Personal Income Taxes	\$ 121,470	\$ 25,881	\$ 119,477	\$ 120,176	\$ 229,377	\$ - 425,853	\$ 93,058	\$ 85,914	\$ - 163,293	\$ - 206,206	\$ 795,353
Business Income Revenues	39,310	9,065	51,621	45,609	132,546	- 64,902	20,032	20,180	- 197,028	56,433	318,363
General Sales Tax	42,075	10,241	47,448	32,577	183,737	- 41,116	37,640	10,544	- 206,530	- 116,616	364,262
Tobacco Taxes	4,614	469	4,606	722	- 19,935	14,595	4,084	6,075	- 18,901	3,673	633
Gasoline Taxes	10,273	34	3,034	- 1,423	22,756	- 6,522	3,407	- 3,339	- 25,643	- 2,578	34,742
Diesel Fuel Taxes	1,735	1,097	1,968	532	7,565	1,458	1,776	- 2,060	- 14,136	66	12,613
Noncommercial Vehicle Licenses	6,242	253	3,791	2,700	7,512	- 4,573	- 1,185	- 7	- 7,897	- 6,837	19,306
Commercial Vehicle Licenses	3,318	801	4,201	1,021	43,477	27,959	- 4,545	- 13,706	- 47,605	- 14,919	34,567
Revenues from Sale of Spirits	3,595	- 703	- 910	7,799	75,310	- 23,046	- 5,919	- 5,686	- 23,456	- 26,984	73,486
Revenues from Sale of Wine	3,997	583	2,985	3,886	- 5,012	2,671	1,838	3,873	822	- 14,001	12,150
Revenues from Sale of Beer	185	374	1,904	2,712	- 11,490	- 222	887	3,513	3,173	- 1,037	- 1,915
Hospital/Medical Insurance Premiums	4,639	799	1,162	1,980	21,534	- 35,185	3,945	7,061	1,804	- 7,737	41,120
Succession Duties Gift Taxes	1,487	296	1,577	1,612	1,184	- 6,155	1,456	784	- 1,686	554	8,396
Race Track Taxes	2,421	131	2,269	2,160	4,319	- 13,710	871	3,148	- 2,364	754	15,319
Forestry Revenues	1,264	2,665	15,650	- 1,800	43,487	108,804	17,679	13,581	32,730	- 231,532	89,998
Crown Oil Revenues	29,055	6,216	42,869	35,474	318,837	430,249	49,826	- 88,872	- 917,241	93,587	393,405
Freehold Oil Revenues	1,482	317	2,186	1,809	16,257	21,483	632	- 5,741	- 44,871	6,445	16,942
Crown Gas Revenues	22,080	4,724	32,578	26,934	242,297	324,854	39,640	20,127	- 684,043	- 29,391	388,580
Freehold Gas Revenues	596	127	879	728	6,537	8,622	1,069	867	- 22,014	2,589	10,803
Sales of Crown Leases	6,724	1,429	9,921	8,212	73,790	99,524	12,072	- 1,038	- 185,716	- 24,929	111,120
Other Oil and Gas Revenues	1,107	237	1,633	1,351	12,148	16,338	1,943	- 1,261	- 34,405	907	17,158
Mineral Revenues	- 15,026	1,049	2,282	2,341	11,544	9,054	3,649	- 12,135	9,963	- 12,724	- 6,295
Water Power Rentals	- 9,285	294	1,841	1,182	- 5,611	10,860	- 1,642	1,675	4,366	- 3,681	- 11,546
Insurance Premium Taxes	2,392	359	1,995	1,105	- 5,089	- 1,370	1,539	1,467	- 2,440	43	3,768
Payroll Taxes	5,190	1,162	4,255	4,561	9,869	- 25,525	2,291	- 5,415	- 1,539	- 5,679	32,743
Property School Taxes	34,057	6,665	36,284	32,212	97,885	- 111,411	2,960	685	- 56,947	- 41,020	209,378
Lottery Revenues	1,991	336	1,399	1,589	3,880	7,830	433	612	205	- 2,204	10,240
Miscellaneous Provincial Taxes	19,112	4,142	19,700	17,538	56,695	- 53,982	5,305	737	- 50,735	- 18,512	123,229
Shared Federal Revenues	270	0	340	295	- 1,018	- 17	76	274	- 227	8	237
Total Entitlements	\$ 343,842	\$ 79,053	\$ 418,943	\$ 355,595	\$ 1,574,388	\$255,049	\$ 294,817	\$ 51,517	\$-2,657,708	\$- 715,502	\$3,118,155

SOURCE: Department of Finance, Government of Canada, Third estimate for 1979-80 of payments under the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977.

Table 9

**THE GOVERNMENT OF CANADA'S EQUALIZATION PAYMENTS, 1977-78
(in Canadian dollars)**

Payments to	Total (in millions of dollars)	Per Capita (dollars)
Newfoundland	\$ 278	\$494
Prince Edward Island	63	524
Nova Scotia	342	410
New Brunswick	273	398
Quebec	1,323	211
Manitoba	237	230
Saskatchewan	58	62
TOTAL	\$2,574	

SOURCE: Department of Finance, Government of Canada, *Seventh Estimate of Fiscal Equalization*, March 31, 1980.

vines. . . ."³⁴ Thus, the issue of resource revenue is bound to be another major point of discussion in the intergovernmental negotiations leading up to the 1982 fiscal arrangements.

One other attempt to lessen regional disparities deserves brief comment. The regional development program of the national government under the auspices of the Department of Regional Economic Expansion (DREE) approaches the problem by attempting to provide incentives to industry to locate or expand in below-par areas of the country (most of them in Eastern Canada) and thus to generate sustained development there over time. The focus has been on providing employment opportunities. Rather than helping individuals with limited employment and mobility opportunities, however, DREE's help has been extended to firms. The mechanism of the transfer of funds has ordinarily been a general development agreement negotiated between the province and DREE (Prince Edward Island operates under a different arrangement). The program as a whole does not appear to have been very successful in that the depressed regions of the country remain in very much the same relative status today that they occupied a decade ago when the program was begun. Early in 1981, DREE announced that it was working on new "options" to make its programs to reduce regional disparities more effective. They would involve, DREE Deputy Minister Robert Montreuil declared, commitment of funds on an industry-by-industry basis to help raise efficiency and cost-competitiveness, a "greater degree of cooperation and consultation, both with governments and with industry, to achieve collective objectives," and a pro-

gram especially directed to the needs of Western Canada.³⁵

Stabilizing Provincial Revenues

In the earlier tax agreements between the national government and the provinces, the national government provided to the provinces some assurance of a revenue "floor." When the 1977 financial arrangements were negotiated, the national government surrendered to the provinces one percentage point of its personal income tax—i.e., agreed to lower its own take by one percentage point—and gave the equivalent of another one percentage point to the provinces on a one-time only basis. This transfer was presented as final. However, the national government did agree to protect each province against a reduction in the personal income tax revenue due it as a result of subsequent changes in the national personal income tax structure. The revenue impact of any such change on each province is estimated by the national government for each tax year. Where the change would reduce the national basic tax more than 1%, a payment of any amount exceeding 1% is divided among the provinces. This guarantee applies only if the national change(s) is announced in a fiscal year to take effect in that same year and the provinces enact complementary legislation.

"This guarantee limits the exposure of provincial governments to unpredictable changes in their revenues arising from maintaining a uniform tax system. But it also

limits the federal government's commitment to the first year in which a change is in effect. Initially this guarantee was to be [limited] to the nine provinces for which the federal government collects personal income tax. After a request from Quebec, however, the guarantee was made available to that province also for instances when it changes its personal income tax in parallel with moves at the federal level."³⁶

Established Programs Financing

The third important area covered by the Fiscal Arrangements Act of 1977 is the financing of three programs whose antecedents date back many years—hospital insurance, medicare, and postsecondary education. In all three programs, as they were originally conceived, the national government essentially matched provincial outlays on an even-stein basis with no ceiling. Over the years, the costs to the national government increased sharply as the provinces, often in response to federal initiatives, added, to varying degrees, services and programs to be matched. Meanwhile, the provinces began to feel that the federal incentives in those areas undermined their control over provincial priorities. There were other considerations, of course, but by the mid-'70s, it became necessary to rethink the arrangements—at least in the most extensive and expensive program areas.

Under the 1977 arrangements, a system of established programs financing (EPF) was instituted to cover the national government's contributions to the provinces toward the cost of the three program areas. Under EPF, the national government's contributions are no longer directly related to provincial expenditures, but instead are tied to the rate of growth of the economy. Nor are grants to the provinces for these programs any longer tied to provincial outlays in the three specific program areas, although the provinces have committed themselves to continue to meet minimum standards in some key respects. Rather, under the new arrangements, about half of the annual contribution from Ottawa is paid to the provinces in cash in the form of block grants. The amount of the block grant to each province is determined by using the 1975-76 federal contribution to hospital care, medical care, and postsecondary education as the base. A formula—which uses half of the national average per capita payment during the base year as the foundation grant, and which incorporates a moving average of growth rates for per capita GNP as an

escalator—is utilized to calculate the exact amount due each province. The cash payments are divided among the three programs on the basis of their respective proportion of the total amount in the base year. Payments to the provinces are made by the program departments in the national government. Roughly one-half is allocated to hospital insurance, one-sixth to medicare, and the remaining one-third to postsecondary education. In addition, the basic cash payment is supplemented by an unconditional grant equaling one percentage point of the personal income tax and—in those provinces receiving equalization payments—of the equalization entitlement as well.

The remainder of the grant to each province under EPF is provided through tax room. The national government yielded to the provinces 13.5 percentage points of its personal income tax and one percentage point of its corporate income tax, once again supplemented by associated equalization in the provinces to which those grants are made. There were also special transitional payments to ensure that each province would receive at least an amount equal to the earlier cash payments had there been no tax transfer.

Finally, a special arrangement was made to provide grants for the first time to the provinces under an Extended Health Services Program. Payments under this program (made on a per capita basis, escalated by growth in per capita GNP) are to assist the provinces in providing such supplementary kinds of services in the health care field as residential and nursing-home care.

As a result of operations of the 1977 arrangements, critics agree, the structure of Canadian fiscal arrangements has been moved "closer to the structure of responsibilities provided for in the constitution . . ."³⁷ At the same time, the financial position of the provinces has been improved substantially. "Counting the equalization payments associated with the transferred tax points, the federal contribution for 1977-78 [was] \$924 million higher than it would have been [under the old arrangements];" and the difference continues to grow. In addition, the national government "now has clearly defined obligations for its contributions in support of three of the major shared-cost programs. . . . It also has the assurance that the provinces will continue to maintain standards in such facets of [the health] programs as portability and degree of coverage."³⁸ For their part, the provinces are considerably freer than they were to devise their own programs, and they are assured of continuing, predictable receipts. Nor do they have to submit to detailed federal monitoring and auditing of

their outlays in the three areas.

Summing up, the Bank of Nova Scotia concluded,

Because there is no longer dollar-for-dollar federal matching of provincial spending, any progress a provincial government is able to make in containing the growth of its spending in these [EPF] areas will be completely, rather than half, reflected in a betterment of its fiscal position. All told, the new arrangements are an entry on the constructive side of the national ledger.³⁹

On the other hand, the assumption underlying EPF was that the cost to the national government of its expenditures in this connection would be justified because it would assure maintenance of "the portability of Canadian citizenship" and of the right of all citizens to the same "basic levels of service . . . in every part of the country."⁴⁰ Whether that assurance is present may be subject to question. It appears that EPF may be an invitation to the provinces to increase their income while at the same time permitting their services in those areas to erode. Some provinces have cut back on their expenditures or have added charges for some services that were formerly free, particularly in the health fields, resulting in some "falling away from the principles of public financing, comprehensive coverage, and universal access"—all of which Canadians have come to expect will be observed.⁴¹

In the area of postsecondary education, where the federal government's funding "has steadily grown from 46% (1976-77) to 57% (1979-80) . . . the provincial share drop[ping] from 38% to 26% in the same period . . . the figures indicate the provinces are bleeding off to other uses the federal funds intended for universities, although the specific sums vary and are hard to tie down." Indeed, concluded Prof. Vaira Vikis-Freibergs, President of the Social Science Federation of Canada, "the federal government rarely receives recognition from the provinces for the \$1.3 billion in unconditional cash grants plus tax points for postsecondary education. Canadians never learn who is supporting their universities. It is, therefore, a natural tendency for federal politicians to want to put their money elsewhere to receive some credit. There seems to be some indication this in fact will happen."⁴²

Unfortunately, the national government left itself with "no accountability mechanism sensitive enough to quantify [possible provincial aberrations] in ac-

curate figures"⁴³—in effect, without either monitoring or suasive powers over the provinces. (With regard to monitoring, the national government does have a royal commission to review program operations. Such a commission was employed to review the medicare part of EPF, and considerable falling away was revealed.) Moreover, based on the intergovernmental consultation process, as the financial arrangements are, they cannot be amended without the consent of all the provinces; even then, by the terms of the act, it requires three years' notice for termination of federal payments. "The only power the federal government really has [is] cutting funding [which] is almost certainly politically untenable."⁴⁴

Canada Assistance Plan

One major shared-cost program is not included under EPF. The Canada Assistance Plan, a major program designed to provide adequate assistance to persons in need, was put into effect in 1966. It is perhaps unique among the products of the intergovernmental consultation process in that it came about as the result of provincial initiatives, which federal policy was designed to accommodate, instead of the other way round. Three general programs are conducted by the provinces under CAP:

- public assistance to needy individuals and families;
- child welfare services, including child protection, juvenile delinquency programs, services to unmarried mothers, and adoption services; and
- preventive social services, including community development programs, early childhood services, counseling services, home-maker projects, and senior citizen services.

The national government pays half of the costs of operating such programs in each province. The province may choose to administer a program itself, designate a municipality as a "provincially approved agency" to conduct a program (in which case it may pass on to the municipality a share of the costs), or make use of agencies operated by private groups which may be designated as "provincially approved agencies." Although the provinces may recommend projects for consideration by the national government, the national government established the programs which are eligible for cost sharing. It is also up to the provinces to determine to which particular in-

dividuals and families payments under the plan will be made. A province may not require a period of residence as a condition of eligibility. At the request of a province, the national government will make available, where feasible, through the federal Department of Health and Welfare, consultative services with respect to the development and operation of CAP programs.

Other Shared-Cost Programs

Over the years the national and provincial governments have negotiated between them agreements to share costs through conditional grants in a wide variety of fields, and those agreements today are one of the distinctive features of Canadian fiscal federalism. The rationale for a conditional grant is generally accepted to be that the federal government should pay provinces for acting as agents of the national government in achieving a level and quality of services that meet the national interest. Constant attention is paid to the development and nature of such programs by agencies and departments of the two levels of government. The total aid package of each province is constantly being altered as new agreements are reached and old ones are redrawn or dropped. Thus, it is hard to ascertain at any particular moment just what the total shared-cost commitment of the national government to the provinces amounts to, or how much federal money is coming into each province at any one time as a result of agreements in effect. Nor is it clear to average Canadian citizens just what the mix of government funding is in the range of governmental services they receive, inasmuch as cost-sharing arrangements vary from one program to another. In recognition of that problem, the national and New Brunswick governments negotiated an agreement in 1978 to cooperate in informing citizens about jointly financed programs. A similar agreement has been in effect with Manitoba since 1975. Finally, the division of labor between national and provincial administrative agencies in most shared-cost programs reduces the possibility of accountability of both governments for the effectiveness of the program in operation.

Much the most important of the grants under shared-cost agreements are those which compensate a province for one-half of its cost for a well defined program. A typical example is the \$18 million agreement between Ottawa and Saskatchewan, initiated in 1980, which provides that over four years the two governments will share equally the costs of projects

that demonstrate the potential for energy savings or encourage the development of alternative energy sources. Shared-cost programs range across almost the entire spectrum of government programs in Canada—from agriculture to manpower training research, from energy development to citizenship and language instruction for immigrants, and from industrial development to assistance in upgrading highways. In 1977, the largest number of programs was in the environmental area; the next largest, programs in aid of northern development. The many agreements and programs come in a variety of guises and involve a range of financing, payment, and management arrangements. Some are bilateral; some have a set timespan and are temporary or one-time arrangements; others are regarded as relatively permanent and do not involve a set termination date.

Special Financial Arrangements Between the National Government and Quebec

This section is reproduced virtually verbatim from a "Summary of Intergovernmental Fiscal Arrangements in Canada," supplied by D. H. Clark, Assistant Director, Federal-Provincial Relations Division, Department of Finance, Government of Canada.

Since 1964, the national government has had special financial arrangements—often referred to as "contracting out" arrangements—with Quebec. These arrangements relate mainly to the financing of hospital insurance and the Canada Assistance Plan. While other provinces receive their transfers in these programs in the form of cash payments, the transfers to Quebec have been partially replaced by a personal income tax transfer—that is, a reduction in the amount of federal tax which must be paid by residents of Quebec, enabling that province to increase its tax correspondingly. The amount of the reduction in federal revenues from the personal income tax is subtracted from the cash transfer that otherwise would be paid to Quebec by the national government. As a consequence, Quebec has no financial advantage over the other provinces. However, it has an enlarged income tax system and is less dependent upon federal cash transfers than are other provinces. This arrangement was originally offered to all the provinces, but the offer was taken up only by Quebec. As of 1979-80, approximately \$800 million had been transferred to Quebec through this special arrangement.

