

**AUTONOMY OR DEPENDENCE:
INTERGOVERNMENTAL FINANCIAL**

and Japan (1947), with well developed economies.

federations in the world. Furthermore, two other factors contribute to the decentralized character of the Swiss federation. One is the high degree of cantonal consultation that the federal government is required to undertake due both to constitutional requirements and to political tradition. The second is that all federal legislation is subject to check by a referendum if a specified number of citizens petition for it.

Switzerland has had since 1959 a system of equalization transfers to moderate the financial disparities among the cantons. In recent years these have been the source of some controversy leading to the consideration of substantial reforms to the system.

The principle of the separation of powers with fixed-term collegial executive councils has been applied to both levels of government. The Federal Council is a collegial executive body elected by the Swiss federal legislature for a fixed term and composed of seven councilors among whom the Presidency rotates annually. The federal legislature is bicameral composed of the National Council (Nationalrat) and Council of States (Ständerat) with equal powers. In the latter the twenty full cantons have two representatives each and the six half cantons have one each. The electoral system based on proportional representation has resulted in a multiparty system, but the fixed-term executive has provided stability, and the tradition has developed that it should encompass the four major political parties representing an overwhelming majority in the federal legislature. The predominant characteristics of the Swiss political processes have been emphasis upon consultation with all groups, respect for minorities, and decisions based upon compromise and consensus. These processes characteristically have required lengthy deliberations but have received widespread acceptance of decisions once arrived at.

(2) Australia (1901):

Australia is a long-standing developed federation with parliamentary institutions. It has been marked by a considerable emphasis upon uniformity and inter-state equity in its financial equalization arrangements.

The Australian federal constitution of 1901 united a group of self-governing British colonies on the continent. Today, the federation comprises six states (of which the two most populous, New South Wales and Victoria, comprise some 60 percent of the total federal population) plus one capital territory, the vast Northern Territory, and seven small administered territories.

By contrast with Switzerland, Australia has a relatively homogeneous society with a population of about 19 million people mostly descended from British and European settlers. However, the geographic vastness of the continent and the concentrations of population in dispersed state capitals, each serving its own hinterland, have made federation a natural form of political organization.

The founders of the Australian federation rejected the Canadian model which they regarded as having a relatively centralized distribution of powers, and followed instead the American model of enumerating a limited list of federal exclusive powers and a substantial list of concurrent powers, leaving the substantial unspecified residual powers to the state governments. In practice, however, the Australian federation has over time evolved into a relatively more centralized federation, particularly with respect to its financial arrangements. A notably significant feature has been the strong revenue position of the federal government, reinforced by some major High Court rulings. Indeed, the federal government controls about three-quarters of the total federal-state-local revenues. Since the states and local governments are constitutionally responsible for nearly half the total public expenditures, this has required a system of very substantial transfers from the federal to the state governments to close the vertical financial gap. Given a political culture emphasizing uniformity and inter-state equity, Australia since 1933 has been a pioneer among federations in developing formal equalization arrangements. In many respects it has been the model that has most influenced the equalization arrangements adopted in subsequent federations in the developing world. A key institution in the evolution of equalization

arrangements since 1933 has been the Commonwealth Grants Commission.

While adopting a different form of distribution of legislative powers, the Australian federation did follow the Canadian precedent of combining federal with British parliamentary institutions (with cabinets responsible to the legislatures at both federal and state levels). At the same time, unlike Canada, the Australians incorporated a relatively powerful directly elected Senate with equal representation of the states. The impact of the parliamentary system has, however, made the Senate in practice more of a 'party house' than a regional 'state house'. The parliamentary institutions which in practice has led to cabinet dominance within each government have also affected the character of intergovernmental relations with the result that Australia has developed the institutions and processes of 'executive federalism' extensively.

(b) Transitional federations:

After some forty years of totalitarian centralization, in 1978 Spain adopted a new constitution establishing a parliamentary democracy. As part of the post-Franco democratization and as a means of balancing powerful regional interests fostered by revived Basque and Catalan nationalism, Spain has pursued a process of regionalization. This led to the development of units called 'Autonomous Communities' of which there are 17 in a country of nearly 40 million.

Although historically a strongly centralized unitary state, Spain has in fact contained considerable diversity. While the political culture of the Castilians has tended to be hierarchical and centralistic, the Argonese, Basques, Catalonians, Galicians, Navarrese and Valencians have each had a strong interest in securing their own cultural identity.

The Spanish response to this situation was the adoption of a constitution in 1978, which although not officially labeled as federal, in fact has virtually all the characteristics normally associated with federation. At the very least it may be called "quasi-federal". Furthermore since its adoption there has been a progressive grant to each region of its own arrangements for autonomy based upon a particular set of compromises negotiated between its regional leadership and the central government. More recently, however, the Madrid government has emphasized that although the different regions are progressing to autonomy at different speeds, ultimately they should become less asymmetrical. As a result of this process since the adoption of the constitution, Spain has moved to a degree of decentralization comparable to those found in developed federations elsewhere. This has, however, been derived less from a constitutional mandate than from party strategies, competition and bargaining within a loose institutional framework.

In practice, the result has been that in the distribution of powers and related financial arrangements there are three groups of Autonomous Communities. The first has been the '*fueros*' (foral) communities, the Basque

Country and Navarra which retain historically significant residual powers and which, unlike the other Communities, have also retained (under the Constitution Additional Provision No. 1) historic tax raising and collecting powers from which a portion is ceded to the central government. Despite this relatively high level of autonomy by Spanish standards, the Basque country has continued to be plagued by relatively intense independist terrorist violence. The other 15 Communities have only limited taxing powers and depend heavily on transfers in the other direction from the central government. This group itself falls broadly into two sub-groups differentiated according to their level of responsibilities. The first, the 'fast track' group (Article 151) Communities including Andalusia,

regimes. This culminated in a decade of political and fiscal decentralization in the 1970s and 1980s, and a new federal constitution in 1988. In area the fifth largest country in the world, and with a population of more than 170 million

distinct 'spheres', but consciously rejects the use

grant while those above the average taxable income pay a fee. In addition the local governments receive a block grant from the central government, containing a population-related and age-related portion. Although levying of income tax is highly decentralized, the collection of these taxes on their behalf by the National Tax Administration, and the definition of tax bases by central law has contributed to tax harmonization.

In terms of the organization of central politics, Sweden is a parliamentary democracy with a constitutional monarchy. Although unitary, the constitution establishes the principles of local government. The 1991 *Local Government Act* defined the roles of municipalities, county councils and regions and provided extensive scope for local inhabitants to monitor and influence the local decision-making process. Every municipality and county has a council whose members are elected every four years on the same day as the parliamentary elections.

Among unitary political systems generally, the Nordic countries, of which Sweden is a good example, are unique in the level of autonomy allocated to local governments both for the provision of many public services and for their taxation authority.

(8) Japan (1947):

Japan is a unitary country with one of the most homogeneous populations of any country in the world, but with a considerable administrative and financial decentralization for its 47 prefectures. The population of some 127 million people is concentrated in a relatively small land mass living mostly in four main islands and 4000 smaller islands, but 80 percent of the population and 85 percent of the economic activity is concentrated in the island of Honshu.

The current constitution of Japan was in effect written and imposed by the United States after World War II, coming into effect in 1947. The constitution does make specific provision for local government and the governors of the prefectures are elected. In relation to the 47

prefectures and some 3,250 local governments within them, the Japanese central government is more powerful than would be the case in most federal systems, and this power has been reinforced by making the lower government levels financially dependent on the centre. Nevertheless, not unlike Sweden, local governments in Japan are responsible for a major share of public spending. Their responsibilities include national land conservation and development expenditure, education expenditure, police and fire brigades, social welfare, sanitation and general administration amounting in 2001 to 62 percent of combined total public expenditures. But, unlike Sweden, the ultimate control of the central government is ensured by a provision in the *Local Autonomy Law* (article 150) that states that the chief executives of the local authority act as agents of the central government to deliver prescribed functions, and makes provision for *mandamus* proceedings allowing the central government to direct local governments to carry out certain activities.

