

Intergovernmental Fiscal Arrangements

Germany • Australia • Belgium
Spain • United States • Switzerland

Background
Paper

for the International
Symposium
on Fiscal Imbalance

Québec

September 13 and 14, 2001

ISBN : 2-550-38021-5
Legal deposit
Bibliothèque nationale du Québec, 2001

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INTRODUCTION

Many countries have implemented or recently undertaken major reforms of their intergovernmental fiscal arrangements. This document describes the situation of fiscal federalism in six of these countries: Germany, Australia, Belgium, Spain¹, the United States and Switzerland. This group of developed countries displays wide diversity. Some have well-established federal institutions, while in others they are more recent. In every case, fiscal relations between the various orders of government are evolving.

A chapter is devoted to each of these countries and examines the operation of political institutions, the general principles of the constitutional division of powers, intergovernmental fiscal arrangements (equalization mechanisms in particular) as well as recent, current or planned reforms.

A review of the experience in other countries can make a valuable contribution to the analysis of the fiscal imbalance in the Canadian federation. An examination of the operation of other federations, in particular the problems they have in terms of intergovernmental fiscal relations and the reforms that are planned or already implemented to resolve them, can only enrich the study of Québec's situation.

The information in this document will also help prepare the work of the International Symposium on Fiscal Imbalance, which will be held in Québec City on September 13 and 14, 2001.

¹ Strictly speaking, Spain is not a federation. Nonetheless, this country has institutions which, in many respects, are similar to those of a federation.

GERMANY

Institutional framework

The Federal Republic of Germany (FRG) was founded in 1949. It now consists of 16 states, or *Länder*, five of which were added upon reunification with the German Democratic Republic (GDR) in 1990.

SNAPSHOT

Official name: Federal Republic of Germany
 Capital: Berlin
 Population: 82 million
 Constitution: 1949 (*Basic Law*)
 Official language: German
 Currency: the deutschemark (DM), to be replaced by the euro as of 2002: 1 EUR = 1.95583 DM)
 Public spending (2000): 42.9% of GDP

The federal parliament consists of two houses, namely the *Bundestag*, to which the ministers are responsible, and the *Bundesrat*, which has regional representation. The FRG is headed by a President (head of the federal state) and a federal Chancellor (head of the government and holder of executive power). Each *Land*² has a parliament with only one chamber.³

Half the deputies of the *Bundestag* are elected in ridings, while the other half are elected by proportional representation. The *Bundesrat* consists of members of the governments of the *Länder* (ministers, permanent secretaries and heads of government). It plays a central role in the highly interlocked relations between the two main orders of government in Germany.

In the *Bundesrat*, each *Land* is entitled to a minimum of three votes. It receives an additional vote if its population lies between two and six million, a fifth vote if it has between six and seven million people, and a total of six votes if its population is greater than seven million. The votes of each *Land* are recorded as a bloc in the *Bundesrat*, i.e. they are indivisible when a *Land* takes a position on a bill or a motion.

Legislative initiative rests in the government, in the *Bundestag* and the *Bundesrat*. Approval by the *Bundesrat* is required for changes to the Constitution (*Basic Law*) as well as for laws affecting the interests of the *Länder* (about 60% of laws). Legislative matters requiring approval of the *Bundesrat* are identified in the *Basic Law*. For other legislation, the *Bundesrat* also takes a position, but its veto can be lifted by a new vote of the *Bundestag* deciding by a majority of its members. However, if the veto of the

² *Land* is the singular of *Länder*.

³ The only senate still existing in 2000 was abolished by Bavaria.

Bundesrat garnered a two-thirds majority, it can be lifted only by a two-thirds vote of the *Bundestag*.

The *Bundesrat* has the right to be kept informed of the affairs of the federation (of the government and of the *Bundestag* in particular) by ministries and other bodies. It also has a right of review over foreign affairs and the affairs of the European Union since its approval is required to pass resolutions relating to these fields.

Division of responsibilities

General division of powers

The *Basic Law* explicitly lists⁴ the exclusive powers of the federal government and includes an exhaustive list of shared powers with federal precedence. It also stipulates a federal power to pass framework legislation in some fields⁵ and gives considerable importance to decentralized administration of laws.

Accordingly, the federal government generally has legislative authority while the *Länder* and the Communes are generally responsible for the implementation and administration of policies. In accordance with this principle of shared responsibilities, the *Länder* administer roughly 75% of federal laws⁶, including the collection of the main taxes (value-added tax and corporate and personal income taxes).

Federal authority is exclusive over foreign affairs, defence, citizenship, immigration, currency, and air transport, in particular. Accordingly, it is exercised concurrently and with priority in about twenty fields, including civil law, criminal law and highways. The *Länder* have jurisdiction over culture, health, education, public security and regional development. The Communes are assigned responsibility for various local public services, local health care delivery centres, school buildings, housing and roads. The *Basic Law* attributes residual authority, i.e. legislative authority in matters not attributed in the *Basic Law*, to the *Länder*.⁷

Federal spending power

The federal spending power is overseen by the *Bundesrat*, which must approve by an absolute majority of votes any use of the federal spending power that affects the *Länder*. The generally understood meaning of the concept federal spending power does not apply in Germany since any federal legislation affecting the *Länder* requires approval by the *Bundesrat*, which is composed of members of their governments.