Provincial-Municipal Grants

As noted earlier in this chapter, local governments (chiefly municipalities) taken together are in a deficit situation all across Canada, meeting less than half of their expenditure obligations from own-source revenues. The balance is made up by intergovernmental transfers, by and large from the provincial sector, making local government even "more of an administrative agency of provincial governments. . . ." ⁴⁵ For the most part, the provinces have opted to make grants in lieu of taxes for provincial property within municipal boundaries and a variety of other grants, chiefly with conditions attached.

Far and away the largest provincial conditional grants are for education, in 1976 constituting 62% of all provincial grants to municipalities. Other conditional grants are for police, water and sewer services, neighborhood improvements, road maintenance, urban transportation, and cultural and recreational activities. Most conditional grants are "'closed' (their amount determined by the province), not 'open' (a fixed percentage of recipient expenditures) as [is] the case with the major federal-provincial conditional transfers." ⁴⁶ Other provincial transfers to municipalities are unconditional—general purpose—grants, under which the province supplies funds on a per capita or other basis to be used more or less at the discretion of local authorities. However, these grants, while coming into somewhat broader use in recent years, still constituted only an estimated 15% of total transfers in 1976.

While provincial grants have been increasing and have come to constitute roughly half of municipal revenues, the grants have not been based "on any part of objective criteria, but on annual negotiations between the two levels of government or on provincial discretionary judgments. . . . This type of annual practice has created uncertainty and inflexibility in municipal finance management" and reemphasizes the lack of municipal autonomy throughout Canada. ⁴⁷

Some of the provinces recently have recognized the need of municipal governments for more revenue. In some, the total amount of grants to local governments has begun to be tied to the yield of specified provincial taxes; and a number of provincial grants to local governments have incorporated equalization or fiscal need components. Several provinces have instituted revenue sharing programs. Quebec, Ontario, Saskatchewan, Manitoba, and British Columbia have instituted programs which "provide municipi-

palities with a defined proportion of provincial revenues collected." Saskatchewan's program rolls certain former conditional and unconditional grants—but not all of them—into revenue sharing, those rolled in differing between rural and urban municipalities. Two pools, the size of which is determined annually, have been established—one for urban municipalities as a group, the other for rural municipalities. Annual increases in the pools are "determined according to an 'escalator' that reflects the growth of the provincial economy." Finally, the two pools are distributed among their respective municipalities according to two specific formulas. Grants for rural municipalities are distributed in much the same way as previously, while those for urban municipalities are distributed under a three-part formula: a flat amount per community, a per capita amount, and a "'foundation grant' which . . . recognize[s] special local circumstances with respect to costs and services." ⁴⁸

For its part, the national government has directly assisted municipalities by making grants in lieu of taxes on federal property within municipal boundaries (although not necessarily in amounts equal to property taxes foregone). Early in 1980 Ottawa announced a new municipal grants program, to be phased-in over a four-year period, to broaden the range of federal properties on which grants in lieu will be paid. Virtually all federal holdings in urban and rural areas, including those of federal crown corporations, will now be included in grant calculations. Other federal grants have been made available to municipalities in the areas of housing, industrial development, urban renewal, and home insulation, as well as those directed at strengthening municipal infrastructure. The amount of money granted to local governments under these programs has been very small and for the most part has been channeled through the provinces. Indeed, Donald Higgins concludes, "As a proportion of total municipal revenue, the federal government's impact is not highly significant to municipalities overall, but only to those that have a heavy federal physical presence." ⁴⁹

In sum, Canada has developed a sophisticated equalization program, and it has replaced categorical grants with established program financing in three important program areas, thus reducing "substantially the role of conditional grants. Yet the large number of remaining grants, mostly for modest programs, is still a significant element of intergovernmental finance." ⁵⁰

THE UNITED STATES

Transfers from the national government to the subnational government of the United States have a long history. As Daniel Elazar points out in his classic *Cities of the Prairie*, federal-state grant programs, "ranging from school land grants which made possible the establishment of the first public schools in the cities of the prairie through a variety of different grants for internal improvements that provided the impetus for connecting them to each other and to the rest of the country, became increasingly common even before the inauguration of the great 20th century cooperative programs. These programs, which were developed in response to the universal problems of the 19th century, led directly into the cash-grant . . . programs of more recent years."⁵¹

The use of federal transfers became increasingly common after World War II and by now constitute roughly one-quarter of total state and local revenues. Put another way, they have come to absorb an increasing proportion of federal expenditures: in 1950 transfers to state and local governments constituted 5.3% of total outlays by the national government (8.8% of its domestic outlays); in 1960, 7.7% of total outlays (15.9% of domestic outlays); in 1970, 12.2% of total outlays (21.1% of domestic); and in 1980 (estimated) 15.6% (20.9%). Most of the growth in the number (498 in 1979)⁵² and in the value (approximately \$83 billion in 1980) of federal transfers—more commonly referred to as grants-in-aid—occurred in the late 1960s and early 1970s, a period encompassing the Great Society concept of the Johnson Administration and the New Federalism concept of the Nixon Administration. The Johnson Administration promoted broad, new initiatives by the national government featuring grants-in-aid in such areas as elementary and secondary education, health care, and urban revitalization. The Nixon Administration actively sought to transfer control of some federal grant programs to the states and brought about enactment of revenue sharing—a major departure in the character of federal transfers.

Recent years have seen a change in the distribution of federal assistance outlays, from those emphasizing commerce and transportation to those for health and human resources programs. They have also seen a change in the objectives and operations of such programs, from supporting ongoing operations of state and local governments to using federal funds to prod those governments to take action in support of specific national purposes as defined by Congress—

thereby permitting federal administrators actively to influence both their program priorities and implementation processes.

With the increasing amounts of federal money poured into intergovernmental transfers, George Break concluded, by 1980 the federal government had become mainly a transfer agency, shifting funds to other units of government which had become the main providers of direct services to the public. "In 1976, the latest year for which national income and product accounts data for all three levels of government are available, purchases of goods and services were only 34% of total federal expenditures but 56% of state, and 96% of local expenditures."⁵³

Today, virtually every general purpose local government unit, and many which are special purpose, receive some federal aid. This constitutes a relatively new phenomenon. Until the enactment of General Revenue Sharing in 1972, many local jurisdictions did not get any federal aid or received such aid only in very small amounts for a few limited purposes. Even today most federal grants go to larger units of government: federal aid to the nation's 47 largest cities, for example, jumped from 2.6% of the cities' own-source revenue in 1957 to an estimated 49.7% in 1978.

The enlarged amount of federal transfers has not only contributed directly to the expansion of state and local government expenditures, but has encouraged state and local governments to raise additional revenue from their own sources through new or increased taxes in order to provide the matching funds required by most grant-in-aid programs to attract federal funds. To a considerable extent, the growth of governmental activity at state and local levels in the U.S. represents the widening range of domestic initiatives taken by the national government, for which federal transfers are made available.

Federal moneys supported state and local efforts to tackle tough social and physical problems, they stimulated new undertakings, they helped develop more systematic ways of identifying interfunctional linkages and coordinating activities, and they encouraged improvement of recipient organizational arrangements and personnel systems, as well as planning and management capabilities.⁵⁴

Indeed, Carl Stenberg concluded, "From the standpoint of intergovernmental impacts . . . the federal government's assumption of progressively greater

responsibility for dealing with domestic problems through use of grants-in-aid stands out as a dominant feature” of the postwar period.⁵⁵ On the other hand, argues D.W. Stephenson, “the plethora of conditional grants . . . has made rational intergovernmental financial arrangements virtually impossible”

Basically, four kinds of instruments are used in making transfers from the national government to subnational governments: formula categorical grants, project categorical grants, block grants, and General Revenue Sharing. Leaving General Revenue Sharing aside for a moment, and speaking only of categorical grants, “there is a general recognition that [they] have been a major cause of increases in government expenditures, and with the current squeeze on revenues, there is a desire to simplify the intergovernmental financial system.” Whether reform is possible seems doubtful to many, given “the ‘iron triangle’ of special interest groups working with the committees of [C]ongress interested in their subjects and the civil servants in the line federal departments who work together to maintain and expand the current chaotic grant structure.”⁵⁶

Categorical grants inevitably involve strings, which often seem to be expensive and intrusive to state and local officials. Both block grants and general revenue sharing represented the efforts of the national government to respond to growing complaints from state and local public officials about the confusion arising from the multiplication of categorical grants, their

uncertainty from year to year, and the infringement upon state and local administrative freedom which accompanies them. Since 1974, however, Congress generally has been unwilling either to extend the block grant concept or to increase significantly the amount of revenue sharing moneys. The desire to maintain control over the priorities of federal assistance is the major source of congressional reluctance to reduce reliance on categorical grants. By 1980, categorical grants had come to count for more than three-fourths of federal grant outlays, while General Revenue Sharing represented only about one-twelfth and block grants about one-ninth.

Transfer Grants

CATEGORICAL GRANTS

These grants are directed at specific, narrowly defined activities. In recent years there has been a slight increase in the use of formula categorical grants. *Table 10* summarizes the categorical grants in effect in fiscal 1978. “Allotted formula grants are much less numerous than project grants in the federal [aid] system but disburse almost as much money.”⁵⁷ Of the total number of federal grants to state and local governments in 1978, 34.6% were formula based.

Formula grants make it possible for the national government to target aid programs “at a clearly defined population of eligible recipients, all of whom

Table 10

UNITED STATES: CATEGORICAL GRANT PROGRAM, FISCAL YEAR 1978

	Nonfederal Matching ^a		Eligible Recipients			
	Yes	No	States Only	State/Local Governments	Local Units Only	State/Local/Other ^b
Formula-Based						
Allotted Formula	61	45	88	8	8	2
Formula Project	25	22	20	10	5	12
Open-End Reimbursement	13	4	16	—	—	1
Total	99	71	124	18	13	15
Project	182	140	67	49	13	193

^aPercentage of matching requirement varies among programs.

^bIncludes private, nonprofit organizations.

SOURCE: ACIR: *A Catalog of Federal Grant-in-Aid Programs to State and Local Governments: Grants Funded FY 1978*, A-72, Washington, DC, U.S. Government Printing Office, February 1979, Table 2, p. 3.

have some need for the aid in question”⁵⁸ A fixed amount of funds is authorized by Congress and a formula is used to determine each eligible recipient’s allotment. Included in the kinds of data used to calculate a recipient’s maximum allotment are total population of the governmental unit applying, composition of population subgroups, level of program, and per capita personal income. Recent formula grants have not only included total population more often as a factor in the formula than previously was the case; they have incorporated measures of program need more frequently. “This probably reflects the addition of new environmental, energy, and transportation programs, in which objectives are more measurable than in such functional fields as human services. Thus, the allocation formulas of the new environmental grants programs contain such factors as number of public water systems and the volume of hazardous waste; the formula of one energy program reflects the number of dwelling units to be weatherized; and several transportation program formulas include miles of public road or miles of rail.”⁵⁹ On the other hand, personal income has been included less in recent formula grant programs.

Some formula grants, though not as many as formerly, involve statutory nonfederal matching requirements; but even where such a provision is lacking, “the authorizing legislation often specifies that recipients should share in the costs of the aided activity, the amounts being left to the discretion of grant administrators.”⁶⁰ Some formula-based grants are closed-ended, covering only specific costs; others provide for open-ended reimbursement, the formula in such cases not allocating a fixed amount of money but committing the government to reimburse recipient costs at a specified rate. Most go to state governments only, while some are available to both state and local governments or to local governments only. In some cases, formulas are applied to project grants (discussed below)—i.e., “competition in project grants funds is constrained by a formula that may . . . determine how much money applicants within each state may receive. These grants are termed formula-project grants.”⁶¹

In 1978, formula grants were most common in ground transportation, education, training and employment, and public assistance and other income supplement programs, although some formula grants were included in virtually every budget subfunction with the exception of community development, health research, and consumer and occupational health and safety.

PROJECT GRANTS

Project grants are used “when neither a well-defined client population nor reasonably objective measures of fiscal need and capacity are available. . . .” Grants are made available to aspiring recipients “for the funding of particular projects in some specified area of public service. This effectively screens out any governments that neither need nor desire the services in question.”⁶² “Project grants are particularly well suited for undertakings of limited duration that involve research, development of new techniques for producing and delivering services, or capital construction.”⁶³ As with formula-based grants some project grants require nonfederal matching funds; others do not. In recent years, project grants have become popular with Congress and have been used in a wide range of functions, with particular emphasis on education, health, the environment, transportation, and economic development.

Project grants require competitive applications by potential recipients, thus they “typically require more paperwork and entail higher administrative costs for all parties than allotted formula grants.”⁶⁴ If the number of applicant requests exceeds the amount of funds available, “grant administrators [are] in a position to pick projects with the greatest promise of success and favor applicants with the greatest need.”

BLOCK GRANTS

This discussion of block grants was written in late 1980; in early 1981 the Reagan Administration proposed consolidating many categorical grants into block grants for specified functional areas.

Block grants provide funds chiefly “to general governmental units in accordance with a statutory formula for use in a broad functional area largely at the recipient’s discretion.”⁶⁵ Although block grants date from 1966, they have not been widely used—in large part due to political resistance to them in Congress. They come with fewer stipulations than categorical grants and, essentially, allow recipient governments to use the funds allotted for any program within a broad policy area. For the most part, block grants have brought together a number of categorical grants in the same general policy field. Thus, the *Housing and Community Development Act of 1974* created a program of block grants for

community development:

[Six] categorical urban aid programs [were consolidated] into a system automatically providing block grants to cities on a three-part formula reflecting a community's population, poverty, and housing needs. The [act] provided for a six-year phase-in period if the shift to the formula reduced a city's previous funding under the categorical programs. While imposing few specific requirements for the use of funds, the [act] generally instructed communities to give top priority to activities helping the poor and eliminating blight. They also had to prepare plans showing how they would meet the housing needs of the poor.⁶⁶

In fiscal 1978, in addition to the Community Development Program, block grants were in use for four other areas: Partnership for Health, Law Enforcement Assistance, Comprehensive Employment and Training (CETA), and Social Services. "Another group of grants to fund a wide variety of state and local capital projects was authorized by the *Public Works Employment Act of 1976*; they have no matching requirements, but state and local governments must apply and compete for these grants, which are administered by the [Commerce Department's] Economic Development Administration. Because of the different administrative requirements [involved]," they are not designated as block grants by the ACIR, though they are considered as such by the Office of Management and Budget.⁶⁷

The five block grant programs differ a good deal from each other. In terms of broad program scope and discretion of local officials, recipients under the Law Enforcement Assistance Program probably had the greatest latitude. (Those grants were phased out in fiscal 1980.) The program scope of both the Community Development and the Partnership for Health Programs is considerably narrower, since some very closely related categorical grant programs remain outside the block grant program. Some require greater adherence to a statewide plan for the service involved, others leave more freedom for local authorities to set priorities. While broadened state discretion is allowed in the social services grant, a number of expenditure limitations were imposed on certain types of activities. The degree of substantive review by a federal agency varies from program to program.

All of the block grants have specific statutory-

based formulas, with population and certain other indices of need being the most prominent factor used. Eligibility in the Social Services Program and in the Partnership for Health and the Law Enforcement Programs is restricted to states, with a required pass-through to localities in the last program. Eighty percent of Community Development grant funds are restricted to metropolitan cities and urban counties meeting certain requirements, while CETA funds can go to cities and counties over 100,000 (individually or collectively), with the states responsible for funding programs for the balance of their respective jurisdictions.

Although all of the block grant programs have administrative requirements, they tend to be less burdensome than those in the categorical grant programs. As George Break concluded, the "components of the federal block grant system are a mixed lot. . . . [T]he ACIR staff studies of them indicated that they 'are not as well defined structurally or as stable politically as other instruments. They are neither widely understood nor widely accepted. They have emerged through historical accident and the politics of compromise, as well as by deliberate design. And they often rest upon unstated premises, unclear intentions, and untested assumptions.'"⁶⁸ But if they have been lauded as valuable and necessary components of federal intergovernmental assistance, the original five have not been added to; and, over the years, Congress has wittled away at them, until, as John Herbers noted late in 1980, "Block grants, only a small fraction of the total [package of federal aid], soon became as restrictive and Byzantine as the categoricals whose evils they were designed to circumvent."⁶⁹

GENERAL REVENUE SHARING

Although distributions to state governments from the general revenues of the national government took place in 1803 and 1837, the idea did not take fire in the U.S. until the 1960s and was not incorporated into law until 1972. The *State and Local Fiscal Assistance Act*, which came into effect that year, provided authorization for a five-year period, which was renewed for another three years in 1977 and for three more years in 1980.

The *State and Local Fiscal Assistance Act* marks a departure from other transfer programs in several ways. Under the act, revenue sharing funds automatically go to the states (except in fiscal 1981) and to all general purpose governments—counties, cities,

towns, and villages—as of the date the law went into effect. Indian tribes and Alaskan native villages are also included within the grant program. No action by any recipient is required. School districts and special districts are excluded from the distribution of funds. Moreover, the act has been both an authorization and an appropriation act, pledging a specific amount of federal aid—about \$6.5 billion a year—to state and local recipients over a set time period. Recipient governments have two years to spend each allotment after it is received. Payments are made four times a year. The funds are drawn from appropriations placed in a trust fund, over which the Senate and House Appropriations Committees have no control. Through the first eight years of the act, both state and local governments received allotments. The amounts due each state (and the District of Columbia) were calculated on the basis of two alternative formulas—the one yielding the greatest return for the recipient being adopted. One formula assigns equal weight to population, general tax effort as measured by the ratio of total state and local tax revenue to state personal income, and the ratio of nationwide per capita personal income to state per capita income. The other formula employs those three factors and adds the extent of urban population and the amount of state income tax collections.