Furthermore, the dominance of the central government is reinforced by the centralization of finances. The constitution establishes the Diet's control over the imposing of taxes and the expenditure of funds. In the Japanese fiscal system, while the majority of expenditures are done at the local level, only a very limited autonomy is available to local governments in their spending decisions, and on the revenue side decentralization is limited and the authority of tax base and rate determination lies with the central government. Because local government expenditures constitute approximately 62 percent of all government expenditures but local tax revenue constitutes only about 42 percent of all government revenues (Table 2), the central government through its transfers plays an important role in helping local governments meet their budgetary needs. As a result transfers form a much higher proportion of local government revenues than in Sweden. Moreover, about two-fifths of these take the form of conditional or specific purpose grants which further limits the autonomy of prefectures and local governments. There is an equalization component in the allocation of the unconditional

transfers which are distributed according to a uniform formula based on basic financial need and basic financial capacity.

Under the 1947 constitution, the Emperor of Japan serves as the “symbol of state” but has no formal governmental power. Effective national executive power lies with the Prime Minister and cabinet who depend on the confidence of the House of Representatives to remain in power. The national Diet is bicameral. The second chamber is the House of Councillors elected on the basis of open list proportional representation from prefectural electoral districts. However, the House of Representatives takes precedence over it. Local authorities have elected assemblies and elected chief executive officers. For most of the period since 1947 (the main exception being 1993-6) the dominant party in the national Diet and government has been the Liberal Democratic Party and the political struggles have been as much between different factions within that party as between parties.

B. A COMPARATIVE REVIEW OF SIGNIFICANT FEATURES OF THE FINANCIAL ARRANGEMENTS IN THE ELEVEN COUNTRIES

1. The Context for Intergovernmental Financial Relations

(i) *Significant historical geographic, cultural, demographic, and economic features affecting financial arrangements:*

Underlying the political and constitutional context for intergovernmental financial arrangements in federal, quasi-federal and decentralized unitary political systems are the similarities and differences in the character of their societies. The historical background is significant, for instance. The longevity of the mature federations such as the United States (1789), Switzerland (1848), Canada (1867), Australia (1901) and Germany (1949) means that these federations have had the opportunity to develop over more than half a century and in four of these over a century, experience in the handling of intergovernmental financial relations and to evolve and modify these in the light of that experience. The same could be said of the mature decentralized unitary systems, Sweden

and Japan. On the other hand, among the transitional federations, only India has had a half century of experience and the other three, Spain (1978), Brazil (1988), and South Africa (1996) have had their current constitutional and financial arrangements in place for only three decades or less. This has enabled some innovations, but the pattern is less settled. Furthermore, in most of them, concern about the fragility of the federal union has led (with the exception of Brazil) at least initially to a greater concentration of powers and finances in the central governments (see for instance Table 1 at end of this report).

Geography has also had a significant impact. Most of the federations considered in this and the previous studies have been extensive in territory or population. The only significant exception among these federations is Switzerland, with a population of only seven million people, but the mountainous topography of Switzerland has divided these people by distributing them in pockets in their distinct

composition and could even be described as multi-national federations. In the case of the first three this has led to considerably more decentralization of constitutional and financial powers, whereas in the two more recent examples, Spain and South Africa, fears of disunity have produced considerable resistance to decentralist pressures and a tendency to insist on retaining strong central powers.

The economic character has also been a significant factor. The existence of different regional economies, especially in countries with continental scope, has helped to reinforce federalization in many instances. Where the market economy has been prevalent this has also contributed to this trend, although in those more recent federations where the emphasis upon economic planning has been strong, as in the early years in India and South Africa, this has led to a much greater emphasis upon providing the central government as the primary planning body with strong financial powers.

(ii) The Constitutional and Political Context:

(a) Features shared in common among the federations:

Six of the countries examined in this study are federations or quasi-federations that share certain features in common with the three federations studied in the previous reports. All nine incorporate the major characteristics of a federation: the establishment of two or more orders of government each acting directly on citizens, rather than indirectly through another sphere of government; a formal constitutional distribution of areas of exclusive and shared (concurrent) legislative and executive authority ensuring at least some areas of genuine constitutional autonomy for each government; a constitutional allocation of revenue resources for each order of government; provision for the designated representation of distinct regional units within the federal policy-making institutions, including usually a federal second legislative chamber designed specifically for this among its functions; a supreme written constitution not unilaterally amendable by either order of government but requiring the assent of the federal legislature and of a significant proportion of the constituent units through their

legislatures, representatives of their governments, or by referendums; an umpire in the form of a Supreme Court or a Constitutional Court to rule on constitutional disputes between governments; and processes and institutions to facilitate intergovernmental collaboration for these areas where governmental responsibilities are shared or inevitably overlap.

Among the common constitutional and political features shared by these mature and transitional federations are number which particularly have an impact on the financial arrangements. First, is the constitutional distribution of expenditure responsibilities and revenue sources. In each case the distribution of legislative and executive authority defined in the constitution has established the scope of expenditure responsibilities that each government in response to political circumstances may undertake. At the same time, in all five mature and four transitional federations, the constitution has also defined for each order of government their financial resources from taxation, borrowing, commercial activities or intergovernmental transfers. In all these federations, either explicitly or implicitly, there is also provision of a "federal spending power," unlimited in certain cases but with limits in others, enabling the federal government to spend its money through transfers on areas of responsibility that normally fall within state

expenditure responsibilities of each government are not matched by its constitutionally allocated revenue resources. These arise for two reasons. First they arise because in all nine federations there has been a tendency for the major taxing fields to be assigned constitutionally to the federal governments because these taxes are important instruments for affecting and regulating the economy and for performing a redistributive role. Second, there has been a general tendency to assign constitutionally to the states more substantial expenditure responsibilities in the interest of more effective administrative decentralization or to meet political pressures from the states seeking to maintain their distinctiveness. Indeed, in all nine federations provision has had to be made, either constitutionally mandated as in Switzerland, Germany, India, Brazil and South Africa, or by governmental action as in the United States, Canada, Australia, and Spain, for financial transfers from the federal government to the state governments to correct these imbalances. The scope and form of these transfers has varied and will be analysed later in this report.

Third, in virtually all these federations there have been political pressures for state consultation and participation in federal decisions about financial arrangements and transfers. These pressures have arisen because no matter how carefully the original designers of the federation have attempted to match the revenue resources and expenditure responsibilities to each other, over time the significance of different taxes has changed and the costs and scope of expenditure responsibilities have varied in unforeseen ways. Consequently, all these federations have found the need to make adjustments from time to time. This has invariably raised the issue of the appropriate processes and institutions for making these adjustments and the concerns in each federation of the state governments that their autonomy should not be undermined by unilateral federal government action. The actual form and character of the manner in which such issues have been negotiated or dealt with in these federations has varied considerably, however, as will be noted later in this report.

Fourth, common to all nine federations has been the supremacy of the constitution and the role of the courts and the rule of law as the basic

systems which are predominantly federations in their constitutions and operation, but which may have some overriding federal government powers more typical of a unitary system. Such hybrids occur because statesmen are often more interested in pragmatic political solutions than in theoretical purity. The five mature federations, the United States, Canada and Germany considered in the previous reports and Switzerland and Australia in this all now belong in the former category. In the case of Canada, its original constitution contained some quasi-federal features,⁵ but these have fallen into disuse in the past half-century, and so the operation of the federation is now fully federal in practice.