⁴ Articles 72 and 74 of the *Basic Law*.

⁵ For instance, higher education.

⁶ OECD (1992).

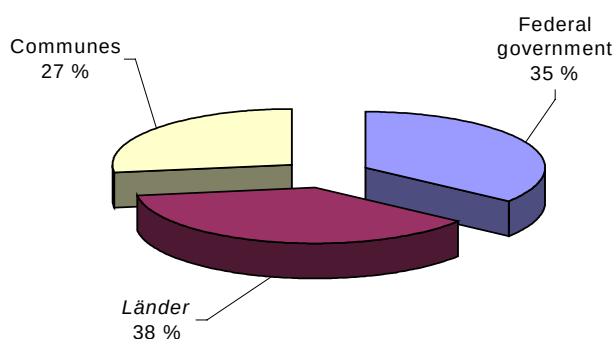
⁷ Article 70-1 of the *Basic Law*.

Spending

Because of the marked degree of intergovernmental integration in most fields, the functional distribution of spending among the various orders of government gives only a very approximate reflection of the division of responsibilities for these functions. For instance, implementation of social policy (health and education in particular) involves the three orders of government, as does investment in infrastructure. Consequently, data on actual spending amounts are not a reliable indicator of the division of legislative authorities in effect in the FRG. Nonetheless, Chart 1 shows the general breakdown of public spending by order of government in 1995.

CHART 1

BREAKDOWN OF PUBLIC SPENDING – 1995
(Percentage of total)



Source : Spahn and Föttinger (1997), using data of the *Bundesministerium der Finanzen* (1996).

Taxation

The *Basic Law* explicitly lists the taxes attributed to the Communes, the *Länder* and the federal government. In addition, it sets out the rules for sharing the proceeds of personal income tax (PIT) and corporate tax between the federal government and the *Länder*.⁸ The Communes' share of PIT is determined by the federal parliament (*Bundesrat* and *Bundestag*). Under these sharing rules:

- the Communes obtain 15% of PIT (according to place of residence) while the federal government and the *Länder* share the rest equally (42.5% each) ;
- the federal government and the *Länder* share corporate income tax equally (according to the location of the head operating or distribution office of the corporation).

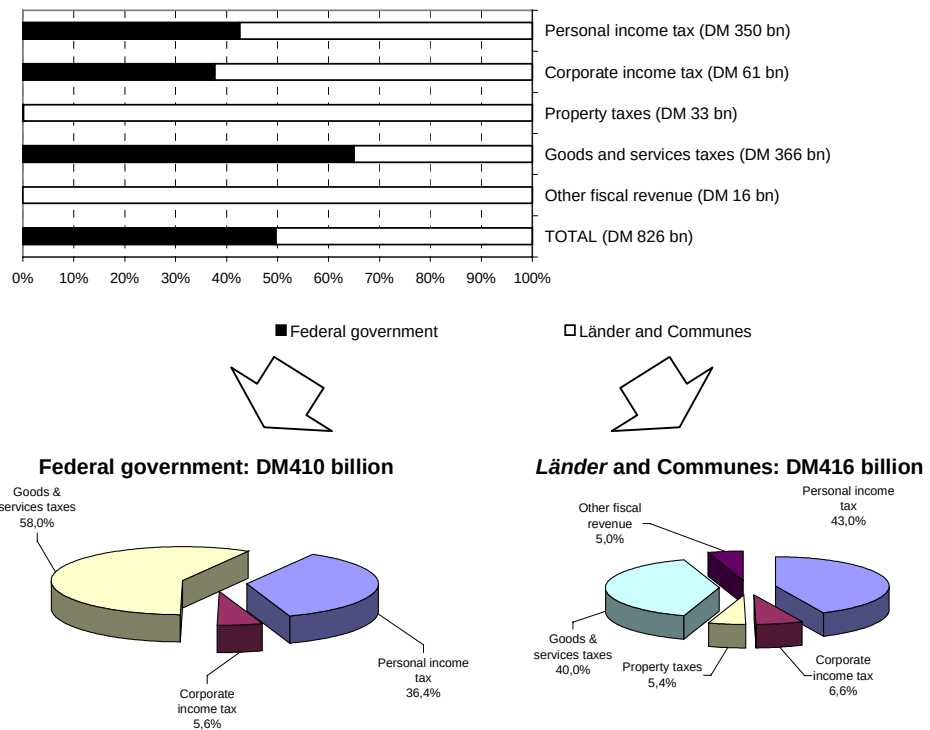
⁸ Article 106 of the *Basic Law*.

Revenue from the value-added tax (VAT) is also shared between the federal government and the *Länder*. However, in this case, a federal law, requiring the approval of the *Bundesrat*, determines the rules of sharing.

These shared taxes are collected by the *Länder* on behalf of the Federation, which returns their shares to them according to rules of sharing set out in the *Basic Law* and in federal legislation. It should be emphasized, however, that the federal government sets, collects and remits the proceeds of two taxes: customs duties, which it remits to the European Union, and duties on beer, which it pays in full to the *Länder*.