Once a state amount is agreed upon, one third of that state's allotment goes to the state government and the other two thirds is divided among all eligible local governments—the latter either by a state-established formula (which to date no state has found it advantageous to enact) or under the procedure defined in the act. That procedure calls for initial distribution among county areas within the state on the basis of population, general tax effort, and relative per capita income of each county area. The local area allocation is then further distributed among local units of government. Counties share in the local area allocation on the basis of their adjusted taxes (taxes directed to purposes other than education) as a proportion of adjusted taxes for the county and other local governments in that county area. If the county area includes one or more township governments, the townships' share is calculated in the same manner as is the county's. The remaining money allocated to the county area is then distributed among all of the other general purpose units of local government in the county on the basis of population, tax effort, and relative income.

Upon receipt of allotments (entitlements), state officials are free to spend their portion as they please

with only one restriction: revenue sharing funds cannot be used, either directly or indirectly, as the state matching component of any other federal aid program. Local officials are subject to the same restriction, and in addition they can spend their funds only for "priority expenditures" as defined in the law—public safety, environmental protection, public transportation, health, recreation, libraries, social services for the poor and elderly, financial administration, and ordinary and necessary capital expenditures authorized by law.

In addition to these program restrictions, a number of procedural and accounting requirements were imposed as well. These include specific prohibitions against discrimination on grounds of race, color, national origin, or sex in any program or activity funded wholly or in part with entitlement funds. Any violation of these prohibitions can lead to the cutoff of revenue sharing payments.

There are also certain constraints on the division of funds. No local government may receive more in revenue sharing money than half of its adjusted taxes plus intergovernmental aid. Also, in per capita terms, no local government may receive less than 20% or more than 45% of the average per capita distribution to local governments in the state. Those local governments—other than counties, Indian tribes and Alaskan villages—that would be eligible under the terms of the act for less than \$200 (and those that may choose to waive their entitlement—and a few have done so) get nothing; their shares are added to the entitlement of their county governments.

It should also be noted that title III of the 1972 act places a lid of \$2.5 billion annually on federal contributions to the previously open-ended social service program. With the exception of child care, family planning, and services to the mentally handicapped, drug addicts, alcoholics, and children under foster care, not more than 10% of the federal moneys can be used to provide services for individuals who are not recipients of, or applicants for, welfare aid or assistance. Distribution of this aid among the states is on the basis of population.

Although it is not always easy to trace revenue sharing funds at work once they have been received by a government (a problem referred to as "fungibility"), the evidence of several years' use of those funds shows that the largest part has been spent on a few categories, especially education by the states and public safety by cities. Those two categories, plus multipurpose government, environmental protection, and public transportation account for most of

the funds expended. On the other hand, the funds have been widely distributed among the various state and local expenditure categories and no category has been wholly neglected. It is also evident that more funds have been spent for operating and maintenance purposes than for capital purposes.

A number of surveys indicate that state and local policymakers enjoy the wide discretion they are allowed in the use of the moneys received under General Revenue Sharing. Indeed, "no other major federal aid mechanism has gendered such cohesive state-local support."⁷⁰ Although an irresistible coalition of state and local elected officials was able to overcome strong Congressional resistance to revenue sharing both in 1972 and in 1976, when the first three-year extension was passed, it was not able to get Congress to expand it to keep up with inflation. In 1979 Will Myers and John Shannon concluded that the "revenue sharing program has been given the slow strangulation treatment—allowed to twist slowly in the inflationary winds . . . inflation has eroded 40% of the purchasing power of federal revenue sharing dollars over the last eight years."⁷¹ Nor were state-local officials able to prevent the Carter Administration from proposing to cut out the state's share of the money were the program renewed through 1983. The argument to do so stressed that while the federal budget situation has become increasingly stringent since enactment of revenue sharing, more and more states have found themselves moving from a deficit to a surplus position.

STATE TRANSFERS TO LOCAL GOVERNMENTS

In addition to transfers from the national government—either directly or indirectly to local governments through the grant process—local governments are on the receiving end of transfers from their parent states. Until about 1972, more than twice as much local aid came from state governments as from the national government. Except for education, state aid, since then, has fallen off slightly, but still remains an important component of the local revenue dollar and of state expenditures as well. More than one-third of the average state's budget goes toward supporting local activities. In 1978-79, the total amount of state aid to local governments—including federal pass-through grants—was in the vicinity of \$70 billion. By far the most—almost half—was extended to school districts, with counties and municipalities sharing about the same amount be-

tween them in roughly equal proportions, and townships and special districts both receiving very little.

For the most part, states have repeated the process by which the national government has created its transfer programs: they have responded to pressures from groups of local governments or from individual units to enact, over time on a piecemeal basis, a series of categorical grant programs which differ a great deal from one another. According to the Census Bureau, 49 states provide general assistance grants to their local governments. Grants to help finance programs in education top the list of functional grants; over half of state aid on the average goes to that function. Public welfare ranks next nationally—but with this fraction varying widely from state to state, depending mainly on whether public assistance programs are administered directly by the state or through local governments. Highway aid comes third. These three functional areas alone account for about 83% of the total, leaving little more than half of the remaining 17% to be distributed for general local government support and for payments for various other specific programs.⁷²

Although a number of states have moved to examine their overall aid program to local governments, for the most part programs have been neither coordinated or integrated nor have they been periodically evaluated in terms of their capacity to meet local fiscal, administrative, and program needs.

FEDERAL-STATE-LOCAL TRANSFERS

In sum, the transfer system in the U.S. places great emphasis on conditional, specific purpose grants, with block grants being substituted to some extent for the still-dominant categorical grants in recent years. The conditional grant programs—which are more often by formula grant than by project grant—usually involve both restrictive expenditure conditions and matching or other constraining revenue conditions. The latter, however, have tended to make federal grants stimulate state-local efforts and increase state and local spending. The General Revenue Sharing Program—and some categorical grant programs—takes into account the tax effort of recipient state and local governments. Although the concept of fiscal equalization has not been embraced to any great extent in relation to the distribution of federal grants to the states and local governments, it has long been accepted in state to local transfers for purposes of public school funding. Reflecting the greater fiscal and administrative role of local govern-

ments in recent years, the percentage of grants to local governments—whether direct or pass through—has climbed, and an increasing amount of state aid to local governments has been made available, some of it taking into account relative tax efforts by local governments.

WEST GERMANY

The German federal fiscal system is very different from those of the other three countries considered in this report. The divergence stems from the different concept of federalism employed in West Germany since the formation of the republic. It will be recalled from the profile on Germany earlier in this study that the laender “pass much of their legislation in accordance with federal ‘framework’ laws, that the land bureaucracy carries out both land and federal administration, and that the land ministers participate directly in the shaping of federal decisions through the Bundesrat. . . . [In other words], the German arrangement is characterized by coexistence and voluntary cooperation leading to a functional separation under which the federal government is assigned the bulk of legislative power while the states exercise most administrative powers.” Basic to the West Germany governance is “contractual sharing by all governments of public responsibilities involving policymaking, *financing*, and administration of government policies.”⁷³

Thus, the basic feature of German fiscal federalism is revenue sharing. But, rather than seeking to transfer money from the federal coffers back to the subnational governments with few or no strings attached, so as to give those governments greater financial independence, “revenue sharing in West Germany reflects an opposite trend: more interaction of levels of government in the federal system in planning and financing policy responses to public demands.”⁷⁴ The specifics of revenue sharing have been discussed in an earlier section of this report; it need only be said here that in an average year in the 1970s considerably over two-thirds of the total tax income of both the national and the laender governments is derived from joint taxes, to be distributed among the three levels of government.

However, the responsibility of the national government for the financial condition of the subnational governments is not considered to be fulfilled by the sharing of revenues only. It will be recalled that the Basic Law commits the federal government to maintain “unity of living standards” among the various

states of the federation. That requirement has come to be met through three other mechanisms: “vertical equalization (federal payments to poorer states); . . . horizontal equalization (payments to poorer states by richer ones); and intergovernmental grants and subsidies for various special and joint projects, as well as federal payments to the states to defray the costs of administering federal law.”⁷⁵ Each of these will be considered in turn.

Vertical Equalization

Federal payments to the poorer states to accomplish vertical equalization are subsumed in periodic adjustments in the distribution of the value-added (turnover) tax. While the equal division of income taxes between the national and the laender governments is incorporated into the Basic Law and therefore is not subject to change, adjustments in the relative share of the value-added tax can be made by negotiation between the national government and the laender. The reforms introduced in 1969, embodied in Article 102 of the Basic Law, specifically provide that up to 25% of the land share of the value-added tax be paid to the poorer laender. The process by which this is done is complicated: A certain portion of the available value-added tax is allocated to states whose revenue from state taxes (*not* including the state’s share of the value-added tax) is below the all-state average. They receive enough tax to bring their tax revenue up to 92% of the all-state average. The remainder of the amount of value-added tax available (up to 25% of the total returns from the tax) is allocated to local governments, with further distinctions being made between municipalities according to tax need and tax potential. In the negotiations leading up to the 25% share, attention is usually “concentrated on the equalization of revenue-raising capacity, although some provision [is] made for differential costs of services associated with differences in the degree of urbanization among the [laender].”⁷⁶ When an agreement is reached, “the result . . . is canvassed in federal legislation [and] requires the consent of the Bundesrat.”⁷⁷

Another element of vertical equalization in the German system involves local governing authorities. Local governments receive a share of the personal (though not the corporate) income tax, “and this is compensated for in part by the transfer of a certain percentage of the locally levied business tax back to the federation and the states. If the business tax [were] included in the shared tax base [which it is not

officially], nearly 80% of all German taxes [would in effect be] subject to vertical redistribution.”⁷⁸

Finally, Article 107.2 of the Basic Law authorizes supplementary grants from the federal government to financially weaker states to even out differences in the financial capacity of states or to assist particular states. “This provision operates mainly in favor of West Berlin which does not participate in the system of interstate equalization,”⁷⁹ although Bavaria, Schleswig-Holstein, Rhineland-Palatinate, Lower Saxony, and Saarland also have received such payments.

Horizontal Equalization

In addition to federal payments to the poorer states, a horizontal equalization scheme which involves financial settlements among the states themselves is also utilized in West Germany. This is a process that has been described as “brotherly,” rather than the “fatherly” schemes of equalization in Australia and Canada.⁸⁰ These adjustments are made through interstate consultation and negotiation once the vertical equalization agreements have been reached. What is considered is more apt to be “mitigating [any] differentials in tax capacities” than evaluating “differences in regional costs or needs.” Taken into account in the complicated calculation of equalization payments are the poorer—or deficit—states’ tax capacity (states’ taxes plus their share of joint taxes plus parts of municipal taxes), special financial burdens having to be borne by those states, the degree of urbanization and population density of the states, and an average tax capacity yardstick for the federation.⁸¹ The tax capacity of the richer—or surplus—states is also calculated, and the equalization payments are made from these states whose surplus, according to calculations, exceeds 102% of tax needs. The richer states, falling between 102% and 110%, are required to give 70% of the surplus to equalization; if a state’s surplus exceeds 110% of needs, the entire surplus over 110% goes into the equalization fund. In effect, the result of these interstate negotiations is that the richer *laender* subsidize the poor ones. Over time, the system has helped to diminish differences in land tax incomes. Along with other forms of equalization, the tax income of the poorer *laender* has been brought up nearly to the average *laender*.⁸²

The Position of Local Governments in German Fiscal Federalism

Local governments in West Germany are the low men on the intergovernmental fiscal totem pole. German localities have few revenues they can call their own, with the result that they are dependent on grants from other governments to enable them to deliver the many services they are mandated by law to provide. As the ACIR found in a comparative analysis of the ratio of locally raised tax revenue to outside aid in 1978, Germany came in a very poor third when compared to the U.S. and Great Britain: For every one dollar of locally raised revenue, German local governments received \$5 of outside aid.⁸³

On the other hand, the same study concluded that fiscal disparities among local governments were minimized to a greater degree than they were in the U.S. and Great Britain, for three reasons: “First, German states [*laender*] provide local governments with most of their spending money in the form of grants and shared tax revenue. . . . About half of the state-municipal grants are categorical, the other half being in the nature of general revenue assistance. . . . the [amount] of which is formula-tied to the states’ own revenues,”⁸⁴ as well as to the tax potential and tax need of local governments. Moreover, “in sharing aid with localities, German states make explicit adjustments for variations in local revenue capacity. Third, and this is very important, the states in Germany have assumed virtually complete financial and administrative responsibility for elementary and secondary education and for most forms of police protection,” thus relieving local authorities from having to bear the costs of those services out of their revenues.⁸⁵

Nor are German localities neglected by the *laender* governments in their administration of funds allocated to them for disbursement. Close control at a highly professional level is exercised by state officials over local financial administration, through “continuing state monitoring of local finances . . .,”⁸⁶ particularly of local government short and long-term debt schedules.

As a result of the operation of this system, local governments in Germany have very little autonomy of expenditure. “. . . [A]lthough a large share of German local government revenue comes in the form of unrestricted tax-sharing funds, the unconditional character of this aid is more apparent than real. Because the state shares its revenue with localities, state authorities assert that they have a right to man-

date that a growing number of responsibilities be financed by localities. As a result local authorities complain of a progressive constriction of their discretionary authority."⁸⁷

Another result of the German system, however, is that great progress has been made in reducing disparities between local governments.

For all practical purposes, Germany has solved the fiscal equalization problem by severely limiting the ability of local governments to shape their own expenditure and tax policies. To put the matter another way, the high degree of equalization at the local level stems from the fact that the 11 states in the German federal system completely dominate the local fiscal and administrative landscape.⁸⁸

Said more jocularly, "Local government in West Germany can be compared to the dowager's pet poodle—a creature noted more for its cleanliness than for its independence of action. The dowager in this case is the German state. She keeps her poodle on a short leash to prevent the dog from being lured away by certain poodle fanciers headquartered at the federal capital in Bonn."⁸⁹

In addition to state grants to counties and municipalities, county budgets in West Germany are partly financed through contributions from the municipalities within them. A certain percentage of the municipal budget is generally set aside for the county, in most cases subject to state government approval.

Specific Purpose Grants

The German Basic Law established a system of joint federal-state functions; common tasks under article 91a and tasks reached by agreement under article 91b. Article 91a defines three common tasks: university construction, regional economic policy, and agricultural policy (including seacoast development). The fiscal provisions for all three 91a areas are similar. For university construction and regional

economic development programs, the federal government contributes 50% of the required amount; for agricultural programs, 60%; and for seacoast improvements, 70%. For the 91b areas, agreements are in force with regard to educational planning and research promotion. Educational planning requires little expenditure on the part of either level of government, but promotion of research involves federal contributions ranging from 50% to 90%, depending on the particular research organization being financed.

By and large, the expenditures involved in these five programs is not great, amounting to under 2% of total federal transfers to states.

In addition to these article 91 programs, there are a good many other transfers from the federal to subnational governments for a variety of other purposes. They are not very important items in terms of amount expended, however. Some transfers are carried on informally, others under negotiated agreements. Some only go to states, others to local governments. Most of the grants made to the laender in West Germany are conditional. But it has not been easy for the federal government to attach very specific conditions to grants to local governments since 1975. In that year the Supreme Court ruled, in a case involving urban renewal, that while the federal government could define the purposes of such grants broadly, it had to leave the specifics of the program to the states. The two major programs involving federal-to-local grants other than renewal are transportation, including both streets and public transit, and hospital construction. These grant programs are the product of the intergovernmental consultation process built into the German federal system. In making them, "criteria such as the 'uniformity of living conditions' in the Federation and other equity considerations seem to prevail. . . . [Indeed] the rationale of West German intergovernmental transfers rests entirely on a welfare type of argument, not solely in terms of providing minimum standards but in terms of *average national standards*. The individualistic calculus of optimizing grants does not seem to play a significant role."⁹⁰

FOOTNOTES

¹A.H. Boxer, ed., *Aspects of the Australian Economy*, Melbourne, Melbourne University Press, 1965, p. 21.

²R.N. Spann, *Government Administration in Australia*, Sydney, George Allen & Unwin, 1979, p. 171.

³*Ibid.*, p. 180.

⁴Russell Mathews, *Regional Disparities and Fiscal Equalization in*

Australia (printed as No. 30 in the Reprint Series of the Centre for Research on Federal Financial Relations), The Australian National University, from *Proceedings of the International Seminar in Public Economics on Regional Aspects of Fiscal Policies*, Toledo, Spain, September 6-8, 1979, p. 33.

⁵*Ibid.*, p. 35.

⁶*Ibid.*, p. 36.

⁷*Ibid.*, p. 38.