Among the four transitional federations, however, quasi-federal features have been notable. Indeed three of them, India, Spain and South Africa, while predominantly federal in their institutional character, have avoided describing themselves in their constitutions as federal. The Indian constitution (1950) describes the polity as a “Union of States” and includes a set of emergency powers⁶ enabling the Union government in emergencies to completely override the state governments, and the use of these powers has not been infrequent. However, the tendency to invoke them has more recently been declining. Spain too, to emphasize its devolutionary and indissoluble character avoids the label “federation” in its constitution, the central government retains extensive powers, and the constitutional provisions for the devolution of powers to the Autonomous Community emphasize that this delegation in no way implies a ceding of central sovereignty. However, it has most of the institutional features that mark a federation. In South Africa, because the previous apartheid had been justified in part on a federalist rationale and because of fears that federalization would restrict the central government’s capacity to implement and consolidate the processes of democratic reform

and reconstruction, the “federal” terminology was avoided in the new 1996 constitution. Analysis of its institutions, however, indicates that in character it is essentially federal, although relatively centralized and including central legislative powers to override provincial legislation under specified conditions, a clearly quasi-federal feature.⁷ In these three transitional quasi-federations, the constitutional emphasis was upon giving their central governments sufficient power to preserve the federation against dissolution during the transitional period. A corollary of this has been that in their financial arrangements, revenue raising powers were correspondingly concentrated in the central government even though expenditure

⁵ For example the federal powers of reservation and disallowance of provincial legislation and the federal declaratory power (Constitution Act 1867, sections 90 and 92(10)).

⁶ Constitution of India (1950), articles 250, 352-360.

cantons, Spain 17 Autonomous Communities, Germany 16 Laender, Canada 10 provinces and 3 territories, South Africa 9 provinces and Australia 6 states (plus 1 territory, 1 capital territory and 7 administered territories). This means that the average scale of operation at the state level in federations varies enormously (as well as varying within each federation) and this affects their capacity to undertake not only legislative and administrative responsibilities but also to take on fiscal and expenditure responsibilities. To emphasize the point, California in terms of wealth would rank in terms of GDP among the top ten independent countries within the world. Uttar Pradesh the largest Indian state has a population over 140 millions. By contrast, Appenzel-Inner Rhodes, the smallest Swiss canton has a population of only 14,000. Furthermore, the degree of variation in size of states within a federation which ranges from a ratio of 343:1 in India to 13:1 in Australia has implications for the horizontal fiscal imbalances likely to result.

(2) Differences in the constitutional status of local governments. The constitutional status of local government as a third order of government, distinct from the federal and state orders, has varied in these federations and this has had an impact upon the financial arrangements affecting local governments. In three of the mature federations, the United States, Canada and Australia, local governments have not been formally recognized in the constitution as a separate order of government, local governments being placed in each as subordinate units under the jurisdiction of state and provincial governments. In the cases of Switzerland (cantons), Spain (17 Autonomous Communities), Germany (16 Laender), Canada (10 provinces and 3 territories), South Africa (9 provinces and 3 territories), and Australia (6 states plus 1 territory, 1 capital territory and 7 administered territories), local governments have been formally recognized in the constitution as a separate order of government, local governments being placed in each as subordinate units under the jurisdiction of state and provincial governments. In the cases of Switzerland (cantons), Spain (17 Autonomous Communities), Germany (16 Laender), Canada (10 provinces and 3 territories), South Africa (9 provinces and 3 territories), and Australia (6 states plus 1 territory, 1 capital territory and 7 administered territories), local governments have been formally recognized in the constitution as a separate order of government, local governments being placed in each as subordinate units under the jurisdiction of state and provincial governments. In the cases of Switzerland (cantons), Spain (17 Autonomous Communities), Germany (16 Laender), Canada (10 provinces and 3 territories), South Africa (9 provinces and 3 territories), and Australia (6 states plus 1 territory, 1 capital territory and 7 administered territories), local governments have been formally recognized in the constitution as a separate order of government, local governments being placed in each as subordinate units under the jurisdiction of state and provincial governments.

federations considered in the earlier reports exhibited three different patterns.

In the United States the constitution identified a very limited list of exclusive powers, a considerable list of areas of shared (concurrent) jurisdiction where federal law prevailed over state law in cases of conflict, and a substantial number of residual authority where exclusive jurisdiction remained with the states. Canada adopted in effect a three-list approach: the constitution listed specifically areas of exclusive federal jurisdiction, concurrent jurisdiction with federal paramountcy in most cases, and a list of exclusive provincial powers, with the remaining limited area of residual jurisdiction being assigned to the central government.¹² Germany broadly followed the United States pattern of identifying exclusive federal and concurrent legislative lists with residual power to the states, but transformed the arrangement by making the two lists much more extensive and the scope of residual state authority therefore very much more limited, and by assigning to the states administrative responsibility for all federal legislation in the concurrent domain.

These three examples have each influenced the arrangements in the additional six federations and quasi-federations considered in this study. The United States model has been influential in Australia, Switzerland and Brazil although with considerable modification in the latter two. Australia followed the American model quite closely. In Switzerland, this basic form came to be substantially modified over time such that in the new 1999 constitution there are extensive constitutional provisions defining what aspects in each specific functional area should be performed exclusively by the federal government, exclusively by the cantons, or shared.

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distinctively different from that in the United States. In Switzerland, at both levels of government, the executive is a collegial body elected by the legislative but for a fixed term. This provides a set of checks and balances which rely heavily upon coalition politics. While all these federations have directly or indirectly elected representation (or combinations of both) as a feature of their federal second chambers, only South Africa has followed (but with significant modifications) the German example of establishing a federal second chamber in which state or provincial delegates serve as such in the deliberations of that chamber. This has created an interlocking intergovernmental character to the deliberations on matters affecting intergovernmental fiscal issues.

(6) Differences in degrees of interdependence and coordination. In previous reports it was noted that in the United States, the diffused, complex and relatively uncoordinated character of intergovernmental relationships generally has led to a complex financial interdependence based on a variety of ad hoc arrangements, while in Germany the closely interlocked legislative and administrative responsibilities of two orders of government and the focal role of the Bundesrat as an intergovernmental institution has led to a much more systematic financial interdependence between levels of government. Canada has differed from both. The dynamics of “executive federalism” have produced a considerably more systematic system of program and equalization transfers than in the United States while achieving a substantially more decentralized set of financial arrangements than those in Germany.

In this respect the parliamentary federations, Australia and India, have resembled most Canada, but their use of regular independent finance commissions to guide adjustments has led to a more systematic set of arrangements. Brazil and South Africa have each resembled more the different models on which they have based their institutions, the United States and Germany. Switzerland with its unique executive and legislative institutions, and its emphasis upon cantonal and local autonomy, has exhibited

a deliberately consultative process of intergovernmental financial relations. In Spain the dominant characteristics of these processes has been the relative dominance of a central government which nevertheless, has found it necessary to accommodate sub-nationalisms by intergovernmental negotiations producing asymmetrical results.

(7) Mechanisms for dispute resolution.

