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Intergovernmental transfers and societal values

"Laws are like sausages: it's better not to see them being made." Otto von Bismarck's concern about the lawmaking process would have presumably been heightened further had he been privy to the behind-closed-doors and away-from-Parliament wheeling and dealing associated with the creation of federal-provincial accords or, more generally, with intergovernmental arrangements. Yet for all their supposed non-democratic procedures and features, what actually comes out of the other end of this intergovernmental legislative processor is truly remarkable. While intergovernmental transfers are, at one level, the adaptive residual components in accommodating horizontal and vertical fiscal imbalances in federal systems, the surprising and unexpected reality is that the underlying design of these transfers across federal systems resonates famously well with the underlying norms of the federations themselves, as the following comparison of Australia, Germany, Canada and the United States reveals.

Australia is not only a highly centralized federation but also a highly egalitarian nation. Welfare payments are designed centrally and are identical for all Australians, university wage grids are also national, per capita GDP disparities across Australian states are much narrower than those across Canadian provinces, and so on. Impressively, the system of intergovernmental grants nicely complements this centralization and uniformity. First, nearly half of Australia's cash transfers are in the form of conditional grants which in turn enhance this centralization. Second, and more importantly, Australia's unconditional grant program is the most comprehensive among federal nations. The underlying fiscal equalization principle is that "each state should be given the capacity to provide the average standard of state-type public services, assuming that it does so at an average level of operating efficiency and makes an average effort to raise revenues from its own sources." Implementation of this principle involves equalizing a states' revenues upward or downward to the all-state standard and then repeating this for expenditure needs. This is *full* revenue and expenditure equalization.

Germany is the second-most uniform federation in our sample. Tax rates for all major taxes (personal and corporate taxes, capital taxes and the VAT) are set centrally. Revenue-sharing arrangements then provide the Länder with much of this revenue, some on a derivation basis, some equal per capita, and some on an equalized basis. Beyond this, there exists an inter-Länder revenue-sharing pool, with rich Länder contributing to the pool and poor ones able to draw from it. Underlying this rather thoroughgoing redistribution is the imperative in the German Basic Law calling for "uniformity of living conditions."

Canada differs from the other federations in that our Constitution contains an explicit listing of exclusive provincial legislative powers (s.92). Beyond this, other features of the Canadian federation propel it toward decentralization. For example, Quebec is legally, linguistically and culturally distinct. Ontario, with roughly one-third of the population and two-fifths of GDP, is also a decentralizing force, as is resource-rich Alberta. Canada is among the most decentralized federations in terms of both sub-national revenues and expenditures.

Not surprising either is that Canada's system of intergovernmental transfers reflects this diverse and decentralized nature of the federation, while the "Peace, Order and Good Government" rhetoric underpins our social contract. Specifically, Section 36(2) states: "Parliament and the government of Canada are committed to making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable tax rates." This we do by bringing the per capita revenues of the have-not provinces up to the five-province standard. Compared to Australia, this is partial equalization in that the rich provinces are not equalized down to the standard nor do we equalize on the expenditure side. Nonetheless, in tandem with the increasingly equal-per-capita CHST, this is the mainstay of our celebrated east-west social contract.

What is unique about the US is that it is the only federation that does not have a revenue-equalization program. Presumably, part of the rationale for this is that any revenue-raising-capacity differences across states will be capitalized in wages, rents and property values, so that there is nothing to equalize, so to speak. This accords well with the "Life, Liberty and Pursuit of Happiness" US constitutional rhetoric.

Thus, intergovernmental transfer arrangements are anything but arbitrary. Indeed, they complement the existing tax and expenditure assignments in ways that integrate overall fiscal federalism in directions consistent with the implicit or explicit values and norms of the respective federations. And it is precisely because intergovernmental transfers are so embedded in the value systems of their respective nations that their distinctive features are not very portable across federations.

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