- ⁸*Ibid.*, pp. 38-39.
- ⁹*Ibid.*, p. 15.
- ¹⁰*Ibid.*, p. 27.
- ¹¹*Ibid.*, pp. 4-6.
- ¹²*Ibid.*, p. 6.
- ¹³Commonwealth Grants Commission, *45th Report 1978 on Special Assistance for States*, Canberra, Australia Government Publishing Service, 1978, p. 14.
- ¹⁴Spann, *Government Administration in Australia*, p. 184.
- ¹⁵Mathews, *Regional Disparities and Fiscal Equalization in Australia*, pp. 15, 18.
- ¹⁶Mathews, *Australian Federalism 1979*, Canberra, The Australian National University Centre for Research on Federal Financial Relations, 1980.
- ¹⁷Spann, *Government Administration in Australia*, pp. 178, 179.
- ¹⁸*Ibid.*, p. 180.
- ¹⁹Mathews, *Regional Disparities and Fiscal Equalization in Australia*, p. 53.
- ²⁰See Norman J. Thomson, "Local Government and the Grants Commissions," *The Australian Quarterly*, September 1979, pp. 89-97, for an analysis of the state grants commissions at work.
- ²¹Mathews, *Australian Federalism 1979*, pp. 196-97.
- ²²Commonwealth Grants Commission, *45th Report 1978*, p. 18.
- ²³Mathews, *Regional Disparities and Fiscal Equalization in Australia*, p. 53.
- ²⁴Spann, *Government Administration in Australia*, pp. 180-81.
- ²⁵Mathews, *Australian Federalism 1978*, Table V-8, p. 162.
- ²⁶Mathews, *Regional Disparities and Fiscal Equalization in Australia*, p. 54.
- ²⁷Mathews, *Australian Federalism 1978*, p. 163.
- ²⁸Spann, *Government Administration in Australia*, p. 237.
- ²⁹Economic Council of Canada, 16th Annual Review, *Two Cheers for the '80s*, 1979, p. 47.
- ³⁰From a study of the Conference Board in Canada, reported in *The Globe and Mail*, Toronto, November 15, 1979, p. B2.
- ³¹See T.J. Plunkett and G.M. Betts, *The Management of Canadian Urban Government*, Institute of Local Government, Queen's University, Kingston, Ontario, 1978, pp. 70-74.
- ³²A good overall review is given in Garth Stevenson, *Unfulfilled Union: Canadian Federation and National Unity*, Toronto, MacMillan, 1979, Chapter 6, "Problems of Fiscal Federalism," and Chapter 7, "Conditional Grants and Shared-Cost Programs."
- ³³David B. Perry, "Fiscal Figures, Equalization and Shifting Provincial Revenues," *Canadian Tax Journal*, November/December 1979, pp. 731, 732.
- ³⁴J.F. Helliwell, Remarks to the 1979 Annual Conference of the Canadian Tax Association, quoted by Edward Clifford, *The Globe and Mail*, Toronto, November 27, 1979, p. B2.
- ³⁵For a critical analysis of DREE, see Michael J.L. Kirby, *Federalism and Regional Economic Development: The Case for a Strong Central Government*, lecture delivered at McMaster University, Hamilton, Ontario, February 6, 1979, Xerox, pp. 59-61.
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- ⁴³*The Financial Post*, Toronto, March 15, 1980, p. 3.
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- ⁴⁵Donald J.H. Higgins, *Urban Canada: Its Government and Politics*, Toronto, MacMillan, 1977, p. 70.
- ⁴⁶Richard M. Bird, "Financing Canadian Government: A Quantitative Overview," *Financing Canadian Federation*, Toronto, Canadian Tax Foundation, 1979, I, p. 61.
- ⁴⁷Yul Kwon, "Revenue Sharing as an Improvement in Provincial-Municipal Relations in Canada: An Evaluation of Saskatchewan's Revenue Sharing," *Canadian Tax Journal*, September/October 1979, p. 576.
- ⁴⁸*Ibid.*, pp. 577-78.
- ⁴⁹Higgins, *Urban Canada*, p. 77.
- ⁵⁰George E. Carter, *New Directions in Financing Canadian Federalism* (Occasional Paper 13), Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1980, p. 19.
- ⁵¹Daniel J. Elazar, *Cities of the Prairie: The Metropolitan Frontier and American Politics*, New York, Basic Books, Inc., 1970, pp. 380, 382.
- ⁵²There are no "accepted rules for determining when an authorized activity is a separate program, [thus] counting the number of grants is not a simple task. A single statute often authorizes a number of separate, albeit related, programs. Other statutes combine activities which, because of funding, operation, or administration, are actually separate programs. Some programs are authorized as earmarked activities under an authorization for a broader activity, or several alternative activities may be listed as permissible under one program." (Advisory Commission on Intergovernmental Relations, "The Intergovernmental Grant System: An Assessment and Proposed Policies," *A Catalog of Federal Grant-in-Aid Programs to State and Local Governments, Grants Funded in FY 1978*, A-72, Washington, DC, U.S. Government Printing Office, 1979, p. 6.
- ⁵³George F. Break, "Fiscal Federalism in the 1980s," *Intergovernmental Perspective*, Advisory Commission on Intergovernmental Relations, Washington, DC, U.S. Government Printing Office, Summer 1980, p. 11.
- ⁵⁴Carl W. Stenberg, "Federalism in Transition," *Intergovernmental Perspective*, Advisory Commission on Intergovernmental Relations, Washington, DC, U.S. Government Printing Office, Winter 1980, pp. 4, 6.
- ⁵⁵*Ibid.*, p. 4.
- ⁵⁶Remarks of D.W. Stephenson, President of the Institute of Public Administration of Canada, in the *Bulletin* of the Institute, vol. III, no. 3, August 1979, p. 3.
- ⁵⁷George F. Break, *Financing Government in a Federal System*, Washington, DC, The Brookings Institution, 1980, p. 130.
- ⁵⁸*Ibid.*
- ⁵⁹Advisory Commission on Intergovernmental Relations, *A Catalog of Federal Grant-in-Aid Programs to State and Local Governments: Grants Funded FY 1978*, p. 3.
- ⁶⁰Break, *Financing Government*, p. 131.
- ⁶¹ACIR, *A Catalog*, p. 10.
- ⁶²Break, *Financing Government*, p. 134.
- ⁶³*Ibid.*
- ⁶⁴*Ibid.*
- ⁶⁵*Intergovernmental Perspective*, Spring 1977, p. 9.
- ⁶⁶Congressional Quarterly, Inc., *Urban America: Policies and Priorities*, Washington, DC, Congressional Quarterly, Inc., 1978, p. 12-A.
- ⁶⁷Break, *Financing Government*, p. 170.
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⁷¹*Ibid.*

⁷²See Advisory Commission on Intergovernmental Relations, *Improving Urban America: A Challenge to Federalism*, M-107, Washington, DC, U.S. Government Printing Office, 1976, pp. 60-68.

⁷³Arnold J. Heidenheimer and Donald P. Kommers, *The Governments of Germany*, New York, Thomas Y. Crowell Co., 1975, 4th ed., pp. 213-14 (*underscoring* supplied).

⁷⁴Robert L. Rothweiler, "Revenue Sharing in the Federal Republic of Germany," *Publius*, Philadelphia, PA, January 1972, p. 25.

⁷⁵David P. Conradt, *The German Polity*, New York and London, Longman Inc., 1978, p. 199.

⁷⁶Mathews, *Regional Disparities*, p. 25.

⁷⁷P.B. Spahn, *The Australian Tax-Sharing Proposals in the Light of West German Experiences*, Reprint Series No. 15, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1977, p. 11. (Spahn's paper was originally presented to seminars in Sydney and

Brisbane in 1976.)

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⁷⁹*Ibid.*, p. 25.

⁸⁰J.S.H. Hunter, *Revenue Sharing in the Federal Republic of Germany*, Research Monograph No. 2, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1973, p. 95.

⁸¹Spahn, p. 26.

⁸²Conradt, p. 221.

⁸³John Shannon, *Local Finance in Great Britain, West Germany, and the United States: A Comparative Analysis*, A Report of the Trinational Cities Exchange, published by the National Urban Policy Roundtable, Columbus, OH, Academy for Contemporary Problems, 1978, Table 1, p. 2.

⁸⁴Spahn, p. 12.

⁸⁵Shannon.

⁸⁶*Ibid.*, p. 3.

⁸⁷*Ibid.*

⁸⁸*Ibid.*, p. 4.

⁸⁹*Ibid.*, p. 5.

⁹⁰Spahn, p. 7.

Problems and Issues in Fiscal Federalism

This study has thus far focused on fiscal federalism in the four countries, as of late 1980. The status quo, however, is unlikely to be maintained very long. Not only are all four countries faced with inflation and energy and other problems, but forces within each of them are at work pointing toward change. It may be that the greatest potential for change lies in Canada, where opening skirmishes in a battle over the very constitutional basis of the Canadian federal system have already been fought. In the U.S., the Reagan election and the more conservative government policies it promises suggest that some adjustments in the prevailing pattern of federalism may be forthcoming. Both Australia¹ and West Germany have recently reelected incumbent governments, thereby suggesting that no great winds of change will move across the countries in the near future. Issues have been identified in both countries, however, and their solutions may point toward some change in the current pattern of federalism. Once again, it is necessary to look at each country in turn in order to analyze the possible new directions in federalism as a whole and in fiscal federalism in particular.

AUSTRALIA

In a 1978 analysis of issues in Australian federalism, Russell Mathews, the foremost student of federalism in that country, noted that "the Australian federal system has moved far along the road to Commonwealth financial domination, and yet federalism is probably more firmly established as the basis of

government than ever before." He went on to note that:

A superficial explanation of this seems to be the success which state governments have had in marshaling political opposition to the centralizing policies of successive Commonwealth governments, but the real reason seems to be a changed attitude towards the notion of federalism itself.

Federalism is no longer regarded merely as a compromise solution, or an interim solution, or a second-best solution to the problems of government. Increasingly, the federal form is recognized as having positive advantages compared with loose associations of nation states on the one hand and highly centralized unitary governments on the other . . . [in Australia] federalism is now seen to be a means of facilitating decentralized decision-making within a unified planning and policy framework.²

The Australian voters seemed to support Mathews' contention in both the 1975 and the 1980 elections, registering their preference for a Liberal-National Country Party coalition operating under its banner of New Federalism over the more centralist Australian Labor Party, which, under Gough Whitlam as prime minister (1971-75), seemed to confront state government power at every turn.

However that may be, a number of criticisms of the existing system and particularly of its fiscal aspects have been made, suggesting the possibility of some alteration in that system. One set of criticisms has been directed at the powerful role of the Commonwealth Grants Commission. A number of critics "claim that it is opposed to all democratic principles for a nonelected body such as the . . . commission" not only to exercise such extensive powers in respect to the fiscal needs of the poorer states, but especially for it to be involved in making recommendations "for the alteration of existing areas of personal income tax made available by the Commonwealth for the states."³ The purpose of utilizing the Grants Commission, of course, was (1) to remove the determination of what would constitute a fair distribution of revenues among governments in Australia from the "political haggling and compromises of the kind that are reached at premiers' conferences and Loan Council meetings," and (2) to assign it instead to an independent "expert and impartial body,"⁴ where the matter could be dealt with rationally and on the

basis of demonstrable facts and statistics.

Criticism of the commission has not come from the people but from state governments, which are understandably concerned that what they have won by hard bargaining might be lost in the application of a formula. Their fears have been somewhat alleviated by the agreement to create a special division of the commission, consisting of three state-nominated appointees to serve along with the three commission members to undertake the relativities review. And the fact that the commission must rely heavily "on the cooperation and expertise of state treasurers and leading departmental officials" to provide the data on which its analyses must be made has further eased those fears.⁵ Thus, the commission continues to operate and does not seem in imminent danger of being dismantled.

Another set of criticisms is levied at the nature of the Australian tax system. Russell Mathews has pointed to "the inability or reluctance of state and local governments to exploit revenue sources under their own control [as] a major disadvantage of Australian taxation arrangements. With divided responsibility for revenue raising," Mathews has noted, "no level of government needs to account for its expenditure decisions by reference to the level of taxes it imposes on its own citizens. This leads to political irresponsibility, economic inefficiency [and] overexpanded services and facilities in some fields and chronic shortages in others." Another disadvantage, as Mathews sees it, is the "lack of adaptability" of the Australian tax system "in the face of changing economic and social circumstances." What governments have done in response to such changes has been merely to make "frequent, minor, partial, piecemeal, and often arbitrary modifications to the tax system. These have had the effect of making it increasingly more complicated, less well understood by taxpayers, and less certain in its impact." And since the Australian tax system is dominated by income taxes, these taxes are "decisive in determining the overall effect of the tax system on the distribution of income and wealth, the level and pattern of economic activity, the economic performance of producing sectors, and the behavior of consumers." Yet the very progressive rate structure of the income taxes has produced a set of problems of its own, prominent among which is its disincentive effect.⁶ Ways to make the existing system work more effectively were examined by the Australian Taxation Review Committee, whose report was published in 1975;⁷ but few of its recommendations have been accepted.

Although the tax-sharing arrangements currently in effect in Australia “represent a significant retreat from the Commonwealth’s income tax monopoly and a step towards vertical balance . . . [and have] the potential for achieving horizontal financial balance,” the states have not reacted wholly favorably to them. They have not responded to the possibility of introducing income tax surcharges, “which some premiers have said would involve double taxation,” and they have been critical both of the use of personal income tax collections as the revenue base and of the recent switches from specific-purpose programs. “Some states have also been reluctant to accept the cost of establishing state grants commissions to advise on the allocation of local government grants.” In short, Russell Mathews argues, “it has become only too clear that the states’ response to the new arrangements is based on expediency rather than principle and that they continue to be more interested in maximizing financial returns than in regaining a measure of financial autonomy and coordinating their policies with those of the Commonwealth.” On the other hand, Mathews also noted that “the Commonwealth has tended to exploit its position by making unilateral decisions affecting the states without adequate consultation or regard for their interests.”⁸

There is also continuing concern in Australia, as in all the other countries reviewed in this study, about the plight of urban governments, which “find themselves year after year facing rising expenditures and more slowly rising revenues, particularly revenues from sources under their own control.” Despite inclusion of local governments in the income tax sharing arrangement and the award of other grants to them, Australian cities complain that they do not have sufficient revenues to enable them to do what they are assigned responsibility for in the federal system. Since they are not an effective part of the intergovernmental consultation process, it is difficult for them to make their case where it counts as strongly as they would like. What Richard Bird concluded generally applies to Australia as well:

Unless and until central governments are prepared to treat municipal authorities seriously as responsible partners in an important national task, there is no reason to anticipate any deviation from recent trends to greater centralization. . . . For municipal governments to contribute their fair share in such a system, they will . . . have to be

restructured to some extent both organizationally and in terms of finances. In particular, the larger and faster-growing urban areas may well require new forms of governmental structure. . . . National governments, on the other hand, will have to recognize the need for genuine local inputs into the decision process more than they have . . . to date.⁹

Finally, it should be noted that the legal standing of the intergovernmental agreements on which much of fiscal federalism rests in Australia is uncertain. “. . . [C]hallenges [have been] mounted in the High Court to determine the validity of the federal government entering into . . . particular agreement[s] in the first place.”

The [C]ourt has rarely proscribed such action because of the far-reaching powers . . . under Section 96 of the Australian Constitution which allows the national Parliament to “make grants to the states on such terms and conditions as it sees fit.” But there has been little litigation which has sought to determine whether the federal government is either escaping its responsibility or exceeding it under any particular agreement.

The situation is made even cloudier . . . because of the uncertain constitutional status of local governments in relation to agreements. [The High Court has] established that the national government could not enter into agreements directly with local governments per se, but if a local government cared to register as a charitable organization or under some other category provided for in the requisite federal legislation, such agreements could be made and money could flow direct. . . bypassing the states.¹⁰

Lacking any formal requirement that intergovernmental agreements be tabled in Parliament, very few are ever debated in either federal or state parliaments at any time in the negotiation process. “On the few occasions on which they are debated the appropriate minister issues a plea that there be no changes to the arrangements because of the daunting logistics involved in getting . . . seven . . . governments to agree. . . . As regards continuing debate on any agreements, in Australia a backbencher would spend most of his or her time (a) ascertaining that there was

an agreement, (b) obtaining a copy of it, and (c) trying to determine which minister was responsible for it. Having followed this tortuous process he or she would ask a question only to find that the minister could shift blame to the other level of government or even refuse to answer the question without falling afoul of the speaker." Nor are there any standing committees in either the federal or state parliaments assigned responsibility for scrutinizing intergovernmental agreements. And to compound the issue, "the executive of the federal and . . . state or local government has a vested interest in blurring the degree of responsibility it has under any agreement and in this it is aided and abetted by an electorate largely unaware of even the broad allocation of government functions in the Constitution."¹¹

All of these caveats notwithstanding, it does not appear that major changes in the arrangements of Australian fiscal federalism are in the immediate offing. The criticisms have not yet become part of the political dialogue of the country, but remain largely in the domain of academic and legal commentary. Nor does anything suggest that these problems are likely to become political issues in the near future. The report of the Grants Commission on the possible revision of relativities in the equalization formula and the review by the Commonwealth and state governments of the tax-sharing arrangements—both due in 1981—may lead to minor adjustment; but overall, the pattern of Australian fiscal federalism seems to be fairly stable.

CANADA

It is in Canada that the status not only of federalism itself but in particular of the existing pattern of fiscal federalism faces the greatest possibility of change among the four countries under consideration in this study. The problem is made infinitely more difficult by the fact that changes in the latter have to be dealt with even while the former has not been clearly established. The issues in both controversies deserve brief comment.