CHART 2

BREAKDOWN AND DISTRIBUTION OF TAX REVENUE – 1998 (Percentage of total)



Notes : All amounts in Deutschemarks (DM). *Property taxes* include property taxes. *Corporate taxes* include corporate income tax and the local business tax. *Goods and services taxes* include VAT, excise taxes, and other specific taxes.

Source : OECD (2000).

The federal government alone sets and collects excise taxes. The *Länder* alone set and collect taxes on gambling and gaming, estate taxes, taxes on real estate transactions, and the tax on motor vehicles. The Communes derive part of their revenue from property taxes. They also receive substantial funds from the local property tax (*Gewerbesteuer*). Prior to January 1, 1998,

this tax had two components. One of these has now been abolished, namely the former local tax on ownership of corporations (*Gewerbekapitalsteuer*), and has been replaced by a share (2.2%) of revenue from the federal VAT.

Intergovernmental financial relations

Germany has a highly developed system of intergovernmental financial relations. Apart from the sharing of tax revenue mentioned above, it includes a three-part equalization system - sharing of VAT, horizontal equalization, additional transfer payments - and a series of shared-cost programs. Taken together, the three components of the equalization system give tangible form, by equalizing the financial capacities of the *Länder*, to the constitutional principle of uniformity of living conditions for Germans throughout the Federation.

Sharing of the VAT

The sharing of VAT revenue is a key component of intergovernmental financial relations in the FRG. The sharing rule between the federal government and the other orders of government is determined by a federal law that requires the approval of the *Bundesrat*. This sharing is one of the main instruments available to the Federation to balance the "current revenue" with the "necessary expenditures" of the two orders of government.

Currently, 2.2% of VAT proceeds is paid to the Communes (since the elimination, in 1998, of the local tax on ownership of corporations) and 5.63% is earmarked for the federal government as compensation for improving its pension plan. Of the remaining 92.17%, the federal government receives 50.25% and the remaining 49.75% goes to the *Länder*. Three quarters, at least, of the share of the *Länder* is redistributed among them according to their demographic weight.

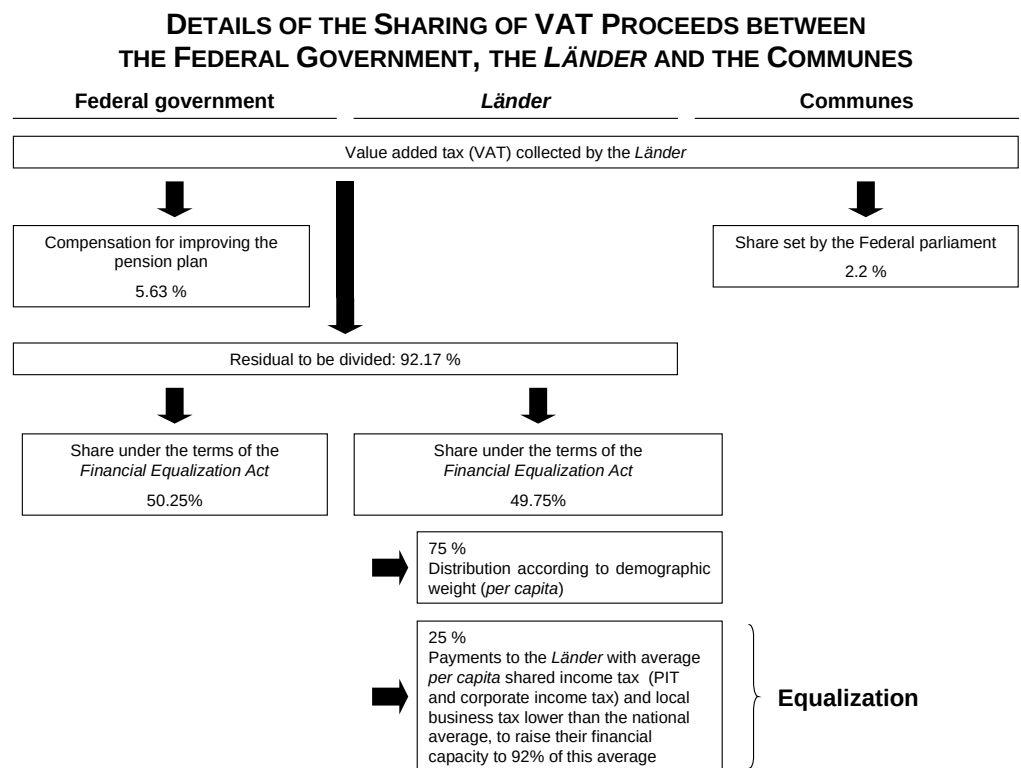
This sharing rule is very different from the one that existed in 1994, before the entry of the *Länder* of the former GDR into the equalization system (63% for the federal government and 37% for the *Länder*). This flexibility in German fiscal arrangements eased the entry of the *Länder* of the former GDR into the horizontal equalization system by ensuring that the amounts exchanged therein did not rise too much.