Intergovernmental financial issues do not often lend themselves well to settlement by courts and judicial processes. Common, therefore, to all federations has been tendency to rely more upon intergovernmental negotiations for the resolution of disputes in this area. Nevertheless, federations are fundamentally constitutional systems upheld by courts enforcing the rule of constitutional law as the supreme law. Thus, with the exception of Switzerland, in the other federations ultimately it has been the Constitutional Courts or Supreme Courts that have been the final arbiters in disputes over the financial arrangements. This has been the case not only in the three federations considered in the previous reports, but in this additional set of federations. Indeed, in Australia some of the most important High Court rulings have related to intergovernmental financial issues. In this respect Switzerland is

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constituent units derive their authority and autonomy, not from the central government but from a constitution which is not unilaterally amendable by the central government or legislature. In decentralized unitary systems such as Sweden and Japan there may even be a constitutional basis for local autonomy, but ultimately, since that constitution can be amended unilaterally by the central government, the local governments are subordinate. This is a difference of fundamental constitutional significance.

financial relations deal with some 6 to 50 constituent units, the federal-local financial

Unitary political systems vary, of course, enormously in terms of their degree of decentralization. Sweden and Japan represent two of the most decentralized unitary systems in the world, and therefore, it is of note that in many respects, although not constitutionally guaranteed, their financial arrangements are similar to those in federations and quasi-federations. In each there is a definition, either by constitutional or statutory law of the expenditure responsibilities and revenue sources available to their local governments. In each it has been necessary (although to sharply differing degrees) to supplement local own source revenues with transfers from the central government to close the gap between expenditure requirements and revenue resources and to equalize disparities among local governments. In each it has been necessary to adjust these arrangements from time to time. In each, as in the federations and quasi-federations, these arrangements have had to accommodate pressures from local communities for self-government and autonomy.

There are, however, two significant differences from the situation in the federations and quasi-federations. One is that (whether the third (local) sphere is constitutionally recognized or not) in federations federal, state and local governments in practice represent three distinct spheres each involving particular financial issues. In these unitary systems there may be several hierarchical tiers of local government, but basically they represent two orders of government: the central government and the subordinate local governments. The second is that while the consideration of federal-state

(i) *Expenditures*

As in Canada, the United States and Germany, in the eight federations and two decentralized unitary countries that this report focuses on, state and local governments perform a range of important functions, and these determine the proportion of total government expenditures for which they are responsible. In the case of the federations these are largely defined by the exclusive and concurrent jurisdictions set out in their constitutions and in the case of the unitary systems in large measure by central legislation. Tables 1 and 2 include a listing of the current proportions of total (federal-state-local) expenditure in these countries performed by the central governments (second column, Table 1) and by the states and local governments (second column, Table 2) Two points stand out clearly.

First, in all of these countries there is an extensive devolution of expenditure responsibilities. State and local expenditures (after transfers) range from just 46 percent (Australia and United States) to 68 percent (Switzerland) in the mature federations, and slightly less from 36 percent (Brazil) to 55 percent (India) in the transitional federations. Strikingly, the decentralization of expenditures in the mature unitary systems is comparable in Japan (62 percent) and Sweden (46 percent). Major fields of central expenditure generally have been foreign affairs, defence, international

269: taxes on sale and purchases of goods), and some taxes are levied and collected by the central government, but the proceeds are distributed between the central and state governments (art. 270). Into this latter category originally came taxes on income other than agricultural income. This category was expanded by the Constitution (Eightieth Amendment) Act, 2000, section 3, to include all taxes and duties on the Union list except those referred to in Articles 268 and 269 and surcharges on a limited range of central duties and taxes. Where central tax revenues are shared, the portion to be shared and the distribution among the states is based on the recommendations of the constitutionally mandated quinquennial Finance Commissions.²⁰ Thus, from the beginning revenue sharing of centrally levied taxes has been a major element in the financial arrangements under the constitution and these unconditional transfers have been expanded over time to increase the states' shares.

In Spain too, revenue-sharing has been an important part of the financial arrangements to match the progressive devolution. In the general system applied to all Autonomous Communities (except the two 'foral' Autonomous Communities, the Basque Country and Navarra), shares of central tax proceeds constituted in 1998 about a quarter of central transfers.²¹ Originally this arrangement related to a thirty-percent of personal income tax, but in 2002 this was increased to 33 percent of personal income tax, 35 percent of VAT, 40 percent of the major excise taxes, and all taxes on registration and electricity. By contrast in the two 'foral' Autonomous Communities revenue-sharing has operated in the reverse direction. These Communities enjoy the revenues from the major

²⁰ Twelfth Finance Commission, *Fifty Years of Fiscal Federalism: Finance Commissions of India* (New Delhi: 2003).

²¹ A Castells, "The Role of Intergovernmental

unconditionally from funds derived this way 14.3 percent of total national revenue and this represented about 21 percent of total local government resources (after transfers).²⁴ By contrast, in Sweden, where their own taxes are the primary source of revenue for local government (about 67 percent of the total) the device of revenue-sharing of central taxes has not been used, the other major sources of local government finance being user fees and central grants.²⁵

Because in many of these cases revenue-sharing of central tax proceeds has been constitutionally mandated, some analysts classify them as a form of state revenues rather than as a transfer. However, that can be misleading for, unlike their own taxes and user fees, the states have no control of the size of the revenues they will receive from revenue sharing. The size of the proceeds the states receive in this way are determined by the rates and levels of central taxation. They are therefore better classified as transfers which in most cases are unconditional. They therefore share the benefits unconditional central grants, but have the further advantage that instead of being determined at a fixed amount by the central government, are based on a specified share of major taxes and therefore have growth potential as the economy grows. That helps to explain why they have been so widely used as one element to reduce intergovernmental fiscal imbalances.

A totally different form of transfer used as at least one element in the total scheme of intergovernmental financial transfers has been the use of conditional grants. These are central transfers to state and local governments which have conditions attached to them so that the central government may influence or even control how they are spent. The issue of conditionality is often a contentious one in federations. Many of the important public services whose provision is decentralized to the state level may also be important from a wider

federal point of view. In such cases, conditionality applied to transfers is one means by which a federal government can induce the states to design their programs in a way that contributes to federal equity and efficiency objectives. One argument in support of conditional transfers has particularly tended to dominate discussion of the subject in the United States. This, based on the principle of financial responsibility and accountability, is that the federal government that has the nasty task of raising the funds by taxation, should in the interests of accountability to the tax payer, control and set the conditions for the use of these funds by the states. The conditions may take the form of requiring specific criteria to be met or of matching by the recipient governments of the central financial contributions to those programs. This “golden lead” as it has been referred to in Germany, may however undermine the autonomy of the states and local governments if conditional grants constitute a high proportion of the transfers and hence a significant portion of state or local revenues. In such situations a heavy dependence upon conditional transfers may distort state expenditures and priorities in areas of primarily state responsibility. Ultimately, most federations have had to draw a balance between the legitimate aim of the central government to achieve its objectives, and the possibility that such conditionality will have too intrusive and distorting an effect on state priorities and policies and detract from the accountability of state and local governments to the needs and desires of their own particular citizens.

Where that balance has been found has varied among the nine federations and two decentralized unitary systems listed in Tables 3 and 4. Here it is noteworthy that in terms of the percentage of total central transfers represented by conditional grants, the mature federations as a group have generally relied more on conditional transfers than have the transitional federations. Nevertheless, of the mature federations Canada has relied least on these. Transitional federations as a group, with the exception of Spain, have tended to rely less on conditional transfers and more on unconditional shares of central revenue sources. The two

²⁴ Government of Japan, Ministry of Finance, Budget Bureau “Understanding the Japanese Budget, 2003”.

²⁵ Institute on Governance, *Intergovernmental Fiscal Relationships: Case Study #1: Sweden*

unitary countries contrast with each other, with Japan relying much more heavily on conditional transfers.