First, issues arising out of the existing pattern of fiscal federalism. The most outstanding issue, Jeffrey Simpson reported early in December 1980, is how, in renegotiating the Fiscal Arrangements Act for extension in 1982, the federal government can save money. "The issue in question," Simpson notes, "involves . . . billions of dollars," dollars of which the federal government finds itself in short supply. "Just how Ottawa will propose to save money awaits a decision

by the federal cabinet. But that the federal government is determined to do so is beyond doubt." Indeed, Simpson concludes, the basic principle of cost-sharing may be at stake. Whatever Ottawa decides to do, "the provinces are sure to scream." With luck, the time bomb which has begun ticking already "will be defused and Canada will be spared another federal-provincial explosion. But if the worst happens some time next year [1981], Canadians can expect a battle between Ottawa and the provinces that may make [previous] disputes . . . look like minor skirmishes."¹²

As noted in an earlier section of this study, the federal deficit has been growing rapidly since 1975. Although smaller deficits are predicted for the next few years, the long-term picture is not cheerful. "While Ottawa's fiscal position has deteriorated, the provinces have been enjoying a collective surplus. . . . [T]he fiscal position of the provinces in general . . . is far healthier than Ottawa's."¹³ Therein lies the rub. Ottawa has concluded that its fiscal position is no longer tenable. The deficit must be reduced. If doing so means that some cost-sharing programs must be cut or abandoned, so be it. "In other words, Ottawa is not going to fork over the same kind of yearly increases after April 1, 1982, as it has since . . . 1977."¹⁴

With austerity dominating the context in which negotiations between governments will be taking place, a number of issues take on added importance. Prominent among such issues, in Canada as in the other three countries considered in this study, is the inadequacy of urban finance. As Richard Bird has noted, in Canada, where "the property tax is the principal source of local revenue . . . the usual demand from hardpressed urban authorities has been for direct local access to the income tax. This demand is greatly strengthened . . . by the understandable dislike of urban politicians [of] raising additional revenues through the highly visible, and highly unpopular, property tax."¹⁵ Even with the hefty intergovernmental transfers which now account for half or more of local revenues in most provinces, local government officials are not happy. A survey of municipal government officials in the early 1970s found great dissatisfaction with the yield of the revenue arrangements then applicable to local governments in Canada. In response to the open-ended part of the questionnaire, a common remark was: "There should be a specific municipal share of income tax revenue." Many respondents suggested sharing with the provinces a wide range of other taxes.¹⁶ To date,

neither of those suggestions has been responded to either in Ottawa or in most provincial capitals.

Similarly, there seems to be considerable dissatisfaction at subnational levels with the policymaking process described in *Chapter 3* of this study. Kenneth Wiltshire conducted interviews with cabinet ministers and public servants across Canada in 1977 and came up with the list of 16 complaints about the intergovernmental agreements which provide the basis of fiscal federalism in Canada. It is not necessary to list them all, or all of them in full, to give a feel of the dissatisfaction with the present system among those interviewed.

1. Too many agreements stress uniformity in delivery across the nation and do not take account of the particular circumstances of each province. . . .

4. Provinces preferred an agreement to be negotiated around lump sum or block funding whereas the federal government favored earmarking of all components of the amounts flowing to the provinces [The] provinces would prefer that the federal government not publish too widely the breakdown of its grants to the provinces so the local pressure groups would not come a-lobbying for what they would then regard as "their" share of federal money.

7. There are disproportionately severe consequences of termination or alteration of an agreement on small provinces compared with those for larger ones.

9. The amount of information required by the federal government under various agreements produces much too heavy a burden on provincial and local bureaucracies and the provinces doubt whether all the required information is really necessary

10. . . . in those agreements (especially DREEs) where the federal government looks directly at regions, the provinces often claim that their sovereignty is being maligned.

11. Agreements can unduly interfere with the administrative structure of a prov-

ince. . . . [How a function is defined in a particular agreement may force the province] to rearrange the whole of its administrative machinery to suit the agreement even though it disagrees with the way the function has been defined. . . .

12. Insufficient attention has been paid to the basic differences between agreements involving capital costs and those involving current or ongoing costs. There arises a serious problem if the federal government negotiates only a capital agreement and doesn't provide ongoing funds as well, or terminates an agreement in a way that leaves the province or local government to bear the ongoing costs.

14. There is a tardiness in updating agreements to modern social needs, particularly demographic changes¹⁷

To be fair, Wiltshire noted, the interview data did not show opposing viewpoints:

Do the provinces really have priorities of their own to be distorted? Isn't there some need for national supervision? Does the federal government abruptly terminate an agreement or is it that the agreement simply ran its full course and the provinces wrongly assumed it would be continued? Doesn't the federal government enter into a lot of agreements precisely because the provinces accuse it of being too remote from the people? Couldn't many of the [difficulties identified] be overcome if the provinces got together for preliminary discussions before entering into dialogue with the federal government? These questions remain unanswered¹⁸

There is, finally, a group of issues arising out of the 1977 Fiscal Arrangements Act which will be raised in the discussions leading to the act's renewal in 1982.¹⁹ There is first of all some discontent specifically with the tax collection agreement, which is the basis of Canadian fiscal federalism. ". . . [I]t is the view of some that the tax collection system impinges provincial freedom and limits the flexibility of provinces in determining appropriate fiscal policies for

[themselves]. Also, since the federal government must consider the direct and indirect effect of its tax changes on the provinces, federal flexibility is impaired." Over the years, there has been "an increasing strain on the tax collection system. This strain basically originates in the conflict between the provinces' desire for flexibility and the desirability of maintaining relative uniformity in the national income tax system."

The provinces' search for flexibility arises out of the growing importance to them of income tax revenue (the provincial share of total income tax revenue collections increased from 15% to 40% between 1962 and 1977) and because of the increased desire to use the income tax system to achieve social and economic policy objectives.

Moreover, inasmuch as the tax collection agreement makes it possible for individual provinces to add such features as tax credits, tax rebates, tax reductions, tax surcharges, and dual corporate tax rates, and a number of efforts have been made toward discriminatory tax treatment, considerable inroads have been made in the system's objective of uniformity. "The wide variety of provincial special measures, many of which are totally unrelated to revenue objectives, and the fact that no two of these are of the same design, even where the objectives are the same, [also] presents Revenue Canada with difficult problems. Effectively Revenue Canada must administer several different systems simultaneously."

In sum, consideration of the tax collection system in Canada raises several questions:

- Should the federal government be concerned about, and take action to promote uniformity and harmony in the national income tax system?
- Should the federal government ignore such concerns and agree to administer provincial measures which have the potential to reduce uniformity and harmony and introduce discrimination or add confusion, complexity, and perhaps inequity into the national tax system?
- Is it necessary to have a central administration and collection agency and, if so, should this be the federal government or, as has been suggested, a quasi-autonomous federal-provincial agency?

- Assuming some sort of coordination of governmental cultivation of the income tax fields is necessary, should this take the form of bilateral and multilateral agreements among some or all of the participants . . . ?
- If the present system of tax collection agreements is to continue, should provinces be required to adhere to the federally defined tax bases and should provinces be required to express their individual income tax as a percentage of federal tax rather than taxable income?

Secondly, there are issues with regard to equalization payments. "There is a common misconception that [they are] financed by the three rich provinces; in fact, [they are] financed from federal taxes collected from all Canadian taxpayers. Thus higher-income Canadians in poorer provinces contribute through their federal taxes to the equalization grants paid to their own provincial governments." As George Carter asks in a recent analysis of financing Canadian federalism, "Should 'windfall' gains to Alberta from nature's bounty bring sharp increases in the equalization costs borne by all Canadian taxpayers?"

After all, full equalization of these large increases in oil royalties of one province would require an excessive increase in federal taxes. Equalization grants, growing at annual rates which exceed the fiscal need they are intended to meet, would run the risk of undermining the integrity of the whole equalization program.²⁰

One answer would be to make the equalization scheme closed-ended instead of open-ended—that is, to impose a ceiling on the annual rate of increase in the payments, tied to some index of growth (perhaps GNP).²¹

There is doubt, too, about the impact of equalization established under the current scheme. It has been argued that the equalization program in effect has tended "to stabilize low income regions and . . . lessen the necessity and desire for adjustments which are required to make them economically viable." The "very important question of the status of the Province of Ontario—which would now qualify for large amounts of equalization if natural resources revenues were included in full"—has yet to be answered. "Finally, any review of the equalization program must start with the basic purpose of the program,

which is to make it possible for all provinces to finance a reasonable level of public services without having to impose unduly high tax rates. The objective is not to redistribute provincial government income or to promote industrial development in areas of high unemployment. These issues must be dealt with by means of program[s] other than equalization. However, some modification of purpose might be accommodated with a two-tier system of equalization.”

There are additional questions with regard to established programs financing. One arises in the area of postsecondary education, where the agreements between the government in Ottawa and the provinces do not provide for the maintenance of minimum standards across the country, as do the agreements concerning health services. “Nor is political pressure apt to be as effective in maintaining the level of provincial support for higher education” as it is for health services. Provincial politicians often perceive “students . . . to be a privileged minority, whereas virtually everyone stands to benefit directly from the health services.”²² Whether such minimum standards are in fact being maintained, even in the health field, is in doubt.

Indeed, George Carter concludes:

Notwithstanding its merits, the . . . EPF arrangement has by no means solved all the fiscal problems of Canadian federalism. By what criteria should national standards be defined and maintained with respect to the EPF program? How can intergovernmental conflicts be reduced? At issue are fundamental questions involving both economic efficiency and equity.²³

Although these are all important issues—issues which likely will have to be dealt with in the negotiations leading up to the renewal of the fiscal arrangements between Ottawa and the provinces—they play second fiddle to the basic controversy over the nature of Canadian federalism itself which is currently occupying that Commonwealth’s attention. This is not the place to go into great detail about the controversy. It is necessary to summarize the events leading up to it and the status of things as of the end of 1980. As indicated earlier in this study, the struggle for power between the national government and the provinces has been an ever-present feature of Canadian life and 1980 was a critical year in that struggle. With the defeat of the Quebec referendum on sovereignty-association in May, the promise Prime Minister Trudeau made to voters in that referendum (and by

implication to all the Canadian people) to take speedy action to renew the federal system now had to be honored. After a summer of fruitless consultation with provincial leaders and a week of unsuccessful negotiations at a full-scale constitutional conference in Ottawa, the Prime Minister announced the intention of the national government to move in that direction unilaterally.

On October 2, 1980, Mr. Trudeau delivered a major address to the Canadian people,²⁴ in which he rejected the concept of a Canada which holds that the national good is “merely the sum total of provincial demands, one where the division of power upon which [the] federation traditionally rests could be altered for no reason other than that the provinces agreed amongst themselves that it should be altered.” To accept that concept, the Prime Minister warned, would be to permit “ten countries” each to seek “advantage over the other, without any means to seek the good of all.” Rather, Canada must find a way to “achieve the good of all, the common good.” To that end, he proposed his own method of breaking the constitutional power deadlock: “Through the one institution in which all Canadians are represented, the Parliament of Canada, Canadians can break the deadlock among their 11 governments.” As the instrument to accomplish that goal in Parliament, he presented a joint resolution to the Queen “respecting the Constitution of Canada,” for consideration by the British Parliament. Briefly summarized, the resolution proposes:

- 1) the patriation of the constitution—asking the British Parliament to repeal the British North America Act and to confer on Canada its own constitution and with it ultimate power to manage its own affairs;
- 2) inclusion in the patriated constitution of a charter of rights and freedoms, binding on all Canadian governments;
- 3) inclusion in the patriated constitution of the principle of equalization—“the principle of sharing across this land—which is the very essence of our country;” and
- 4) inclusion in the patriated constitution of an amending formula.²⁵

After several months of consideration of its pros and cons by a joint Commons-Senate Committee, the resolution came before the House of Commons in February 1981. By early March, it began to appear that the debate might drag on long enough to force

the Trudeau government to invoke cloture (a device rarely used in Canada to cut off debate).

In the weeks after the government's action, there was a great deal of side-taking in Parliament itself, in the provinces, and in the Canadian press and public. Not only have angry voices been raised at the unilateral way the government went about proposing constitutional change, leaving the provinces no role to play; they have been raised also about what would be included in the repatriated constitution. Perhaps not surprisingly, more of the debate over the proposal focused on the contents and impact of the charter of rights and on the methods of amending the new constitution than on enshrining the principle of equalization there.

It is the latter which is of central concern to this study. Should it be embodied in the constitution, as proposed in the resolution, it would commit not only the national government but the provincial governments as well to promoting equal opportunities for all Canadians. Specifically, part II of the resolution, entitled "Equalization and Regional Disparities," provided:

- (1) Without altering the legislative authority of Parliament or of the provincial legislatures, or the rights of any of them with respect to the exercise of their legislative authority, Parliament and the legislatures, together with the government of Canada and the provincial governments, are committed to—
 - (a) promoting equal opportunities for the well-being of Canadians;
 - (b) furthering economic development to reduce disparity in opportunities;
 - (c) providing essential public services of reasonable quality to all Canadians.
- (2) Parliament and the government of Canada are committed to taking such measures as are appropriate to ensure that provinces are able to provide the essential public services referred to in paragraph (1) (c) without imposing an undue burden of provincial taxation.

Yielding to subsequent pressures for change, the Trudeau government announced on January 12, 1981, that it had amended paragraph 2 of the equalization section of the resolution to read:

Parliament and the government of Canada

are further committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

Whether inclusion of such a provision in the constitution of Canada would make a difference in Canadian practice is debatable. As Sen. G.I. Smith, formerly premier of Nova Scotia, concluded, inclusion of an equalization provision "without some sanction or some means of enforcing it is no more valuable or useful than the present arrangement."²⁶

Most observers agree that, in the end, the Trudeau government, with its majority in Parliament, will carry the day—though perhaps with some changes in the rights and amendment parts of the proposed constitution. Indeed, even as Commons began its debate, Prime Minister Trudeau made some concessions in those areas. The end may be fairly long in coming, however: Six of the provinces have challenged the proposal in provincial courts, and the outcome of those cases cannot be predicted with any assurance. An appeal to the Supreme Court of Canada will likely be made, and all that takes time.

Once passed by the Canadian Parliament (Senate concurrence seems to offer no problem), the resolution will have to be considered by the British Parliament. There are few if any precedents to guide that Parliament in handling the case. A select committee of Parliament began to hear evidence on both sides in December 1980. Early in February 1981, it was reported that its decision was to advise Parliament to reject the constitutional package, inasmuch as there was no evidence that it had the backing of the "great majority" of the provinces. As of early March 1981, the outcome remained to be seen. Prime Minister Thatcher promised Mr. Trudeau that the resolution "would be put before the Commons as a government bill, and an attempt will be made to pass it."²⁷ If it does not pass muster in Parliament, Prime Minister Trudeau has indicated that he has no plans to declare unilateral independence patterned on the Rhodesian model. Originally, it was hoped that the whole process of patriating the constitution was to be concluded by July 1, 1981. That does not seem likely now.

In any case, the constitutional issue was shortly joined by an even more contentious issue when the federal budget message was delivered to Parliament in Ottawa on October 28, 1980. Contained in the budget was a new national energy program which

went directly to the heart of federal vs. provincial power. Indeed, as one observer noted, "the new federal budget was clearly more of an energy policy statement than a traditional budget. Since energy pricing, revenue distribution, and self-sufficiency . . . represent the core of many of Canada's fundamental economic concerns today," and since the budget "represents the first step in the direction of restoring to the federal government a more favorable fiscal balance relative to the provinces,"²⁸ debate over it quickly heated up and joined the constitutional debate at center stage.

Of particular importance to this study were the budget's promises nearly to double oil and natural gas prices by 1983—with petroleum prices rising immediately—and to levy a federal tax on exports as well as on domestic sales of natural gas. In addition to the natural gas tax, an 8% levy on oil and gas company revenues was announced, along with a "petroleum compensation payment" of 80 cents a barrel, which will be increased to \$2.50 a barrel over the next three years. In effect, the federal government imposed an energy pricing and revenue sharing formula, not having been able to negotiate one with the provinces. In dollar terms, the new formula would give a massive increase in revenues to the federal government compared to what it has been receiving from the oil and gas bonanza.

The budget further provided impressive expenditures on new energy projects over the next three years, the money to come largely from the new energy taxes, including programs for energy conservation, conversion from oil to natural gas and coal, and extension of the natural gas pipeline to the Maritime Provinces. A western development fund of \$4 billion would be set up, \$2 billion of which would be spent over the next three years on economic projects in consultation with western provincial governments.

Notwithstanding the concession represented by the fund, and ignoring Federal Finance Minister Allan MacEachen's assurance that the energy program was necessary "to put Canada's energy house in order" and to give Ottawa "a fair share" of oil and gas profits,²⁹ the western provinces—particularly Alberta and British Columbia—reacted immediately and resoundingly. At issue, they feel, are both the provinces' stoutly defended power over energy resources and millions of dollars of potential provincial revenue. To make their case, Alberta began to slow oil production by 100,000 barrels a day starting March 1, 1981, and went to the Alberta Court of Appeal to test the constitutionality of the federal tax on

natural gas produced and sold by the Alberta government. That court declared the tax unconstitutional. The federal government will no doubt appeal the decision to the Supreme Court of Canada. For its part, British Columbia began to "withhold payments to Ottawa of the tax collected by its provincially owned gas distribution arm, B.C. Hydro."