Equalization⁹

Component 1: Sharing of the VAT

The portion remitted to the *Länder* that is subject to the rules of equalization, namely 25% of their share, is paid to the less affluent *Länder* to raise their per capita income to 92% of the national average. If the objective is achieved with less than the 25% stipulated for this purpose, the remainder is redistributed to all the *Länder* based on their share of the population. At this stage, only the revenue from the sharing of PIT, corporate income tax and the local business tax is considered in the calculations. The amounts paid to seven *Länder* under this component of equalization amounted to DM17.0 billion in 2000.

DIAGRAM 1



Sources: *Bayerisches Staatsministerium der Finanzen* (2001) and *Financial Equalization Act* (*Länderfinanzausgleichsgesetz*).

⁹ Unless otherwise indicated, data for this section are taken from the *Statistisches Bundesamt* (2000), *Bundesministerium der Finanzen* (2001b) and *Bayerisches Staatsministerium der Finanzen* (2001).

Component 2: Länderfinanzausgleich (LFA)

The LFA, or horizontal financial equalization,¹⁰ is a mechanism for equalizing the financial capacities of the *Länder* and is funded entirely by them. In 2000, almost DM16.3 billion was paid in compensation by the more affluent *Länder*.

There are four stages in the horizontal equalization system:

- 1) Estimate of the financial capacity of each *Land*;
 - The financial capacity corresponds to the per capita tax revenue of the *Länder* and to 50% of that of the Communes ;

The tax revenue considered in the case of the *Länder* are: personal income tax, corporate income tax, taxes on gambling and gaming, estate taxes, the tax on motor

- vehicles, duties on beer and the VAT obtained from the sharing under component 1 of equalization.
- 2) Calculation of the equalization index, namely a weighted average of the financial capacities of all the *Länder*;
 - The weighting depends on size and population density, it being assumed that needs rise in proportion to these two factors.
 - 3) Comparison of the financial capacity of each *Land* with the equalization index;
 - A *Land* whose capacity, expressed in proportion to the reference index, is greater (less) than 100% is considered to be in surplus (deficit).
 - 4) Collection of contributions from *Länder* in a surplus position and payment to *Länder* in a deficit position of the amounts thus obtained. The LFA seeks to raise their financial capacity to 95% (at least) of the equalization index:
 - capacity less than 92%: disparity made up in full;
 - capacity between 92% and 100%: 37.5% of disparity made up;
 - capacity between 100% and 101%: 15% of surplus collected;
 - capacity between 101% and 110%: 66% of surplus collected;
 - capacity greater than 110%: 80% of surplus collected.

¹⁰ The principle of equalization is enshrined in the *Basic Law*. Article 107-2 of the Law stipulates that “appropriate compensation for disparities in financial capacity between the *Länder* must be ensured by the Law, taking into account the financial needs and capacities of the Communes (or group[s] of Communes)”.

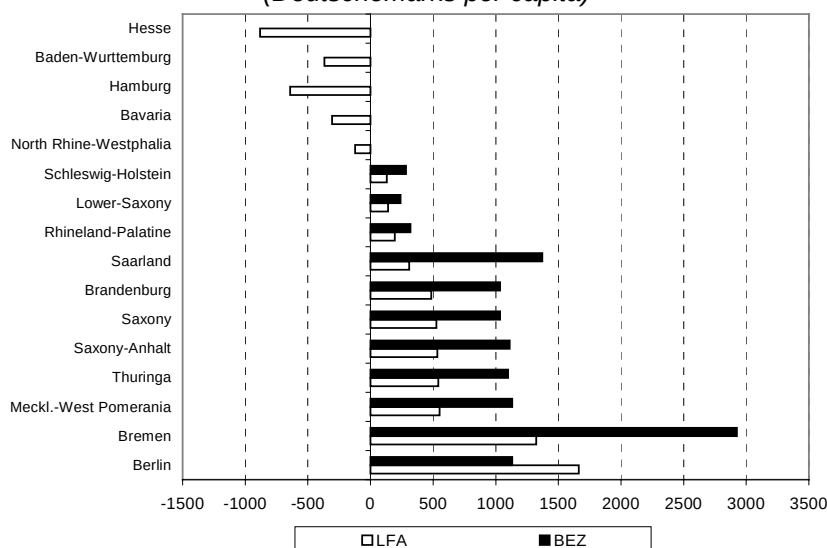
In the event that the total amount to be paid by the *Länder* in a surplus position is less than that to which the recipient *Länder* are entitled, the difference is made up in full by the *Länder* in a surplus position.

Component 3: Bundesergänzungszuweisungen (BEZ)

The BEZ, or additional transfer payments, are the third component of the German equalization system. Some BEZ were created following reunification with the GDR and, accordingly, meet the special needs of the new *Länder* that are much less affluent than those of West Germany. The federal government covers the cost of these programs, some DM26.1 billion in 2000.

CHART 3

TRANSFERS UNDER THE LÄNDERFINANZAUSGLEICH (LFA) AND THE BUNDESERGÄNZUNGSZUWEISUNGEN (BEZ) – 2000 (Deutschemarks per capita)



Sources : Statistisches Bundesamt (2000) and Bundesrat (2001).