While on the subject of the distinction between unconditional and conditional grants, it is important to note that there have been differing degrees of conditionality in those federations employing conditional transfers. For instance, most of the conditional grants in the United States, Australia and Germany have embodied precise and strict conditions or matching requirements imposed on the recipient governments. In Canada this was also the case up to 1977, but when the Established Programs Financing (EPF) replaced the previous shared-cost arrangement for health and post-secondary education, these became block grants with only broad conditions applied to health transfers and no conditions to those for post-secondary education. Subsequently, when these were modified in 1996-7 into the Canada Health and Social Transfers (CHST) in support of health, post-secondary education, and social services, because of the broad and largely unenforced conditions specified these transfers verged on the unconditional. Nevertheless, for the purposes of Table 3 and 4 of this study they have been classified as conditional transfers, thus bringing conditional transfers to 43.6 percent of all central transfers and 15.8 percent of total provincial revenues. Given the almost unconditional nature of CHST transfers which provide the provinces with considerable independence in the size and design of their social programs, if all CHST transfers were classed as unconditional, then the respective figures for Tables 3 and 4 would be radically altered, conditional grants becoming 4.3 percent of all central transfers and 0.9 percent of total provincial revenues, much the lowest among all the countries considered in this study.

A third approach would be to break down the proportion of CHST transfers in Canada notionally for health and social welfare (where there are some very broad conditions aimed at minimum national standards), and for post-secondary education (where there are no conditions), classifying the former as conditional (even though the conditions for these are very

general) and the latter as unconditional. If applied in Tables 3 and 4 this would produce figures of the order of 33 for percentage of central transfers that are conditional and of 12 for percentage of provincial revenues constituted by conditional transfers. However, since the CHST transfers are a single block grant, which since 1999 has been an equal per capita grant to the provinces, any such breakdown would be based purely on notional assumptions about the percentages of these transfers applied to the different categories. The essential comparative point to be emphasized here is that the category of conditional grants noted in Tables 3 and 4 may itself embrace a considerable range from grants with very precise conditions to block grants with conditions so general that they may verge on unconditional.

The proportion of total state or local revenue made up by central conditional transfers provides one significant measure of the financial constraints upon the genuine autonomy of these governments. Table 4 indicates the degree of dependence of states in different countries by indicating the extent to which all central transfers (first column) and conditional transfers (second column) constitute an element of their total revenues from all sources. Significantly as a group the transitional federations by comparison are more dependent on central transfers, but with the exception of Spain are generally less dependent upon conditional transfers. Indeed, apart from Spain, the two federations in which conditional transfers constitute the largest portion of their total revenues are the United States and Australia. The constituent units in Sweden, Brazil, and if the CHST transfers are essentially unconditional, Canada, have the least dependence on conditional transfers. Particularly striking is the South African case in which the provinces are the most highly dependent on central transfers, but the proportion of these which is conditional is relatively low.

A third element often found in intergovernmental financial arrangements is the use of unconditional grants. These, like most cases of central revenue-sharing, are unconditional, but unlike tax revenue-sharing

significant and therefore that there will be a greater pressure for equalizing mechanisms. Experience indicates otherwise. Indeed, where the greater decentralization reflects a higher degree of social and cultural diversity and fragmentation, as in Canada and Switzerland, the stronger have been the pressures for regional distinctiveness, autonomy, resistance to dependency upon federal funding aimed at inducing more uniformity. It is significant that

federal Tax Harmonization Law which came into effect in 1993 harmonizes the tax bases for personal and corporate income taxes but does not harmonize tax rates, schedules and personal allowances. This has facilitated the collection by the cantons of the direct taxes levied by the federal government. In Sweden the pattern is similar with local authorities setting the tax rate for income tax and central law defining the tax base, but in this case it is the central government that is responsible for its collection. The one other country where both the federal and state governments exercise considerable taxing powers is Brazil, but in this case there has been little successful tax harmonization.

(ii) Extent of tax competition:

The degree of intergovernmental tax competition has depended largely on the extent to which tax harmonization has been lacking. In those cases where the major taxing powers have been concentrated in the central governments and states or local governments have depended heavily upon central revenue-sharing, this has reduced the scope for tax competition. On the other hand, in those countries where the different levels of government levy major taxes, but tax harmonization arrangements have been implemented, either by intergovernmental agreement (e.g. Canada and India) or by central legislation (e.g. Switzerland and Sweden) the harmful effects of excessive tax competition have been moderated. At the same time, the Swiss authorities have considered that some inter-cantonal tax competition, kept within bounds, outweighs the negative effects of overly constraining cantonal choice of tax structure.²⁶

The effects of intergovernmental tax competition have been most apparent in the United States and Brazil, particularly in the latter. One of the greatest problems of Brazilian federalism has been intense “fiscal war” among most of the states for large-scale industrial investment. The “war of tax incentives” arising from the attempt to attract investment has led to a misallocation of resources and contributed to

unrest in the more backward regions.²⁷ This example suggests that unbridled intergovernmental tax competition can be extremely harmful.

5. Decision-making processes for intergovernmental fiscal relations:

(i) Formal and informal institutions and processes:

Because, as already noted, the relative values of revenue resources and expenditure responsibilities change over time, federations and decentralized unitary systems have found it necessary to establish institutions and processes to facilitate regular or periodic adjustments to the intergovernmental financial arrangements. Table 6 summarizes the arenas in which these issues have been dealt with in the different countries referred to in this study.

In some cases formal institutions and process have been specified in the constitution itself. Germany, India and South Africa represent examples of this. In other cases quite elaborate formal institutions and processes have been established by intergovernmental agreement. Australia has been a pioneer in this respect, but Canada also provides an example. In some cases formal institutions have been

²⁶ D. Carey, K. Gordon and P. Thalmann, *Tax Reform in Switzerland* (OECD Economics Department Working Paper No. 222, 1999), p. 6.

bodies, but the Budget Council (composed of the Minister of Finance, the Executive Council members responsible for finance in the provinces and the chairman of the FFC) and the Budget Forum (made up of the Budget Council and local government representatives) are intergovernmental bodies established under the central Intergovernmental Fiscal Relations Act, 1997. These are supplemented by the MinMecs (sectoral intergovernmental ministerial councils) and the Technical MinMecs (sectoral intergovernmental councils of senior officials).

In addition to the variety of constitutional and other formal institutions and processes dealing with intergovernmental financial issues, in most of these countries there has been extensive intergovernmental consultation and negotiation on issues related to the federal financial arrangements.

In terms of the institutions and processes for adjusting issues of federal finance, five distinct patterns can be identified. In Australia, India and South Africa, although varying in precise form, expert commissions established by the ceexpert cTsgP90.0013 T50.001e intergov2rnmUtMinquinquenn(filutiony)-4.7(3(na

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financial arrangements have been more modest in Brazil. The federal government did in 2000 send to Congress a Fiscal Responsibility Law (modelled on the Fiscal Responsibility Act of New Zealand) which imposed maximum limits on the debts and personnel outlays of the federal government, the states and the municipalities. Two other reforms have had some impact on intergovernmental relations. The first was a constitutional amendment in 1996 which created a fiscal fund (called FUNDEF), composed of state and municipal revenues, to finance in redistributive (per capita) terms, the basic public educational systems. The second was in the health sector where the federal government has recently instituted a fund that provides direct monetary transfers based on per capita criteria for basic municipal health programs.

Since the new South African constitution came into effect only in 1996, the major efforts there have been on implementation rather than immediate reform. These have included a Provincial Tax Regulation Process Act in 2002 which enables provinces to impose new taxes, subject to approval by the national government. Provinces are now in a better position to address the central government's general aim of reducing poverty, vulnerability and inequality. Indeed, their budgets have reflected a strong alignment to nationally agreed government priorities.

The decentralized unitary regimes have also seen some efforts at financial reform. In Sweden, the proportion of conditional central grants was reduced in 1991 so that two-thirds of the grants would be unconditional. The new unconditional grant was to be distributed according to three factors: revenue equalization, structural cost equalization, and a supplement for population reduction. There were some criticisms of the new mechanism on the lack of "teeth" to the revenue equalization component and on the difficulty in understanding the structural cost equalization component.³⁰ In 1996, a new equalization scheme was adopted, based on three elements: a population-based

grant, revenue equalization, and cost equalization.