As of early March 1981, little progress was reported on either the constitutional or the budget front, although by then it appeared that the government of Alberta was beginning to reconsider its hard-line approach to Ottawa on the energy issue. Thus, Canada may be in for a prolonged period of conflict. Separatism, which used to be thought of only in terms of Quebec, has developed adherents in the West. As *The Globe and Mail* put it editorially, Westerners have added complaints about the proposed constitution and the national energy policy to their old grievances, "the largest of which, of course, is the failure of the federal government to deal realistically with the West on resources. . . ."

The constitution and control of resources intertwined—two crises that have brought Canada to the position where two provinces have threatened a tax strike against Ottawa, one province has threatened to reduce its supply of oil to the rest of the country [Alberta did so effective March 1, 1981], and six provinces have taken the federal government to court. Not small crises.³⁰

"Divisiveness" seemed to be the Canadian watchword as the country entered 1981.³¹

Even so, what the distinguished legal scholar, Maxwell Cohen, recently said has to be borne in mind: "Canada cannot tolerate chronic threats of confrontation, litigation, or separation as a way of life."³² He was confident that "appropriate institutions" can be created into which to channel the disputes threatening to rend Canada apart. The beginning of that creative process may well be seen in 1981.

THE UNITED STATES

Federalism in the United States has always been in flux, and it remains so today. Both Jimmy Carter in 1976 and Ronald Reagan in 1980 dwelt heavily on the nature and nurture of federalism as they understood it. Neither they nor anyone else has seriously suggested that fundamental changes be made in the system as it is. What is argued for most often are adjust-

ments in the so-called "balance of power" between the national government and subnational governments. For a good many years during and after the New Deal, advocates of tilting the balance toward Washington seemed to be in control of the policy process. Addressing all problems through federal programs seemed to have been accepted as the proper way to proceed. By the 1970s, however, the balance had been corrected somewhat toward the subnational side, partly because the states themselves have become more innovative and self-assertive than they were formerly. As the Advisory Commission on Intergovernmental Relations concluded in the fall of 1980:

Generally, state governments have made great strides in strengthening their capabilities by adopting many reforms that have been urged for over 50 years. The improvements have affected all three branches of state government . . . and have involved structural, procedural, fiscal, and functional changes. . . .

In the past 20 years, the states have assumed a key role in the intergovernmental system as prime recipients and disbursers of federal aid; as planners, administrators, and supervisors of big intergovernmental programs (including their own as well as federal); and as objects, supplementers, and resisters of federal regulatory activities. This drastically expanded intergovernmental assignment, in effect, has conferred on the states a major new role in the overall federal system; at the same time their traditional prime function of serving as 50 differing representational systems has been revitalized in recent years thanks to major changes in their political processes³³

But if an enhanced role for the states has been developed, "local governments have become increasingly more dependent fiscally on the state and federal governments, particularly the latter." Although they "continue to be the workhorses of the federal system in terms of the provision of direct services to the public," their growing reliance on grants from the national and state governments "has curtailed the administrative discretion of local officials since expenditure of the vast bulk of the aid money is circumscribed by specific programmatic and procedural requirements and crosscutting national poli-

cies. . . ." Distinctions between the several types of local government (municipalities, counties, special districts) have become blurred, and attempts to link local units together for better service delivery have not been very successful. The states, taken together, have received mixed reviews for their performance as "power source, supervisor, helper, and encourager vis-a-vis their local governments. . . . [O]verall they have demonstrated more responsibility for their localities in the important areas of financial aid, organizational and functional discretion, and financial management than was the case a generation ago. The failure of most states to promote structural improvement at the local and substate regional level is a serious shortcoming, however." Another shortcoming is the lack of attention given by the states to the assignment of public services and functions at the state and substate levels.³⁴

This section was written in late 1980.

The 1980s can be expected to see further changes in American federalism, some of them taking place as a consequence of ACIR studies and recommendations, and some of them stemming from the initiatives of the Reagan Administration. Shortly after his election in November 1980, President Reagan promised to "restitute this nation as a federation of sovereign states," presumably by returning some taxing and program authority from Washington to the states and localities.

Whatever course is taken, the point to be made is that the status of federalism in the U.S. as it enters the 1980s is, as it has always been—a subject of intense concern to those seeking to exercise power in the people's name, but accepted by them and the people as well as *the* system within which governments must work to accomplish their purposes. Each new administration in Washington has its own set of proposals to make it work better—or differently—and others are offered by politicians and scholars across the land. The continual reassessment of the operative side of federalism, indeed, has long been a major American concern.

But federalism as such is not the subject of this study. As might be expected, the fiscal side of federalism is where some of the most sensitive nerves are found in its operation, so that we turn now to the major issues demanding attention and solution there.

Once again, as in the other countries being surveyed in this study, the fiscal problems of local governments constitute a major issue. As a committee of

the South Carolina General Assembly put it in a March 1980, report, those problems "are real, immediate, severe, and incredibly complex."³⁵ Their basic cause is the limited fiscal powers granted to local governments by their parent states, and they have been exacerbated recently by local taxpayer opposition to increased property taxes, as evidenced by Proposition 13 in California and Proposition 2-1/2 in Massachusetts. For it is primarily the general property tax with which the states expect their local governments to meet most of the increasing costs of providing local services, some of which are mandated by the state without the accompanying funds to pay for them.

Attention has begun to be focused on what alternatives to the property tax might be developed. Among the alternatives are:

- state revenue sharing programs, which would provide a portion of state general fund tax revenues for counties and municipalities;
- tax-base sharing, under which municipalities in a designated district would agree to share the financial benefits of increased tax rates in any one town in the district (the revenue so generated to be returned to the municipalities on a formula based on need);
- broadening the range of taxes available to local governments (the committee of the South Carolina General Assembly, for example, recommended enabling legislation to allow local governments to levy a gross receipts tax on hotels, motels and other lodging places and a local option county/municipal sales tax;³⁶
- levying the property tax on a statewide basis; and
- transferring to the state the financing of education, which in most localities comprises the largest element of the local budget.

Legislatures throughout the country will be faced with making hard choices among these—and other—alternatives in the years just ahead. And the choices will be made even harder by the likelihood that federal spending—and thus some grants-in-aid to local governments—seems likely to be reduced under the Reagan Administration and in the Congress.

It was the clamor of beleaguered local government officials that persuaded the 96th Congress, late in its second session, to concentrate federal general revenue sharing at the local level—to the tune of \$4.6 bil-

lion a year—for fiscal 1981. For a while it appeared that general purpose local governments might be the only recipients of revenue sharing funds for the next three-year entitlement period. In any case, there was general consensus, as one member of Congress put it, that,

. . . [G]eneral Revenue Sharing has returned to the local level, with a minimum of paperwork, the opportunity to use federal taxpayer dollars to meet local needs. Thousands of small cities and counties, many of which receive no other form of federal assistance, have been able to provide [services] with the help of Congress.³⁷

The problem, as suggested in an earlier section of this study, was what to do about the states. The improved fiscal status of a number of states³⁸ seemed to suggest that as a whole they were no longer in need of federal assistance in the form of revenue sharing. In the end, and subject to later appropriations, Congress authorized \$2.3 billion a year to be distributed among state governments in fiscal 1982 and 1983.

The issue of revenue sharing is far from settled, however. The three-year extension means that it will become a matter of debate in the Reagan Administration. The states will again press their cause, emphasizing that revenue sharing was not conceived originally as a handout but as a sharing of the federal tax base with subnational governments to help meet the substantial costs incurred in administering federal programs and meeting federal requirements, and that it aids states plagued with rural poverty, declining cities, and weak industrial bases by making it less necessary for them to levy taxes too far out of line with those levied by more fortunate states. Advocates of the states will argue, too, that the fiscal resurgence of some states in the late 1970s will have been replaced by the early 1980s by increasing financial difficulties.

According to the latest figures from the Department of Commerce and Data Resources, Inc., the state surpluses of earlier years will have disappeared by the end of fiscal year 1980. In that year the states will show a net deficit nationwide of approximately \$12 billion. In 1981, this deficit figure rises to approximately \$15 billion [and will increase thereafter]

Perhaps even more than for local governments, the fiscal outlook for the states dur-

ing times of economic downturn is strained. Because states often rely primarily on income and sales taxes for their revenues, the states find their income quickly depressed during recession. And because many states are required by their state's [constitution] to balance their budgets, this must immediately result in reduction of services.³⁹

Thus, the states can be counted on to press their case before Congress and with the President as the next round of revenue sharing renewal approaches.

But while grants-in-aid and revenue sharing are undoubtedly of help in remedying the fiscal mismatch of American federalism—the greater ease with which the federal government can acquire revenue, the greater burden which subnational governments bear for providing increasingly expensive public services—they do little toward removing the basic inequality of resources among the states. Nor has any other method of achieving equalization been attempted by the federal government.

The problem is an old and entrenched one. As Michael D. Reagan and John G. Sanzone summarize it:

Because the taxable capacity of the states varies widely, the tax revenues of state and local governments also vary, and with them the ability of each state to meet the service needs of its people. Unfortunately, with states as with families, those with greatest need for public services tend to be those with lowest resources. Although governments too are subject to “cost of living” differentials from one region to another, the savings obtainable through lower prices in rural states are not as great as the differences in tax capacity. Even by trying harder, the states with lower levels of taxable resources per capita are unable to raise as much revenue as the wealthier states.⁴⁰

To bring the matter down to cases, in 1978, against a U.S. average of \$7,836, state per capita personal income amounted to \$5,529 in Mississippi and \$5,969 in Arkansas (and this despite a quantum leap in those states from earlier times), to between \$6,000 and \$6,999 in 13 other states, and to between \$7,000 and \$7,836 in 12 more states. On the other hand, Alaska had reached a per capita personal income of \$10,963 by 1978; the District of Columbia, \$9,924; and Nevada, \$9,439—with the remaining 21 states standing

between \$7,836 and \$9,924. Or if the U.S. average per capita personal income be taken as 100, the 1978 range between states was from 140 for Alaska to 71 for Mississippi—or to use less dramatic examples, from 114 for Connecticut, Illinois, and California to 76 for Arkansas and 80 for South Carolina. The problem still looks bad when viewed regionally:

United States Per Capita Personal Income by Region,^a 1978

Region	Amount	Percent of U.S. average
Far West	\$8,738	111%
Mideast	8,593	110
Great Lakes	8,096	103
Plains	7,532	96
New England	7,420	95
Rocky Mountain	7,415	95
Southwest	7,203	92
Southeast	6,591	84

^aRegions as defined by the Advisory Commission on Intergovernmental Relations (see *Chapter 2* of this study).
 SOURCE: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1979-80 Edition*, M-123, Washington, DC, U.S. Government Printing Office, 1980, p. 189.

Reagan and Sanzone conclude their consideration of the problem thus posed:

Nothing the states can do individually can overcome the differential of resources. “Bootstrapping” only goes so far. The implication is clear: if we decide as a nation that we want a certain level of education, or welfare, or health care for all persons as U.S. citizens . . . only by having Uncle Sam collect more revenues from the wealthier states and distribute more in grants or shared revenues to the poorer states can equalization of services be attained.

Furthermore, resource disparities are at least as great between towns and counties within individual states as between states. The equalization principle therefore also must be applied at the level of “little federalism” . . . through state grants.⁴¹

At least in the field of elementary and secondary education, the 1970s saw steps taken which led to some equalization at the substate level. Supreme Court decisions in several states recognized the disparity of resources among school districts and declared unconstitutional in those states the traditional reliance on local property taxes as the resource base for public education. The legislatures of those states were forced to make a greater state input into local education financing. Whether other states will move in that direction remains to be seen.

One change in the pattern of fiscal federalism was almost accomplished by the 96th Congress: the proposed Federal Assistance Reform Act of 1980, which the Senate passed but not the House. The work of the Subcommittee on Intergovernmental Relations of the Senate Committee on Governmental Affairs, the act dealt with the consolidation of categorical grant programs, the streamlining of financial management practices, the strengthening of the joint funding simplification process instituted by the *Joint Funding Simplification Act of 1974*, and the provision of better information on federal aid availability and awards. It recognizes, as subcommittee chairman Sen. James R. Sasser (D. TN) told the Senate that,

As the federal assistance system is constructed today. . . [n]arrow categorical grant programs. . . [force] federal bureaucrats to involve themselves in concerns that could be the prerogative of states and localities. The role of the federal government has become too broad when specific programs are enacted or proposed for jellyfish control, car pool projects, police pensions, and dog and cat spaying.⁴²

The reforms made possible by enactment of the same bill by the 97th Congress would “reconstruct the categorical grant system, slimming and streamlining its processes” so as not only to make better management possible but to “make a sizable dent in overhead costs” associated with the many grants in effect today.⁴³ (S. 45, introduced in the first session of the 97th Congress, early in 1981, is substantially the same bill.)

The ACIR made most of the recommendations on which the assistance reform act was based. In addition to its long interest in the consolidation of categorical grants into block grants at the federal level, it has urged the trade-off of functions, either through assumption or devolution, among levels of

subnational government. By late 1980, it had come to believe, however, that,

. . . proposals to trade off functions. . . and consolidate grants cannot succeed in arresting the growth of federal intrusiveness into state and local affairs unless the technique of advancing national goals by attaching multiple requirements to all forms of federal assistance is simultaneously addressed. To put it more simply, it is doubtful whether a block grant to which a multitude of non-discrimination, environmental, employment, and administrative requirements has been attached is much less of a constraint on state and local discretion than a group of narrow categorical programs. And an unfunded direct order can certainly be an extreme form of federal intrusion.⁴⁴

In sum, ACIR has concluded, “the growing use of mandates by the federal government is profoundly impacting state and local discretion and budgets.” This is reflected in the ever-increasing complaints of state and local officials regarding the extraordinary intrusiveness of mandates, as well as by then President-elect Reagan’s promise to “reexamine the mandates issued by the federal government, which now impose so many federal burdens on state and local governments.”⁴⁵ Assessment of those impacts and possible suggested changes in them may well constitute one of the major thrusts in American fiscal federalism in the years just ahead.

WEST GERMANY

There are basically two problems demanding attention in West Germany federalism—one, the by-now-familiar problem of financing local governments satisfactorily; the other, the viability of the federal structure itself. Both of these problems must be considered against the background of recent German economic performance. As long as West Germany seemed to have achieved for itself a “miracle economy,”⁴⁶ neither question was terribly pressing. But by the end of 1980, the German economy had slowed down, threatening “to bring growth in the national economy—long regarded as Europe’s powerhouse—to a standstill.” Although Germany’s performance statistics, as suggested in *Chapter 2* of this study, are still remarkable comparatively, a number of indicators show that Germany may be about to sail into troubled economic waters. Both economic growth

rates and productivity rates have fallen recently, and government indebtedness has risen dramatically. Indeed, the size of the federal debt—estimated to be the equivalent of about \$115 billion at the end of 1980—was a central issue in the 1980 campaign, “making the public especially sensitive to federal spending policy” at the very time that the German population is aging and declining and the bill for social benefits is mounting.⁴⁷ In this changed context, the two questions assume greater urgency. Each one thus deserves brief comment.

Although local governments were brought into the tax-sharing arrangement in Germany in 1970, they “have not been able substantially to improve their financial position relative to the other tiers of government. . . . [The] increased relative costs and swelling demand for public services at the local level do not seem to have been acknowledged” in the country’s fiscal arrangements.⁴⁸

On the revenue side, the discussion is centering around the question of how to transfer a secure and steadily expanding financial basis to municipalities, that is more or less independent of the business cycle, yet strong enough to enable communes to deal with their needs. . . .

On the expenditure side there is the complex problem of the actual local planning process itself . . . [and of] how to coordinate the multiplicity of [local] government agencies horizontally, and how to integrate their policies into general policies designed at the federal or [laender] level. . . .

Even in the affluent 1970s, no answers were found for the revenue side of the matter, and consideration of the expenditure side runs into the constitutional difficulties of Article 28 of the Basic Law, which guarantees municipal autonomy as far as local expenditures are concerned. “Traditionally, the federal government as well as the [laender] have tried to promote desired policies at the local level by means of grants, in particular conditional grants.” But these have come under increasing criticism as undermining the guaranteed local autonomy. Indeed, P.B. Spahn concludes that “municipalities in West Germany are regarded more like private business firms than constituents of public authority by the central government. This contrasts with the general characteristics of the German federal machinery established to integrate federal and [laender] policies . . . which is largely coordinative in the sense that ‘decisionmaking

responsibility is shared and the policies of different governments are coordinated.’ ”

How to remedy the situation may depend on the resolution of the second problem identified at the outset of this section; namely, what to do about the German federal system itself. As David Contradt has summed it up, “the federal structure of the Republic is being increasingly considered by students of the Germany policy process as an impediment to efficient government and social and economic progress. Federalism is viewed as ‘old-fashioned,’ something out of the 19th century that now frustrates future-oriented reforms and innovations. Opinion polls have . . . shown increased popular support for centralization and a unitary state. . . .”⁴⁹ The laender are coming to be viewed as obstacles in the way of more effective national planning and action in critical problem areas such as water and air pollution control, law enforcement, and control of terrorism. As for local governments, there is general agreement that many are “structurally outmoded.”⁵⁰

A partial solution to the overall problem might be—

. . . the consolidation of the federal system through a reduction in the number of states from the present [11] to five or six units of roughly similar size, population, and economic resources. Such a federal structure would greatly reduce, if not eliminate, the “poor state-rich states” problem and hence the need for Bonn and the richer states to pay subsidies or equalization money to the poorer states. Realignment and consolidation would also end the veto power now enjoyed by even the smallest state in many joint federal-state undertakings.⁵¹

To be sure, to attempt a restructuring of the federal system would require major constitutional change. But it would be recalled from the profile of West Germany in *Chapter 2* of this study that the Basic Law under which the country now operates has from the beginning been regarded as provisional only. Because it was virtually dictated by the victorious Allied powers and designed negatively to prevent another Weimar catastrophe, rather than positively to provide a permanent base for future development, the Basic Law has not come to occupy a central place in the affections of the German people. Thus, it might not be so difficult to move into the revision process. In a way, that process has been ongoing

since 1949, as the Basic Law has been amended. It is worth noting, incidentally, that most of the many amendments have dealt with intergovernmental relations and with fiscal issues.