The BEZ consist of five programs:

- transfers to the *Länder* whose financial capacity index remains under the equalization index after calculating the LFA payments, to raise their financial capacity to 99.5% of the index (DM7.2 billion in 2000) – these transfers are funded from the federal government's share of VAT revenue;
- transfers to the *Länder* of the former GDR (DM14 billion until 2004) to assist their integration;
- compensation to the Western *Länder* that, because of reunification, have suffered a drop in revenue or transfer payments (declining payments spread over ten years, including DM0.7 billion in 2000);

- transfers to small *Länder* to compensate for the lack of economies of scale in the provision of services and public management (DM1.5 billion annually);
- assistance to Bremen and to Saarland to facilitate budget restructuring (DM1.6 billion and DM1.1 billion in 2000).

Other transfer programs

The federal government and the *Länder* have developed a number of shared-cost programs, in particular to improve institutions of higher education and develop the regional economic structure (federal share: 50%), to support agriculture and its infrastructures (federal share: 60%) and to preserve the shoreline (federal share: 70%).

Dispute settlement mechanisms

Although the *Basic Law* grants the *Bundesrat* a right of review on any federal draft legislation designed to amend the Constitution or affect the finance or administrative jurisdiction of the *Länder*, at times the two houses can fail to agree on the scope of this right, one arguing that it is entitled to oppose a bill while the other maintains that the bill lies outside its province. In such cases, the parties may ask the Constitutional Court to settle the dispute.

In addition, it often happens that the two houses fail to reach a compromise on bills that require the approval of the *Bundesrat* and the *Bundestag*, i.e. bills affecting the *Länder*. In such cases, either house may call on the Mediation Committee. This committee consists of a representative of the government from each *Land* (member of the *Bundesrat*) and of 16 deputies of the *Bundestag*, in proportion to the seats held by each party, for a total of 32 members. It is chaired alternately by a member of each house.

Furthermore, there are a large number of intergovernmental councils that coordinate the various policies of the three orders of government. While these councils have only an advisory role, their views are generally taken into account when formulating policy. The most important are the Financial Planning Council and the Economic Policy Council (consisting respectively of the federal minister of finance and those of the *Länder* as well as representatives of the Communes).¹¹

¹¹ OECD (1992).

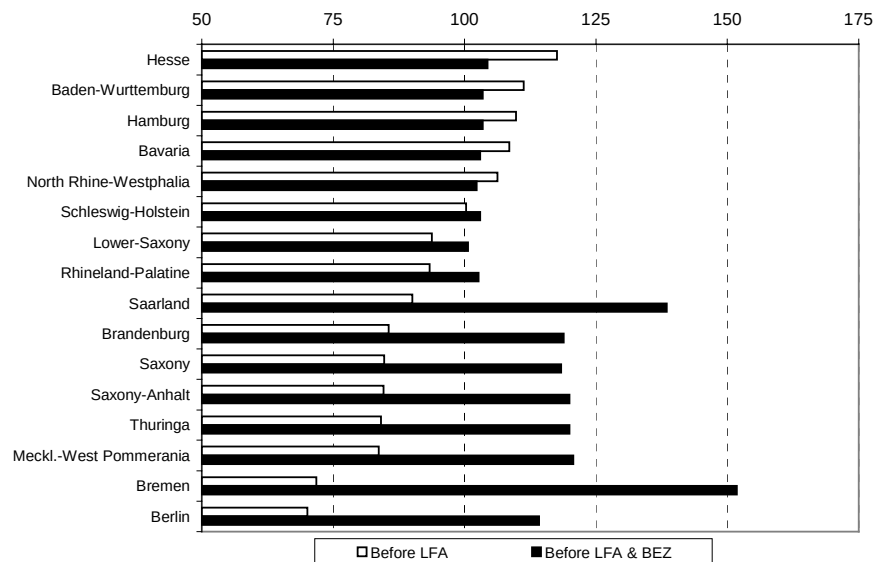
Outlook

Germany's equalization system has come under criticism for some time. Many believe that the tax-back rates are too high and reduce the incentive to economic development. These critics maintain that the *Länder* do not retain a sufficiently large share of the fiscal benefits generated by strong economic growth. For a *Land* receiving equalization payments, for instance, any increase in tax revenue greater (less) than the average significantly reduces (increases) the amounts of equalization received.

In addition, some analysts have shown that, when considered as a whole, the German equalization system exceeds its objective of equalizing the financial capacities of the *Länder*. The BEZ, which are not considered when their financial capacity is assessed, sometimes increase the financial capacity of less affluent *Länder* beyond that of *Länder* that were required to pay contributions under the LFA, a situation that is considered unfair.

CHART 4

RELATIVE FINANCIAL CAPACITIES OF THE *LÄNDER* – 2000
(100 = average of the *Länder* before LFA)



Notes : *Länderfinanzausgleich* (LFA) and *Bundesergänzungszuweisungen* (BEZ).

Source : Spahn and Franz (2000).

Lastly, a recent decision of the Constitutional Court¹² regarding the existing equalization system has led to a review of the program (see sidebar). In June 2001, the *Länder* and the federal government reached an agreement in this

¹² The German Constitutional Court consists of 16 judges appointed by the *Bundestag* and the *Bundesrat* (eight each). The magistrates are divided into two chambers. The Court is the highest judicial body in Germany and oversees compliance with the principles enshrined in the *Basic Law*.

regard stipulating changes to the equalization system that will become effective in 2005.