In Japan a Decentralization Promotion Law came into effect in 2000. Its purpose was to clarify the roles of central and local governments and minimize central involvement in areas of local jurisdiction. The objective was to encourage local governments to carry out their administration more independently so that their operations will fit better the actual conditions of particular local sectors.³¹

7. Identification of Distinctive and Unique Features

These federations and decentralized unitary systems have had in common issues such as the appropriate revenue and expenditure allocation among governments, dealing with vertical and horizontal imbalances by various forms of transfer including in most cases systematic

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³⁰ Institute of Governance, *Intergovernmental Fiscal Relationships*, Case Study #1: Sweden.

taxing powers has facilitated or hindered the management of the economy to achieve stabilization policies.

efficiency advantages of the German one while avoiding some of the major disadvantages. The decentralization of expenditure responsibilities is accompanied in Canada by real discretion for the provinces to tailor their programs to suit the needs and preferences of their constituents. The main issue in the Canadian case is whether there is too much decentralization from the point of view of efficiency. While in some areas of provincial spending, such as health, there is some degree of harmonization, in others which are important for efficiency objectives, such as education, there is virtually none. The United States, like Canada has a considerable degree of financial decentralization. However, some of the advantages of this are undermined by the fact that a substantial proportion of grants from the central government are conditional or are used to impose mandated expenditure programs upon the states. As well, although the tax system is not as decentralized as it is in Canada, there is no explicit system of tax harmonization.

From the point of view of equity objectives, these three federations achieve quite different degrees of redistributive equity. In the case of Germany common standards of equity apply across the federation. The common national system of income and sales taxation and the great lengths to which full equalization has been

other extreme is the United States where intergovernmental cooperation, while not insignificant, has largely been of an ad hoc nature focused on specific projects and programs. Mid-way between them comes Canada where the processes of “executive federalism” have led to intense interaction among officials and ministers and even on occasion meetings of first ministers in relation to the financial arrangements between the federal and provincial governments. As a result, while the federal government may on some of these matters have the legal final word and has on occasion even acted unilaterally, in practice the degree of intergovernmental consultation and negotiation has been extensive. Nevertheless, unlike Germany, “executive federalism” is not formally grounded in the Canadian constitution and has on occasion been marked by inadequate collaboration or by federal government unilateralism. Thus, where in Canada there have often been calls for more collaboration and coordination, this contrasts with the calls in Germany for some loosening of the interlocking financial arrangements there in order to introduce larger elements of autonomy, more intergovernmental competitiveness, and clearer

flow from decentralization. Indeed as Table 2 indicates, it is the most decentralized of all the federations in terms both of expenditure and of own-source revenues. The fundamental principle has been that of subsidiarity. Competencies have generally been vested as far as possible at the local and cantonal levels and have been reluctantly transferred to the federal level only when a lower level is no longer in a position to provide a service “efficiently”. Despite or because of this approach, Switzerland has maintained a relatively prosperous economy with one of the highest per capita incomes in the world.

By contrast, in Australia most of the major taxing and revenue sources have been concentrated in the hands of the federal government, its percent of total government revenues being the highest among the mature federations. This has reduced intergovernmental tax competition and provided the federal government with the ability to exert an integrated and coherent economic policy. At the same time on the expenditure side there in Australia is a considerably greater degree of decentralization to obtain benefits from providing the states with considerable room for state initiatives. Unlike the German federation, decentralization on the expenditure side does not consist of administration of federal legislation but represents fields where the states have both legislative and executive responsibility. The considerable dependence on specific purpose conditional grants (Table 4) does, however, provide a source for central influence over state policies.

These two federations also provide contrasts in the degree to which they have emphasized the objective of equity. As in Germany, in Australia there has been a very strong value placed upon the goal of equity and of removing disparities among the states. This led to the first development of an equalization system in any federation in the world in 1933. The Commonwealth Grants Commission now takes into account some 18 revenue categories and some 41 expenditure categories in arriving at its recommendations. Switzerland introduced its first equalization scheme somewhat later in

1959. Because of the moderating impact of the Swiss emphasis upon cantonal autonomy, the Swiss equalization scheme has not been as far reaching in its total scope as those in Australia and Germany, or even that in Canada. Furthermore, the means of achieving equalization has been less systematic, being applied through a number of instruments including revenue sharing, conditional grants, and the cantonal contributions to the federal government’s social expenditures. In this respect Switzerland has been somewhat closer to the pattern in the United States although the approach has been more systematic. Consequently, the need to reform the equalization scheme has come to the fore very recently and has proved a contentious subject.

Fiscal management and stabilization policy as an objective for the federal government has been particularly prominent in Australia, and has been a major factor in the concentration of nearly all the major taxing powers in the federal government. The desirability of a centralized Keynesian approach to issues of fiscal management and stabilization which was so prominent in Australia for a significant period during the twentieth century, was much weaker in Switzerland, however. Consequently, the comparatively strong decentralization of both revenues and expenditures has persisted in Switzerland.

On the issue of autonomy of the constituent units, despite some pressures towards increased central policy-making and revenues during the latter half of the twentieth century, the Swiss cantons have remained fiercely independent in their outlook. As a result, as already noted, Switzerland continues to be the most decentralized federation in the world in terms of the distribution both of own-source revenues and of expenditures (Tables 1 and 2). Even in those considerable areas where the cantons implement federal laws, by contrast with Germany, the cantons are left by virtue of the constitution with a great deal of autonomy and the federal government is required to take into account the financial burden that is associated with implementing federal laws by transferring

sufficient equalized funding.³⁹ In Australia state autonomy has not been revered to the same extent as in Switzerland or Canada. Consequently, the own source revenues of the states are the lowest among the mature federations (Table 2), and the proportion of state revenue received in the form of conditional specific purpose grants is higher than in any

capable of adaptation. This evolution by piecemeal adaptation is illustrated by the more than one hundred constitutional adjustments, including many on financial matters, made by formal constitutional amendments during the twentieth century, and by the modernization of the federal structure by the total revision in 1999. Australia too has displayed over a century of political stability. However, although having an almost identical procedure for constitutional amendment as Switzerland, the process has proved much more difficult in Australia. Indeed, by contrast with Switzerland over the same century, of 42 proposed constitutional amendments sent to referendum in Australia only 8 received the necessary double majorities for adoption. Nevertheless, the processes of executive federalism have provided an alternative means for some adaptability as illustrated by the implementation of the new GST tax as the pool for equalized transfers to the states.

concentrated taxing powers in the central government but decentralized expenditure responsibilities to promote efficient delivery of services (Tables 1 and 2). South Africa has carried this to the greatest degree with 95

Many of the differences between Switzerland and Australia in the evolution of their financial arrangements can be attributed as much to differences in their respective political cultures as to their political institutions. The largely egalitarian political culture of Australia has played an important part in the emphasis in its financial arrangements upon centralization facilitating uniform treatment and upon full equalization of both the revenue and expenditure aspects of inter-state disparities. By contrast, in Switzerland its linguistic and religious diversity has fostered an insistence upon decentralization and cantonal autonomy and has moderated the impulse for equalization.

4. The transitional federations: India, Spain, South Africa and Brazil:

Of the group of transitional federations, India, Spain and South Africa have shared some common tendencies, while Brazil is clearly differentiated from the other three. The first three will therefore be reviewed as a group and then Brazil separately.

In relation to the criteria of economic efficiency, India, Spain and South Africa have each on grounds of economic efficiency

coordination among the two important specialized institutions – the Finance Commissions and the Planning Commission – that both play a part in determining the size and form of total central transfers to the states.