It is likely that a process for constitutional revision would have to be developed from scratch—perhaps by convening another constituent assembly—since Article 79 of the Basic Law, as interpreted by the Federal Constitutional Court, prohibits amendments directly affecting the federal structure of the state—specifically, the division of the federation into laender.

Even so, Conradt found that “since the late 1960s a growing number of constitutional scholars and political leaders have been considering the possibility of a new constitution” and that they have been devel-

oping an agenda of issues which would have to be addressed in the process. Prominent among them is the federal structure of the nation. “A reduction in the number of states and a clearer statement as to their powers and responsibilities appear to be inevitable in any new constitution.”⁵²

Whether either of the two issues of German federalism will be dealt with in the immediate future is problematical. Neither issue received much attention in the 1980 federal election campaign, and neither appears high on the agenda of the victorious coalition government. Although the impact of a declining economy might serve to hasten consideration of the structure of federalism, it can hardly be expected to make a contribution to the solution of the urban fiscal plight in Germany.

FOOTNOTES

¹Though opposition parties won greater strength in the Senate than did the Liberal-National Country Party coalition (Australian Labor Party 27 seats, Australian Democrats 5 seats, for a total of 32, compared to 31 seats for the Liberal-National Country Party coalition), thus presenting the possibility of Senate attempts to block passage of legislation sought by the government.

²Russell Mathews, *Issues in Australian Federalism*, Reprinted from *Economic Papers*, No. 58, March 1978, as Reprint Series Number 24, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1979, p. 5.

³R. Else-Mitchell, “Fiscal Equality Between the States: The New Role of the Commonwealth Grants Commission,” *Australian Journal of Public Administration*, June 1979, p. 166.

⁴Russell Mathews, ed., *Intergovernmental Relations in Australia*, Sydney, Angus and Robertson, 1974, p. 238.

⁵R. Else-Mitchell, “Fiscal Equality Between the States,” p. 165.

⁶Russell Mathews, *The Structure of Taxation*, Reprinted from Proceedings of the Australian Institute of Political Science Summer School on *The Politics of Taxation*, January 26-28, 1980, as Reprint Series Number 34, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1980, pp. 23, 24, 25.

⁷See *Taxation Review Committee Full Report, January 31, 1975*, Canberra, Australian Government Printing Service, 1975.

⁸Mathews, *Issues in Australian Federalism*, pp. 37-39.

⁹Richard M. Bird, *Central-Local Fiscal Relations and the Provision of Urban Public Services*, Research Monograph No. 30, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1980, pp. 43-45. For a discussion of metropolitan governance and recommendations for change in it, see Richard H. Leach, *The Governance of Metropolitan Areas in Australia with Lessons from Canadian and American Experience*, Research Monograph No. 21, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1977.

¹⁰Kenneth Wiltshire, “Working with Intergovernmental Agreements—The Canadian and Australian Experience,” *Canadian Public Administration*, Fall 1980, pp. 367-69.

¹¹*Ibid.*

¹²Jeffrey Simpson, “Cost-Sharing: A Federal-Provincial Time Bomb,” *The Globe and Mail*, Toronto, December 3, 1980, p. 5.

¹³*Ibid.*

¹⁴*Ibid.*

¹⁵Bird, *Central-Local Fiscal Relations*, p. 43.

¹⁶Richard H. Leach, *Perceptions of Federalism by Canadian and Australian Public Servants*, Research Monograph No. 18, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1976, p. 44.

¹⁷Wiltshire, “Working with Intergovernmental Agreements,” pp. 364-66.

¹⁸*Ibid.*, pp. 366-67.

¹⁹The comments on the tax collection agreements, are quoted from *Draft Discussion Paper on Federal-Provincial Fiscal Arrangements*, May 23, 1980, prepared by the Federal-Provincial Relations Division, Department of Finance, Ottawa, pp. 18-21.

²⁰George E. Carter, *New Directions in Financing Canadian Federalism*, Occasional Paper 13, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, 1980, pp. 10-11.

²¹Suggested by Thomas J. Courchene, *Refinancing the Canadian Federation: A Survey of the 1977 Fiscal Arrangements Act*, Montreal, C.D. Howe Research Institute, 1979, p. 11.

²²*Draft Discussion Paper*, pp. 26-27.

²³Carter, *New Directions*, p. 18.

²⁴The Prime Minister’s statement was published by the Canadian Embassy in Washington, DC, as CR-1 in its Information Series on Constitutional Reform. The quotations are from that source.

²⁵The text of the proposed constitutional resolution was published by the Canadian Embassy in Washington, DC, as CR-9 in its Information Series on Constitutional Reform. The quotations are from that source.

²⁶Quoted in *The Chronicle-Herald*, Halifax, March 11, 1981, p. 1.

²⁷*The Globe and Mail*, Toronto, February 21, 1981, p. 13.

²⁸Arthur Donner, *The Globe and Mail*, Toronto, November 17, 1980, p. B6.

²⁹Quoted by Ronald Anderson, *The Globe and Mail*, Toronto, December 12, 1980, p. B2.

³⁰*The Globe and Mail*, December 30, 1980, p. 6. See also J.F. Conway, “West’s Separatist Roots Go a Long Way Back,” *The Globe and Mail*, Toronto, December 23, 1980, p. 71.

³¹The word used to describe Canada’s condition by Governor General Edward Schreyer in his year-end message, 1980, quoted in *The Durham [N.C.] Morning Herald*, December 27, 1980, p. 3A.

³²Maxwell Cohen, “The Constitution; Shared Joy or Bitter Tragedy,” *The Globe and Mail*, Toronto, December 4, 1980, p. 3.

³³The quotations here are from Advisory Commission on Intergovernmental Relations, Minutes of 71st Meeting, Washington, DC, September 25-26, 1980, Xerox, pp. 6-19 passim.

³⁴*Ibid.*

³⁵South Carolina General Assembly, Study Committee on Alternate Sources of Revenue for Counties and Municipalities, *Final Report*, Columbia, South Carolina General Assembly, 1980, pp. i-ii.

³⁶*Ibid.*, p. iii.

³⁷Rep. John Paul Hammerschmidt (R-AR), *Congressional Record*, November 13, 1980, p. H10577.

³⁸No state showed the same degree of improvement as Alaska, which is reaping an immense fiscal harvest from oil revenues. Its surplus had become embarrassing by 1980. Several years ago, the Alaska Permanent Fund, a special trust fund, was created, into which currently 25% of the state's receipts from oil royalties and lease bonuses are being fed.

³⁹Rep. John W. Wydler (R-NY), *Congressional Record*, November 12, 1980, p. H10506.

⁴⁰Michael D. Reagan and John G. Sanzone, *The New Federalism*, 2nd ed., New York, Oxford University Press, Inc., 1981, p. 42.

⁴¹*Ibid.*, p. 43.

⁴²*Congressional Record*, December 10, 1980, p. S16127.

⁴³*Ibid.*

⁴⁴Memorandum from Wayne F. Anderson, Executive Director, Advisory Commission on Intergovernmental Relations, to Members of the Commission, December 9, 1980, p. 2.

⁴⁵*Ibid.*, p. 3.

⁴⁶Bradley Graham, "Germany's Slowdown Symptom of Middle-Aging Economy," *The Washington Post*, December 5, 1980, p. E 1.

⁴⁷*Ibid.*

⁴⁸The material used in this paragraph is largely drawn from P.B. Spahn, *Issues of Municipal Reform and the Future Role of Local Governments in West Germany*, Reprint Series Number 14, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, The Centre, n.d. The quotations are from pp. 11-12, 16, 17. The inner quotation is from R.L. Mathews, *The Changing Pattern of Australian Federalism*, a paper delivered to the Nigerian Institute of International Affairs International Conference on Federalism, May 1976, p. 51.

⁴⁹David P. Conradt, *The German Polity*, New York and London, Longman Inc., 1978, p. 200.

⁵⁰*Ibid.*, p. 205.

⁵¹*Ibid.*, p. 201.

⁵²*Ibid.*, pp. 215, 216.

Four Federal Systems in Comparative Perspective

The presence of two major levels of government (remembering that local governments are subsumed as part of the subnational level), each with a certain amount of constitutional autonomy, obviously creates problems in the fiscal areas which have somehow to be solved through the institutions of government. Federal nations vary among themselves as to what institutional arrangements are established and utilized for that purpose.

The problems to be solved, however, are very much the same in all federal nations. One important problem is to assure that each level of government will have adequate financial resources to carry out the responsibilities it is expected to assume in the overall scheme of things in national affairs. This means that revenue sources in the nation must be both appropriately divided and harmonized sufficiently so that undue and unequal burdens are not placed on taxpayers. A problem of almost equal importance is to find a way to assure that subnational governments across the country are able to provide to their citizens substantially the same quality of service without some of them having to impose much higher taxes than others. A third problem arises out of the necessity of having some way to assure that certain basic services—health care, education, transportation, welfare—even though they are the responsibility of subnational governments, are offered at about the same standard and to about the same groups or individuals across the country. Finally, a problem arises in devising ways to secure some degree of compatibility between the levels of government as

far as economic and taxation policies adopted by each are concerned.

There are no pat solutions to any of these problems, and the four countries under review in this study have approached solving them in different ways. In none of the countries have perfect solutions been arrived at; and given the pushes and pulls within each of the systems which are constantly felt in national politics and policymaking, it is not likely that such solutions will ever be achieved.

The purpose of this study was to compare and contrast fiscal federalism in four nations. While recognizing that each nation and its federal system is unique because of the geographic, demographic, economic, social, and political factors of the particular country, the four federal systems—those of Australia, Canada, the United States, and West Germany—have faced many similar problems over time, especially in the area of fiscal policy. How the others have attacked those problems may provide insight into the American federal system as it moves into its third century.

SELECTION OF COUNTRIES

The three foreign countries selected for the ACIR study—Australia, Canada, and West Germany—were chosen because they possess certain basic similarities to the United States. Most important, certainly from the present vantage point, is that the three countries are democracies and are governed by federal systems, in which responsibilities are shared among different governmental levels. In addition to having the same system of government, each of the countries has a highly industrialized economy along with a well-educated and trained labor force. All four countries have predominantly urban populations. The standard of living differs somewhat among the four but is high in all of them. While currently, and recently, experiencing greater than usual economic problems—particularly the stagflation combination of high rates of unemployment and inflation—each country retains a distinctly “have” rather than “have-not” economic status. Strong parallels in matters of government and economic and social structures thus exist.

It is equally true, however, that none of the countries is a mirror image of another. Needless to say, each nation possesses its own history, institutions, culture, and traditions, and, as such, can lay claim to being “unique.” Indeed, no shortage of distinctions exists among the four countries studied here. For

one, Australia, Canada, and the U.S. are large in area; West Germany is not. For another, the U.S. has a far larger population than any of the other three—with, for example, ten times the number of people that Canada has and 3-1/2 times as many people as West Germany.

It should be pointed out that in certain important respects Australia, Canada, and West Germany have much more in common with each other than they do with the United States: All three are governed by a parliamentary system emphasizing strong party discipline; the U.S., with its separation of powers and the presidential system, is characterized by weak party discipline. Further, Americans are served by a far greater number of governments—particularly local governments, both single and multipurpose—than are their counterparts abroad. All told, there are just under 80,000 governmental units in the U.S., including 50 states, as opposed to 11 German laender, 11 Canadian provinces, and six Australian states. The critical distinction to be made on this point, however, centers not only on the number of governments but on the distribution of power and authority among the three governmental levels and the traditional uses of governmental power. Largely owing to the number and independence of one from another, and to the large role reserved for the private sector, governments' power is far more diffused in the U.S. than is the case in the federal systems of Australia, Canada, and West Germany. This diffusion of power is particularly evident in the fiscal strength of the local government sector in the U.S. as compared to its relative weakness and dependent status fiscally in the other three countries. This diffusion also underscores and reflects another critical distinction—American society is more pluralistic and heterogeneous than are the societies of the other three federations.

The similarities and differences that exist among the four countries could be extended considerably. The abbreviated discussion presented here, however, should serve to suggest that there are a number of strong common factors both among the selected countries and between these countries and the U.S.

LESSONS AND LIMITS OF FOREIGN EXPERIENCE

There are two reasons for studying foreign experience: (a) to discover approaches that might be helpful in solving American problems, and (b) to gain better insight into, and appreciation of the

American system.

While there is undeniably something inherently interesting in studying the ways other federal systems are organized and how their institutional arrangements confront some of the same fiscal problems faced by the U.S., there are also limits to what we can learn from experience elsewhere. Even granted the existence of similar problems and common elements among the four countries studied, the question remains: How much—if any—of foreign experience can be transferred to the U.S.? The differences already mentioned—size, number of governments, degree of autonomy, etc.—and others all serve as obvious restraints on the transferability of experience from abroad.

Further, the studies of Australia, Canada, and West Germany are, in essence, case studies, and like all case studies it is difficult to generalize—in this case, from a sample of three. Finally, the question arises, does the U.S. want to alter its system to bring it more closely in line with other federal systems? What trade-offs in terms of local discretion and negotiating ability, for example, would have to be made if one were to move to the more centralized fiscal federalisms of Australia and West Germany? In any case, in seeking to extract lessons from the experiences of other federal nations, the purpose of the exercise is not to provide an alternative fiscal pattern for the United States. By and large, that pattern is so deeply rooted in law, custom, and practice in the U.S. that radical substantive change seems highly unlikely. The individual peculiarities of the other three nations serve to tailor the fiscal pattern in each so that none of them would fit the American body politic. However, there do seem to be some substantive and a good many procedural lessons which can be extracted and offered for consideration.

For all of these reasons, it is necessary to approach the lessons to be learned from those studies with caution. What we can learn from foreign experience, however, is “how they do it,” and then decide—on whatever criteria, objective or judgmental—whether some of those lessons can be adapted to the practice of federalism in the United States.

MAJOR CONCLUSIONS

This study reaches three main conclusions:

- Fiscal federalism as organized in the United States is less formally structured, more fragmented, and consequently less neat and orderly than in any of the other three countries.

- The United States grant system is more complicated and extensive than is the case abroad.
- The United States pays less attention to the goal of fiscal equalization than do Australia, Canada and West Germany.

Each of these conclusions deserves some comment. Other points of comparison are condensed in the “rating” table (*Table 11*).

STRUCTURAL ASPECTS: PROCESSES, PROCEDURES, AND ARRANGEMENTS OF FISCAL FEDERALISM

The structure of intergovernmental fiscal relations in the U.S. is in sharp contrast to the institutional arrangements developed in the three other federal systems studied.

Fiscal policymaking—government taxation and expenditure issues—is conducted in the U.S. at the national, state, and local levels by members of the executive and legislative branches, with an increasingly important role being played by the federal and state courts. With the large numbers of decisionmakers involved, it is not surprising that a good deal of fiscal policy—especially between the federal and state sectors—appears uncoordinated, if not atomized, in comparison to the other three federal systems. As this study notes in *Chapter 3*, “the American federal system consists of a great many independent fiefdoms, under a multiplicity of elected and appointed officials, many going in different directions, few of them taking into account the impact of their fiscal and economic actions on the others in the system.”

Yet, coordination—while weak—is by no means wholly absent from the federal-state relationship. In the federal arena, two devices—tax deductibility and the reciprocal exemption of interest income derived from government securities—are unparalleled in foreign experience. By their open-ended nature, available to all subnational governments, these features tend to promote governmental decentralization, enhancing the independence and autonomy of the state-local sector, and do little to bring about coordination between federal and state sectors. Perhaps significantly, one measure that would work toward coordination—the federal offer to collect state income taxes (subject to certain conditions)—has not been accepted by any state thus far. If the budget and tax processes of the U.S. are in the main

Table 11

RATING FOUR FEDERAL SYSTEMS—AN “IMPRESSIONISTIC” EVALUATION

Selected Indicators	Australia	Canada	United States	West Germany
National Unity	Strong	Fairly strong ^a	Strong	Strong
State Influence on Federal Policy-makers	Fairly strong	Strong	Fairly weak	Strong
State Government Constitutional Status	Strong	Fairly strong de jure; very strong de facto	Fairly weak ^b	Strong
Actual State Control of Local Government	Strong	Strong	Varies from fairly strong to fairly weak	Strong
Range of Local Government Responsibilities	Limited	Fairly extensive	Fairly extensive	Limited
Local Government Influence on State Policymakers	Weak	Fairly strong	Fairly strong	Weak
Local Government Influence on State Policy	Weak	Fairly strong	Fairly strong	Weak
Local Government Influence on Federal Policy	Weak	Weak	Fairly strong	Weak
The Character of Fiscal Federalism	Two-tiered; centralized	Two-tiered; decentralized	Three-tiered; unstructured	Two-tiered; quite integrated
Federal-State Intergovernmental Transfers	Important; emphasis on conditional grants	Important; emphasis on unconditional grants	Important; emphasis on conditional grants	Unimportant; emphasis on tax sharing
Federal-Interstate Equalization Performance	Very strong; revenue and expenditure disparities reduced substantially	Strong; revenue disparities reduced substantially	Weak; some tax effort equalization	Strong; revenue and some expenditure disparities reduced substantially
State Tax Performance	Fairly weak	Strong	Fairly strong	Fairly strong
Local Government Fiscal Independence	Fairly strong	Fairly strong	Fairly strong	Weak

^aBut threatened by unresolved problems.