The changes designed to meet the criticisms leveled by the Constitutional Court and by other critics include:

- elimination of deductions for special charges previously allowed *Länder* with sea harbours;
- inclusion of 64% of Communes' revenue rather than 50%;
- introduction of an exemption to encourage growth of *Länder* tax revenues.

These adjustments to equalization will ensure, according to the estimates made by the parties, that no *Land* is penalized financially by the reform. The political agreement also stipulates that the new equalization system will be in force for a period of 15 years. Thereafter, it is stipulated that the *Länder* of the former GDR will then be treated like the other *Länder* and that some BEZ payments may be eliminated.

THE NOVEMBER 1999 JUDGMENT

Legal proceedings contesting the current equalization system, instigated by Baden-Württemberg, Bavaria and Hesse, culminated in November 1999 in a decision of the Constitutional Court in which it:

- asks that the VAT no longer be shared on a per capita basis, but rather on the basis of criteria that reflect the needs of the *Länder*, i.e. by comparing the current revenue of each order of government to its necessary spending, these last two concepts to be defined objectively and scientifically on the basis of statistics;
- condemns the concept of special charges considered by the LFA, i.e. the greater weighting of the population of city-states and large cities and, especially, the charges for sea harbours;
- calls for all revenue of *Länder* and Communes to be taken into account in the calculation of financial capacity used for horizontal equalization; currently, only 50% of municipal taxes are included;
- considers the high and recurring amounts of the BEZ to be inappropriate.

AUSTRALIA

Institutional framework

Australia comprises six states and two territories and has been a federation since 1901. Canberra, the Australian Capital Territory, and the Northern Territory, are autonomous political entities whose powers are almost identical to those of the six states.¹³ Eight external territories are also attached to Australia, i.e. Christmas Island, Norfolk Island, the Cocos (Keeling) Islands, the Coral Sea Islands and Norfolk, Lord Howe, Heard, McDonald and Macquarie islands.

SNAPSHOT

Official name: Commonwealth of Australia
 Capital: Canberra
 Population: 19.3 million
 Federation: 1901
 Official language: English
 Currency: Australian dollar
 Public spending (2000): 32.7% of GDP

Australia is a constitutional monarchy. Queen Elizabeth II is head of State and Queen of Australia and is represented by a governor general in the Commonwealth and a governor in each state. However, effective executive power lies in the hands of the government leader, the prime minister, who is normally the leader of the party or majority coalition in the House of Representatives in the federal parliament and is appointed by the governor general.

The federal parliament has two houses, as do the parliaments of each of the states,¹⁴ except for the Queensland Parliament, which does not have a legislative council (senate). The federal parliament comprises the House of Representatives and the Senate. Members of parliament are elected by universal suffrage in their ridings and no state may have fewer than five representatives. The Constitution also stipulates that the total number of representatives must be double the number of senators.

The Senate is made up of 12 senators per state and two per territory. Senators are elected by universal suffrage through proportional representation. The Senate has a right of veto in respect of legislation adopted by the House of Representatives. Should disagreement persist between the two houses, the executive branch may dissolve them. Should

¹³ The territories are nonetheless subordinate to the central government, unlike the states. For example, several years ago, the federal parliament rescinded controversial legislation adopted by the Northern Territory authorizing euthanasia.

¹⁴ Unless indicated otherwise, the expression "states" includes the territories.

the disagreement continue after the subsequent election, both houses meet jointly to settle the dispute.

The High Court of Australia, whose seven justices are appointed by the federal cabinet, settles constitutional disputes, as a last resort. Federal legislation governing the High Court stipulates that the federal justice minister must consult his state counterparts before recommending court appointments.

Division of responsibilities

General division of powers

The Australian Constitution confers on the Commonwealth various exclusive fields of jurisdiction and indicates numerous areas in which the Commonwealth and the state governments enjoy concurrent jurisdiction, although the federal government has precedence.¹⁵

Under the Constitution, federal authority encompasses 40 or so fields, including foreign affairs, defence, immigration, trade, currency, old age and disability pensions, unemployment insurance and family allowances. The states may also delegate legislative jurisdiction to the federal parliament.

The Constitution does not explicitly mention residual jurisdictions. Section 107 nonetheless grants the six former British colonies that make up the Australian federation exclusive legislative jurisdiction over the fields in respect of which the former colonies exercised jurisdiction.¹⁶ Consequently, the states exercise exclusive jurisdiction over public security, urban development, housing, transportation and public services.

Local governments are subject to the legislative control of the states and the Constitution does not grant them any exclusive powers.

Moreover, the two main orders of government share responsibility for health (the federal government plays a key role in funding private hospitals and Medicare) and education (jurisdiction over postsecondary education is shared).

Federal spending power

Section 96 of the Constitution stipulates that the Commonwealth may make grants to any state under the terms and conditions that it deems appropriate. In the past, the courts have very broadly interpreted this section and the jurisprudence is bolstering the federal government's spending power. Canberra frequently resorts to this power in order to influence the decisions

¹⁵ Sections 51 and 109 of the Constitution.

¹⁶ Most authors deem section 107 of the Constitution to be a residual clause.