In the case of Spain, the economic efficiencies gained from the different allocations of taxing powers and expenditure responsibilities have been moderated by the political necessity of treating the Autonomous Communities asymmetrically, particularly the “foral” cases. For these various reasons, the wide variation in vertical imbalances among the Autonomous Communities have in the end counterbalanced significantly the intended gains in economic efficiency from combining centralized taxation with decentralized expenditure.

In South Africa and India the disparities in wealth among the constituent units have been much deeper than that generally found in the mature federations. Consequently inter-unit equity has been a particular concern. In the case of South Africa, this has been reinforced by the avowed objective of reversing the inequities of the previous apartheid regime in relation to the Bantustans. Consequently, the notion of “equitable shares,” both in vertical and horizontal terms, permeates the constitutional provisions relating to the financial arrangements (article 214), and is set out as an objective for the Financial and Fiscal Commission (art. 214 (2)(d), (e), (f) and (g)). In its operation, the Commission has developed a methodology involving an array of indices to meet this objective (see Table 5). Since the constitution came into effect so recently in 1996, it is too early to judge the degree of success towards meeting this criterion, except to say that a start has been made. In India, too, the disparities in wealth among states are severe and the equalization of state revenues has been a major factor in the recommendations of its Finance Commissions. The criteria they have used have tended to be more general (see Table 5) than the multiple indices used by the Australian Commonwealth Grants Commission since in India the disparities are much wider. In spite of nearly 50 years of equalizing transfers in India,

per capita expenditures still show wide variations. These differences translate into

autonomous governments (through the system of grants) and therefore remains largely in control.⁴⁴

As far as autonomy of constituent units is concerned, because of the restricted range of own-source taxing powers and high degree of dependency upon central transfers, the financial autonomy of the constituent units in these federations is much more limited than in the mature federations generally (see tables 2 and 4). To some extent this has been partially mitigated by a heavier reliance on unconditional rather than conditional central transfers, but the more genuine autonomy that comes from substantial own-source revenues whose size is determined by the constituent units has been limited.

In these three federations, there is a considerable degree of coordination of intergovernmental relations, largely in the form of inter-executive consultation and meetings (especially in South Africa), but this has generally been characterized by central government leadership and a top-down approach rather than by a spirit of cooperation among governments of equal status.⁴⁵ While this characterized the situation in India in the early decades after independence, more recently the replacement of Congress Party dominance by coalitions of regional political parties within the Union government has moderated the centralist bias in intergovernmental financial negotiations. In South Africa, on the other hand, the continued overwhelming dominance of the African National Congress at both levels of government and, as the 2004 election has indicated the continued strength of the party's central organization in relation to the political dynamics at all levels shows no sign of weakening. The change of central government in Spain in 2004 may moderate the heavily top-down character of the previous financial arrangements, but it is too early to judge the impact of the change of government in Madrid.

⁴⁴ I.Joumard and A. Varoudikis, *Options for Reforming the Spanish Tax System*, OECD Paper 249, 2000, p.10; 2000, p. 10; Castells, op.cit., p. 98.

⁴⁵ See, for instance, Murray, 2001, op.cit. pp. 530-31.

substitution of some lump sum central transfers by regionally levied tax revenues was intended to increase the accountability of Communities to their electorates, but the effect has been limited by the continued heavy dependence on central transfers. In South Africa the Fiscal and Financial Commission has held the view that provincial taxing powers are essential if the provincial governments are to be properly accountable,⁴⁹ but taxing powers have nevertheless remained highly centralized.

Despite shortcomings in relation to a number of the criteria reviewed above, these three transitional federations have performed remarkably well in terms of overall political stability and adaptability. This is perhaps clearest in the Indian case. Despite the dire predictions of some of the critics in the early decades, the adaptability of the federal system, enabling the accommodation of its extensive socio-cultural diversities, has enabled the federation to hold together. The states and local governments have come to play an important role, raising some 34 percent of total government revenues and being responsible for some 55 percent of total government expenditures (see Table 2). The increased democratic decentralization which has occurred since the inception of the constitution in 1950 and particularly in the 1990s has provided an important and effective answer to subnational and ethnic conflicts.⁵⁰ In Spain while the asymmetrical devolution has been highly complex, especially in relation to the financial arrangements, they have enabled the promotion of self-government for its minority nations. Public debates on federalism and the nature of the Spanish constitution continue, but at a time when the constitution of 1978 has reached its quarter-century, the Spanish democracy now appears relatively stable, particularly since the ETA ceasefire of 1998 which removed the threat

of secessionist violence from the public sphere. The South African constitution of 1996 is still less than a decade old, and therefore it is clearly too early to talk about long-run political stability and adaptability, but the election of 2004 has provided ample evidence that despite difficult economic circumstances, the Republic has got off to a strong political start.

In these three federal examples institutional structures and the prevailing political culture have both played a part in shaping their federal systems.^{8.2ofyunderal-3.8(d)TJT*0.0006 Tc0.00TJs, theth evide(ac}

⁴⁹ Murray, 2001, op.cit., p.517.

⁵⁰ H. Bhattacharyya, "Federalism, Decentralization and State-Building in India: Aspects of Centre-State Fiscal Relations," in R. Bird and T. Stauffer, (eds.), *Intergovernmental Fiscal Relations in Fragmented Societies* (Fribourg: Institut du Fédéralisme, 2001), p. 278.

performs purely formal functions.⁵⁴ Relations between the federal government and the states and municipalities, and between the state governments and their respective municipalities are characterized largely by mutual independence and competition, and the federation lacks effective institutional mechanisms to facilitate cooperative intergovernmental relations. The result is that a distinctive characteristic of the Brazilian has been intergovernmental tax competition which often goes to the length of 'tax warfare'. A high degree of party fragmentation and weak party discipline at the federal level has contributed to producing a relatively weak federal government.

Nevertheless, in 2000 the federal government sent to Congress a Fiscal Responsibility Act inspired by the Fiscal Responsibility Act in New Zealand. This Act introduced new concepts such as responsibility and transparency and was intended to create a responsible fiscal management at all three levels of government. It required all levels of government to formulate and publicize three-year targets, prohibited the federal government from bailing out state and municipal debts, and applied hard sanctions to those responsible for misuse of government funds.

Although the current federal constitution has been in operation for only a decade and a half, in that brief period the tax system seems to have undermined rather than contributed to political stability. It has encouraged 'fiscal warfare' among vertically and horizontally among governments, and this has if anything intensified in recent years.

It would appear that to a considerable extent the institutional structures established by the 1988 constitution have been distorted by the socio-economic pressures that have been inherited from the preceding regimes in Brazil. The major social and economic disparities have created intense inter-state and federal-state rivalries and fiscal competition at the expense of any efforts at coordination.

5. The decentralized unitary systems: Sweden and Japan:

Both these unitary systems have sought the objective of economic efficiency through substantial decentralization. Indeed, as Tables 1 and 2 indicate, the extent of decentralization has been comparable to that in many federations.

The major difference between them and the federations has not been in the degree of decentralization, but rather in the fact that in the federations the decentralized authority of the constituent units is conferred and guaranteed by the constitution rather than by the central government.

The major social or differences in federations tax systems

⁵⁴ Costa, *op. cit.*, p. 50.