^bAs interpreted by the courts.

SOURCE: Table prepared by John Shannon, Washington, DC, ACIR, 1980.

aptly characterized as uncoordinated, fragmented, and atomized, however, the General Revenue Sharing (GRS) program, in effect since 1972, at least gives explicit attention to the overall status of state and local finance. In addition, the *Congressional Budget Act* attempts to pull together the various parts of the federal budget under the jurisdiction of the various committees and subcommittees so as to make assessment of the overall federal, if not intergovernmental, budgetary picture possible.

If relatively uncoordinated, the intergovernmental fiscal policy process does not take place in a void. There is no shortage of meetings, conferences, and lobbying efforts, all such mechanisms being well entrenched and actively pursued in the American federal system. State-local interests are continuously promoted in Washington by national organizations—the public interest groups. While such meetings and forums forge linkages among the three governmental sectors, the discussions tend to center on specific topics, with little attention paid to an overview of intergovernmental relations.

What is lacking in the United States, as emphasized by comparison with Australia, Canada, and West Germany, is an institutional structure or set of procedures that can be invoked on a regularly scheduled basis to assess the general direction or overall impact of federal-state-local policies. That is, no arrangements presently exist to develop an overall federal-state-local economic or fiscal policymaking framework. Unlike Australia and Canada, for example, the U.S. does not have anything comparable to the basically annual conferences of first and other ministers to hammer out federal-state relationships; unlike West Germany, the U.S. Constitution does not sort out governmental responsibilities in any detail. Thus, both by means of comparison with foreign experience and with regard to its own “open-ended” type of federal-state coordinating devices, intergovernmental relations in the U.S. can—at the risk of oversimplification—be considered very much the sum of its parts: program parts, governmental level parts, and governmental branch parts.

The intergovernmental relations network in this country contrasts most strongly with the practices and procedures followed in Australia. Three Australian institutions—the premiers’ conference, the Grants Commission and the Loan Council—conduct some of the most vital intergovernmental negotiations. Because these three institutions constitute a locus of power for decisionmaking on vital intergovernmental topics, the Australian system of

federalism is far more centralized than its U.S. counterpart; the powers possessed by these three Australian institutions are either absent or much more widely diffused in this country.

The premiers’ conference takes place regularly on an annual basis and fiscal matters constitute the leading—though not the sole—agenda items. The conference provides the setting in which the overall federal-state financial relationship is determined; it is the vehicle for presenting the national fiscal plans and policies to the states. Also distinguishing the Australian federal system from this country is the Australian Grants Commission, which has the authority to use its own calculations to assess grant applications for special financial assistance for the financially weaker states. Although the commission itself does not make the grants, its recommendations are almost always accepted by the national government. Equally distinct from American experience is the Australian Loan Council, which decides the total amount of governmental borrowing that will take place and then divides this total among those governments seeking to borrow. While some types of debt are excluded—federal defense borrowing, for example—the decisions of the Loan Council need not be ratified by national or state parliamentary actions. Needless to say, no governmental institution in the U.S. has such powers. As W.R.C. Jay concludes, “It is hardly conceivable that a similar body could be set up in a federation like the United States, with its vast population, its multitude of local authorities exercising major functions of government, its 50 states and its complex economy.”¹

The distinguishing feature of Canadian intergovernmental relations is the heavy reliance placed on the consultation process for making policy decisions. This consultation process takes place in an extensive and elaborate number of meetings at virtually all levels—the basically annual meeting of first ministers (the Prime Minister and the ten provincial ministers), meetings of deputy ministers, senior departmental officers, etc. A typical year, 1975, was marked by no less than 782 federal-provincial meetings. In part due to the complex nature of the problems addressed and to the fact that Canadian political parties have taken on a provincial rather than national character, a good deal of power has been transferred to bureaucrats. Indeed, a new term—executive federalism—has been coined to describe Canadian federalism.

The development of so many meetings, with so many participants, covering so many problem areas,

with so much power exercised by bureaucrats, has not gone either unnoticed or uncriticized. For present purposes, however, the essential point is that Canada has developed a structured consultation process for determining the direction of federal-provincial policy, which is not the case in the U.S.

West Germany presents the most formally organized system of federalism. The Basic Law (or constitution) of that country goes into detail as to how the fiscal arena is to be divided up by federal, state and local governments. Secondly, the Basic Law established the Bundesrat, the second house of the national legislature. The Bundesrat consists of 41 delegates sent and instructed by their laender (state) governments. The main function performed by the Bundesrat is to review legislation passed by the Bundestag for its effects on the laender governments. It can, but rarely does, initiate legislation. The Bundesrat is thus the forum for conducting intergovernmental relations. Since its veto of any legislation can only be overridden by a two-thirds vote of the Bundestag, the Bundesrat plays a central role in domestic—particularly fiscal—policymaking in West Germany.

FEDERAL GRANTS-IN-AID

By virtually any yardstick, the United States relies heavily on an extensive and complicated network of grants-in-aid—predominantly categorical in nature—to assist and stimulate the state-local sector to undertake programs held to have a “national interest.” In good measure, the complexity of the grant system can be traced to a mushrooming growth of grants during the late 60s and early 70s. Between 1965 and 1975, for example, federal grants increased from \$10.9 to \$49.8 billion. By fiscal 1980, total grants had reached the \$91.5 billion mark, representing 21.1% of federal domestic budget outlays and 26.3% of state and local expenditures.

The \$91.5 billion grant total is transferred to the state-local sector by three different grant mechanisms. The General Revenue Sharing program is largely “unconditional” in character, recipients having wide discretion in the uses they make of the aid. “Block” grants are a hybrid concept providing aid for closely related programs in broad areas. The distinguishing feature of the U.S. grant system, however, is its heavy reliance on the categorical grant-in-aid, each designed to assist in financing a single, specific public program. The dominance of this form of aid is apparent in an analysis by the Office of Man-

agement and Budget. Using its definitions, categorical aids were used to transfer \$72.6 billion, or just under 80% of total federal aid dollars in fiscal 1980.

Indeed, it is the categorical aid component that accounts for the present complexity of the grant system in this country. As of 1978—the last year for which data are available—no less than 492 categorical aid programs, divided into formula and project grants, as well as matching and nonmatching grants, were made available to four groups of eligible recipients: states only, localities only, states and localities, and states, localities, and private nonprofit organizations (see *Table 12*).

While categorical aids largely establish the present complexity of the grant-in-aid system, it is the General Revenue Sharing program that provides its extensive nature. Through this program, federal assistance is channeled to approximately 38,000 units of general-purpose local government. In addition, 26 categorical aid grants (as of fiscal 1978) provided federal aid directly to local governments, thereby bypassing the states. This federal-local direct-aid connection, while the exception rather than the rule, is practiced to a far greater extent in the U.S. than in the other three countries.

But if the highly categorical grants system is an important part of intergovernmental relations in the U.S., it has recently come under increasing attack, by the Commission and others. The scope of the grant system is held to be excessive, with federal aid and policymaking intruding into areas more appropriately left to state-local decisionmakers. The number of grants and their conditions and requirements, when coupled with federal mandates and regulations, are seen as hamstringing state and local officials. And any grant system—certainly the extensive and complex U.S. system—raises the basic issue of political accountability. With such a system in operation, is it possible to assign responsibility to the appropriate decisionmaker?

To streamline the present grant system, the ACIR has recommended a “decongestion strategy”—to simplify the aid system through a reorganization of aid programs that includes such steps as the federalization of some programs, the termination of others, and the consolidation of still others. Decongestion is less of a problem or issue in Australia, Canada, or West Germany. In West Germany, the Basic Law provides more “sorting out” of responsibility and authority among governmental levels than is the case in the U.S. In all three countries, local governments are kept on a much tighter leash

Table 12
**CATEGORICAL GRANT PROGRAMS, BY GRANT TYPE, EXISTENCE OF
NONFEDERAL MATCH, AND ELIGIBLE RECIPIENTS, 1978**

	Nonfederal Match		Fiscal Year 1978			
	Yes	No	Eligible Recipients*			
			1	2	3	4
Formula-Based						
Allotted Formula	61	45	88	8	8	2
Formula Project	25	22	20	10	5	12
Open-End Reimbursement	13	4	16	—	—	1
Total Formula-Based	99	71	124	18	13	15
Project	182	140	67	49	13	193
TOTAL	281	211	191	67	26	208
	57.1%		38.8%	13.6%	5.3%	42.3%

*Key: 1—States only.
2—States and local units.
3—Local units only.
4—State-local and other (e.g., private nonprofit organizations).

SOURCE: Advisory Commission on Intergovernmental Relations, *A Catalog of Federal Grant-In-Aid Programs to State and Local Governments: Grants Funded FY 1978*, A-72, Washington, DC, U.S. Government Printing Office, February, 1979, p. 3.

by the states or provinces, so that the direct federal-local dimension of the complexity question does not rise as sharply—if at all. Further, the grant systems of the three countries differ from the U.S. model in that fiscal equalization is much more heavily emphasized, rather than a profusion of specific purposes carried out via the categorical aid route and claimed as part of the “national interest.” To be sure, these countries use categorical aid—but nowhere to the extent it is used in the U.S.

Despite the lesser reliance placed upon categorical aids in Australia and Canada—motivated mainly by cost containment considerations—both countries have acted to “decongest” their federal aid package. A “rollback” in categorical aids has taken place in Australia since 1976-77. Canada changed its established programs financing in 1977 so that the national government’s share of the three programs (hospital insurance, medicare, and postsecondary education) is provided via a “closed-end” grant and the availability of tax room—whereby the provinces pick up the share of the personal income tax vacated by the federal government.

FISCAL EQUALIZATION

Fiscal equalization is less accepted as a goal—and consequently is pursued to a lesser extent—in the United States than in any of the three federal systems studied here. This country has no counterpart to the Australian Grants Commission, which, for example, is designed by law to determine the method of calculating and the amount of equalization assistance to be provided to the financially weaker states. Further, the measures of fiscal capacity used in the U.S. are probably less accurate—and certainly less sophisticated—than either the representative tax system approach adopted (1) in Canada, where 29 different sources are involved in the capacity measure; or (2) in Australia, where the Grants Commission calculates the aid that a claimant state would need to provide services comparable to the standard states (New South Wales and Victoria) without having to impose higher taxes and charges than the standard states. Perhaps the greatest contrast regarding fiscal equalization, however, is with West Germany. There, the governments have not only assumed responsibil-

ity for many services provided by local governments in the U.S., but equalizing transfers also take place not only from the federal government to the states (vertical equalization) but also from the richer to the poorer states (horizontal equalization).

Thus, it seems clear that the United States is less committed to equalizing fiscal resources than are the other three federal systems studied. Yet equalization is by no means absent from the field of U.S. intergovernmental relations, where the General Revenue Sharing program constitutes the major vehicle to achieve this objective. This program provides aid to more than 38,000 units of general government, and as the ACIR's and other studies have noted, the assistance does successfully transfer resources in an equalizing manner, with greater amounts being provided to the less fiscally able jurisdictions. In addition to General Revenue Sharing, a number of categorical aid programs have formulas that include measures of fiscal ability to distribute aid for specific purposes.

Fiscal equalization, however, is the exception rather than the rule in the United States. Even in equalizing programs, measures of fiscal ability are combined with factors designed to represent program need so that no program in this country distributes aid with the exclusive purpose of lessening fiscal disparities. It thus follows that, unlike the other countries studied, the U.S. has no targeted program of equalization aid under which the richer states do not receive any financial assistance.

For the purpose of equalization, aid must be provided in inverse ratio to a measure of the recipient jurisdiction's fiscal capacity. In the U.S., capacity has most frequently been measured by personal income and, to a lesser extent, by tax effort—the ratio of taxes to personal income. Tax effort, however, is not a clear measure of the ability of a governmental unit to provide public services or its need for additional outside assistance. The tax effort factor is taken to represent fiscal capacity because those jurisdictions with more limited fiscal resources may be forced to tax to a greater extent, so as to provide services comparable to their more affluent counterparts. Since high measures of tax effort can also result from a preference for public—rather than private—sector goods and services, or because of an inefficient or wasteful public sector, tax effort is a flawed measure of fiscal capacity or fiscal pressure.

The more frequently used measure of fiscal capacity—personal income—has also been under attack. Largely due to tax exporting—the ability of one

jurisdiction to levy taxes that are paid by nonresidents as, for example, severance taxes and sales taxes paid by tourists—there is increasing skepticism as to the accuracy of the personal income measure to reflect fiscal capacity.

The United States thus pursues equalization to a lesser extent and measures fiscal capacity in a less rigorous manner than do the federal systems of Australia, Canada, and West Germany. If further steps in the direction of equalization are to take place here, the General Revenue Sharing program is the preferred vehicle. It is unlikely, however, that the U.S. will pursue equalization to the same degree that is presently the case in the three countries studied.

CURRENT ISSUES

In addition to the continuing issues posed by the processes and arrangements for conducting intergovernmental relations, fiscal equalization, and intergovernmental transfers, the four countries studied are all challenged by two common problems—local government finance and containing governmental costs. Local governments in general and urban governments in particular stand out as the weakest part of the intergovernmental fiscal totem pole, requiring as they do resource supplementation in each of the countries studied. Given the prospect of less than fully buoyant economies in the years ahead, fiscal austerity appears the order of the day for each of the four federal systems. With a more slowly growing economy, Australia, Canada, the United States, and West Germany all will face heightened tensions as to how the economic or public-sector pie is divided among governmental levels.

Among the four countries studied here, Canada seems likely to face the greatest stresses and strains, both of federalism itself and of intergovernmental fiscal affairs. The Canadian Parliament has before it a joint resolution respecting the constitution of Canada. Debate has been joined over several features of this resolution—including the provisions for a charter of rights and freedoms binding on all Canadian governments and a formula for amendment. The federal and provincial governments also are at loggerheads over the energy issue. The new energy package proposed by Ottawa, presented in the federal budget message of October 28, 1980, would increase federal revenues from energy sources—something the federal government is determined to see happen, just as the energy-rich provinces of Alberta and British Columbia are certain to attempt to forestall it.

Though there is no sense of immediacy involved, constitutional revision is also in the wind in West Germany. Discontent has been voiced by many concerning the number and efficiency of the laender governments which, according to the critics, lack a clear statement of authority and responsibility. Because the Basic Law of West Germany was virtually imposed by the Allies and has always been regarded as provisional, there are probably fewer hindrances to developing a new constitution than would be the case elsewhere. There is at present no indication, however, that constitutional reform or revision are issues that rank high on the West German political agenda.

Both Australia and the United States, while confronting a full array of continuing and common problems, are doing so without any basic questioning of the federal system itself. There will be continuing adjustments to seek greater balance among governmental levels in both countries, and steps toward greater decentralization in both may be anticipated. Such changes as take place, however, are more than likely to be in the context of federal systems very much as they are presently constituted.

In comparison to the other three federations, the United States clearly scores rather poorly when tested against traditional norms of orderly federalism. Fiscal equalization is more honored in the breach than in the observance. Our metropolitan areas are Balkanized by a multiplicity of rather powerful local

governments, which have learned to bypass the states and go directly to Washington for all forms of special assistance. A hyper-responsive Congress, in turn, has created a thicket of narrow categorical aids, thereby serving to uphold and sustain local power and intensify the problem of fixing political accountability in the American federal system.

Despite its disorderly appearance, the U.S. system must be given high marks on one crucial test—national unity. It also scores very high on diversity. Such diversity—although it may seem disorderly at first glance—is actually a reflection of our highly pluralistic society.

While the United States could probably profit from the more orderly fiscal patterns of Australia, Canada, and West Germany, these three federations might also learn from some of our achievements. For example, our recent success in strengthening the tax position of the states might be of interest to Australian states that are extremely dependent on federal fiscal transfers. In addition, all three of the other federations might take a leaf from our local government book: Local governments in the U.S. exhibit far greater fiscal viability and political clout than do the local governments in the other federations.

FOOTNOTE

*W.R.C. Jay, "The Australian Loan Council," *Publius*, Philadelphia, PA., vol. 7, no. 3, p. 117.



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The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the Federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three Federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from slates nominated by the National Governors' Association, the National Conference of State Legislatures, the National League of Cities, U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Congressmen by the Speaker of the House.

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As a continuing body, the Commission approaches its work by addressing itself to specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with the all important functional and structural relationships among the various governments, the Commission has also extensively studied critical stresses currently being placed on traditional governmental taxing practices. One of the long range efforts of the Commission has been to seek ways to improve Federal, state, and local governmental taxing practices and policies to achieve equitable allocation of resources, increased efficiency in collection and administration, and reduced compliance burdens upon the taxpayers.

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