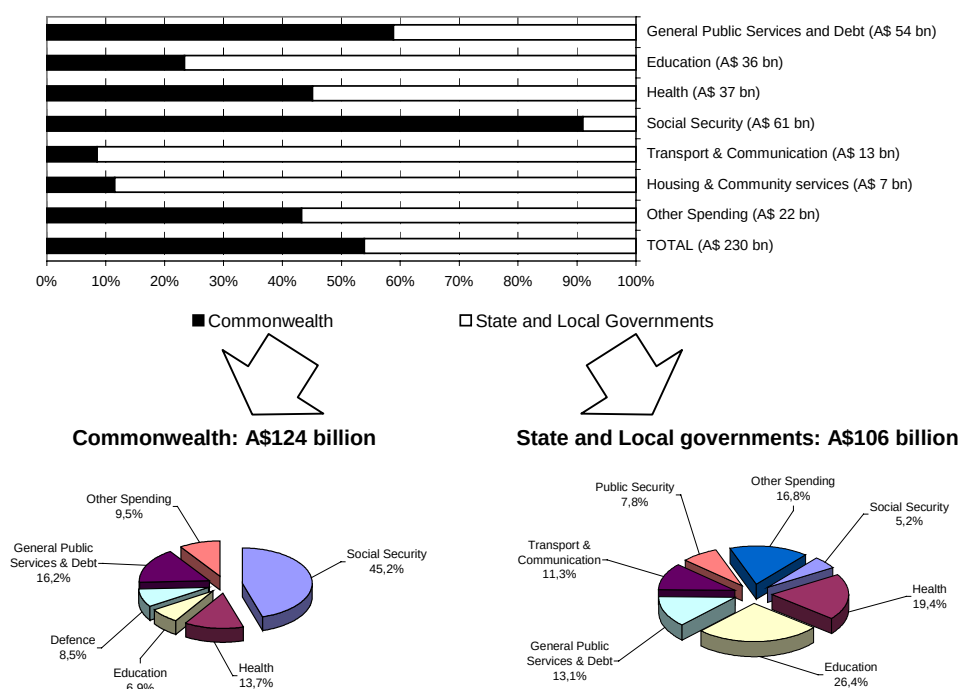
of state and local governments, impose its priorities and foster the coordination of macroeconomic policies.

Spending

Federal government spending, net of transfers to other levels of government, accounts for 54% of total government spending in Australia. State and local government spending accounts for 46% of the total.

CHART 5

BREAKDOWN AND MIX OF PUBLIC SPENDING – 1999-2000 (Percentage of total)



Notes : All amounts in Australian dollars (A\$). Federal spending excludes federal transfers. These transfers are included in the expenditures of state and local governments since they carry out the final spending.

Source : Australian Bureau of Statistics, document 5512-0.

Income security is the biggest federal government spending sector (state and local governments assume less than 10% of spending in this sector). However, state and local governments assume the lion's share of education spending, although federal government transfers in this respect are substantial (A\$5.7 billion in 1999-2000, just over half of this amount to local governments to fund private schools).

The two levels of government make substantial outlays in the health sector, i.e. over A\$37 billion all told in 1999-2000. Most of the spending is in the form

of specific federal government transfers to the states, i.e. over one quarter of the A\$24.5 billion allocated to health care by the states in the same year.

Taxation¹⁷

The Constitution confers on the federal and state parliaments distinct legislative jurisdiction in respect of taxation, while the states delegate to local governments part of their power to levy taxes.

Australia elaborates its key fiscal policies in a highly centralized manner. Constitutional jurisprudence is bolstering federal primacy in the realm of taxation.

When the portion of revenue raised by the federal government (69%) is compared with its share of public spending (54%), a striking discrepancy is apparent between the level of program spending and the revenues collected by the state and federal governments.

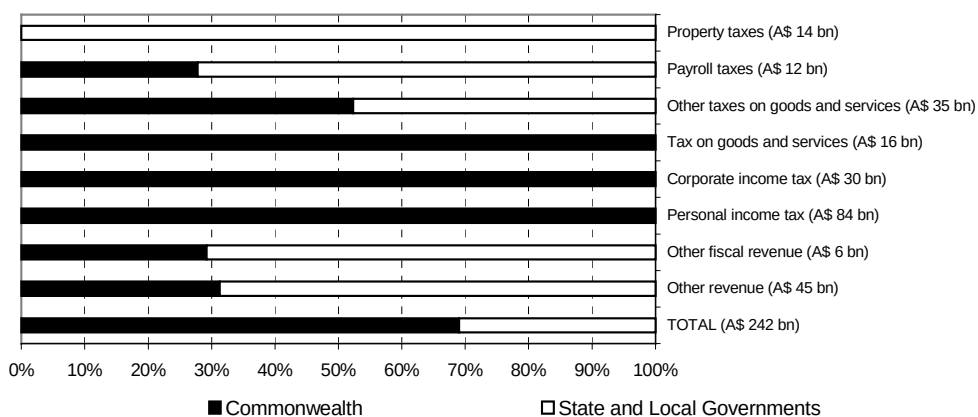
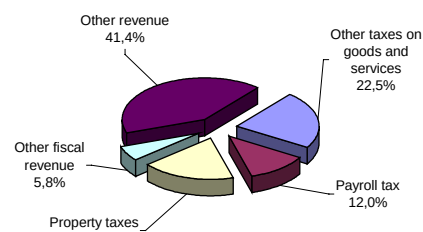
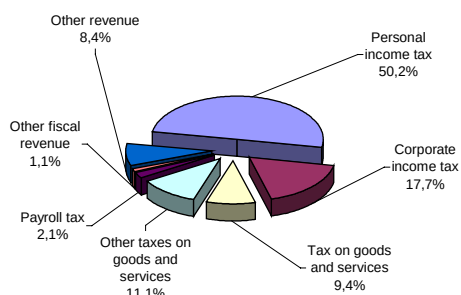
The federal government exercises effective exclusive control over several major sources of revenue, including personal income tax and corporate income tax. Furthermore, it levies the lion's share of goods and services taxes. Most of its revenues are derived from personal income tax (50%) and corporate income tax (18%).