**TABLE 1: CENTRAL GOVERNMENT SHARES OF TOTAL
(ALL GOVERNMENTS) REVENUE AND EXPENDITURES¹**

Country	Percent of Total all Governments Revenue	Percent of Total all Governments Expenditure
<i>Mature Federations:</i>		
Australia	69	54
United States	67	54
Germany	65	37
Canada	44	37
Switzerland	40	32
<i>Transitional Federations:</i>		

Countries and Japan,” *The Journal of Economics*, 64(4) 1999; Sweden, Ministry of Finance, *Budget Bill* (2003); South Africa, Financial and Fiscal Commission, “Towards a Review of the Intergovernmental Fiscal Relations System” (2003); B. Dafflon and S. Perritez, “Federal-Cantonal Equalization in Switzerland: An Overview of the Present System and Reform in Progress” (BENIFRI, Fribourg, 2003); *Supplement to 2002 Government Finances Statistics Book* (IMF); A. Castells, “The Role of Intergovernmental Finance in Achieving Diversity and Cohesion: The Case of Spain” in R. Bird and T. Stauffer, eds., *Intergovernmental Fiscal Relations in Fragmented Societies* (Fribourg). Russian figures are derived from R.L. Watts, *Russian Fiscal Federalism in Comparative Perspective* (Kingston: Institute of Intergovernmental Relations, Queen’s University, 2005), Tables 1 and 2.

TABLE 2: STATE AND LOCAL GOVERNMENT SHARES OF TOTAL (ALL GOVERNMENTS) REVENUE AND EXPENDITURES¹

Country	Percent of Total all Governments Revenue	Percent of Total all Governments Expenditure	Vertical Imbalance
<i>Mature Federations:</i>			
Australia	31	46	15
United States	33	46	13
Germany	35	63	27
Canada	56	63	07
Switzerland	60	68	08
<i>Transitional Federations:</i>			
Spain	17	49	32
South Africa	05	50	45
Brazil	31	36	05
India	34	55	21
<i>Mature Unitary Systems:</i>			
Japan	42	62	20
Sweden	43	46	03
<i>Russia:</i>	9	54	45

- Revenue shares are before transfers of shares of central taxes and grants to state and local governments. Expenditure shares are after transfers of shares of central taxes and grants to state and local governments. Figures are rounded to the nearest percent. Countries in each category are listed broadly in ascending order of decentralization. Depending on source figures are for 2000 or 2001.
- Vertical imbalances are identified by difference between total state and local expenditures and total state and local own source revenues (before transfers of shares of central taxes and grants).

Sources: As for Table 1.

**TABLE 3: CONDITIONAL GRANTS AS PERCENTAGE OF
TOTAL CENTRAL TRANSFERS**
(Total Transfers = shares of central taxes plus unconditional grants plus conditional grants)

Country	Year	Percentage
<i>Mature Federations:</i>		
Australia	2000	47.1
United States	1996	100.0
Germany	1996	64.5
Canada	1996	43.6*
Switzerland	1997	73.1
<i>Transitional Federations:</i>		
Spain	1998	66.1
South Africa	2001/02	11.5
Brazil	2000	25.0
India	2001	40.7
<i>Mature Unitary Systems:</i>		
Japan	2003	43.5
Sweden	2003	15.7

Note: Figures are mostly for 2000 and 2001 except for those for Canada, United States and Germany which are for 1995 or 1996 (derived from previous studies for this project).

* If CHST transfers are considered as unconditional, the percentage for Canada would be 4.3%.

Sources: *Government Finances Statistics Yearbook* various years; R.L. Watts, *The Spending Power in Federal Systems: A Comparative Study* (1999), p.56; see also sources for Table 1.

**TABLE 4: CENTRAL TRANSFERS AS PERCENT OF TOTAL
CONSTITUENT UNIT (States and Local) REVENUES**

Country	Total Transfers	Conditional Transfers
<i>Mature Federations:</i>		
Australia	45.3	21.3
United States	29.6	29.6
Germany	43.8	9.8
Canada	19.8	15.8*
Switzerland	24.8	17
<i>Transitional Federations:</i>		
Spain	72.8	41.9
South Africa	96.1	11.0
Brazil	30.0	7.5
India	46.0	18.7
<i>Mature Unitary Systems:</i>		
Japan	37.2	16.2
Sweden	15.8	4.4

Note: Figures are mostly for 2000 and 2001 except for those for Canada, United States and Germany which are for 1995 or 1996 (derived from previous studies for this project).

* If CHST transfers are considered as unconditional, the percentage for Canada would be 0.9%.

Sources: *Government Finances Statistics Yearbook*; R.L. Watts, *The Spending Power in Federal Systems: A Comparative Study* (1999), pp.53, 57; see also sources for Table 1.

TABLE 5: EQUALIZATION ARRANGEMENTS

United States	No generalized equalization scheme: some equalization occurs from cumulative effect of provisions in specific federal grant-in-aid schemes as approved by Congress.
Switzerland	Federal transfers based on formulae involving a range of criteria ranking cantons by financial capacity as the basis for tax-sharing and conditional grants, but the equalizing transfer system is smaller than in Germany, Canada and Australia.
Canada	Federal transfers: stand-alone equalization scheme based on formula (adjusted from time to time) assessing provincial revenue capacity in terms of 33 provincial tax and non-tax revenue sources against a middle range five-province standard and providing unconditional grants representing 42% of all transfers.
Australia	Federal transfers: based between 1933 and 1981-82 on recommendations derived from determination of needs of claimant states by a standing independent Commonwealth Grants Commission; after 1981-82 took the form of adjustments to the general Adjustment Grant transfers based on calculation of relativities of expenditure needs among states; since 2000 based on application of relativities to distribution of central GST tax. Allocation by CGC based on calculation of revenue capacity and expenditure needs from comparisons of 18 revenue categories and 41 expenditure categories.
Germany	Primarily inter-state transfers (62%): equalization through an inter-state revenue pool to which rich Länder pay and from which poor Länder draw according to a formula; plus federal transfers (38%): Federal Supplementary Payments of 1.5% of value-added tax (VAT). The primary per capita distribution of the shares of the Länder of a portion of the VAT also has an equalizing effect.
India	Federal transfers from a pool of all union taxes supplemented by unconditional grants, based on the recommendations of quinquennial Finance Commissions recommending both the share to be allocated to the states as a group, and the allocation among states taking account of population, per capita income, area, economic and rural infrastructure needs, and tax effort.
Spain	Federal transfers: since 1987 criteria including population, size, personal income, fiscal effort, number of internal provinces within Autonomous Community, and distance to state capital; applied by federal government to shares of federal tax revenue transferred to Autonomous Communities.
Brazil	Distribution of state participation fund (state share of three main federal taxes) with participation

TABLE 6: ARENAS FOR RESOLVING ISSUES OF INTERGOVERNMENTAL FINANCE

United States	Congress: negotiations among representatives of different states within Congress over allocation of grant-in-aid programs: representatives of state administrations act as lobbyists.
Switzerland	Federal Parliament: negotiations within Federal Council (i.e. federal executive) and Parliament (containing cantonal representatives), but with extensive consultation of the Conference of Cantonal Governments, and assisted from time to time by commissions.
Canada	Processes of executive federalism predominate. Ultimate decision lies with federal government and federal legislation, but in practice for each five year period renewal is preceded by extensive federal-provincial negotiations through officials and federal and provincial finance ministers to arrive at an agreed program.
Australia	Processes of executive federalism predominate. Ultimate decision lies with federal government and federal legislation, but equalization transfers from GST pool are based on recommendations of an independent expert Commonwealth Grants Commission (CGC), whose recommendations are usually implemented, the recommendations being made within a context established by an intergovernmental Ministerial Council.
Germany	Executive federalism: ultimately fiscal arrangements require endorsement of the Bundesrat composed of representatives of the executives of the Länder.
India	Ultimate decision lies with Union government, but constitutionally mandated independent Finance Commissions make recommendations for total state share of shared central taxes and for unconditional grants to states, and for distribution of both among states. Recommendations have in practice usually been implemented. These transfers are supplemented by substantial conditional grants allocated on the recommendation of the Planning Commission.
Spain	Executive federalism: regional financial arrangements are negotiated every five years in the Fiscal and Financial Policy Council, an intergovernmental ministerial body with the decisions