The states are absent from these two taxation fields, although the Constitution and its subsequent interpretation do not prohibit their presence. This situation results, in particular, from the perpetuation of the federal government's temporary assumption of exclusive jurisdiction over the taxation of personal and corporate income during World War II (1942).

State and local governments derive a significant portion of their income from payroll taxes, property taxes and taxes on financial transactions.

Until July 2000, the states received compensatory payments (Revenue Replacement Payments) in respect of taxes abolished by a decision of the High Court, which, in 1997, rescinded the states' right to levy taxes on certain specific goods and services. The compensatory payments equalled the proceeds from the increase in federal taxation rates on alcoholic beverages, fuel and tobacco products.

¹⁷ The situation described is that prevailing in the last year prior to the reform in the year 2000.

CHART 6**BREAKDOWN AND MIX OF REVENUE – 1999-2000***(Percentage of total)***Commonwealth : A\$167 billion****State and Local governments: A\$75 billion**

Notes: All amounts in Australian dollars (A\$). Transfers between public administrations are not included. The category *Other taxes on goods and services* includes, for the state and local governments, specific taxes on fuel, alcohol and tobacco (collected by the federal government but ceded back to the states under the *Revenue Replacement Payments*), duties on motor vehicles and taxes on insurance, while it includes excise taxes in the case of the federal government. *Other revenue* includes non fiscal revenue.

Sources: Australian Bureau of Statistics, 5506-0 and 5512-0.

Intergovernmental financial relations

On August 13, 1998, the federal government announced that it would reform the Australian tax system effective July 1, 2000. The reform called for the implementation of a goods and services tax (GST),¹⁸ the abolition of certain taxes levied by the states, and a reduction in income and other taxes.

¹⁸ The GST is actually a value added tax (VAT) that is called the Goods and Services Tax.

Moreover, the reform significantly altered the financial arrangements between the federal and state and territorial governments.

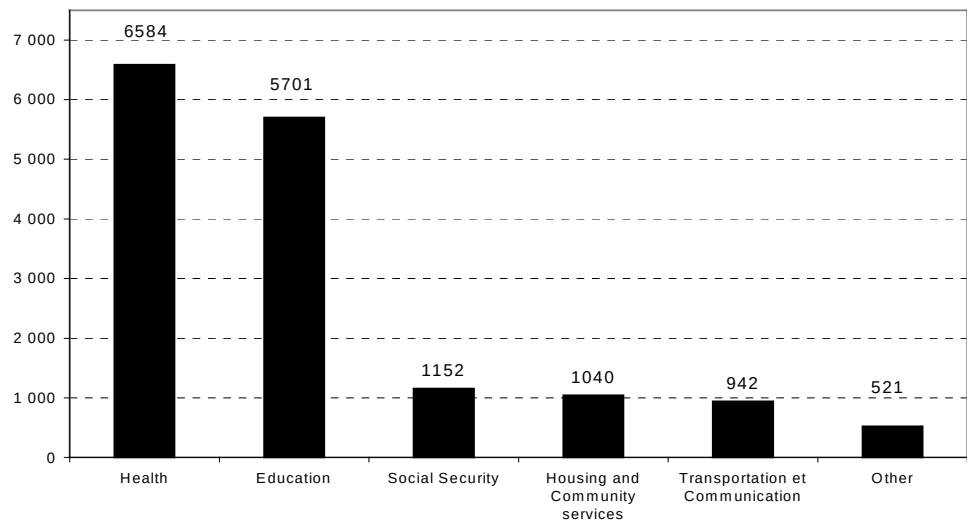
The high degree of centralization of taxing power and the striking discrepancy between the level of program spending and the revenues collected by each level of government explain the importance of intergovernmental transfers in Australia.

Transfer programs

During the 1990s, federal government financial transfers to the other levels of government accounted for nearly 36% of state revenues and nearly 13% of local government revenues.¹⁹ In 1999-2000, such transfers were almost equally divided between *specific transfers* (roughly A\$16 billion),²⁰ used to fund specific programs, and *unconditional transfers* (roughly A\$18 billion),²¹ by and large in the form of Federal Assistance Grants, now discontinued.

CHART 7

SPECIFIC TRANSFER PAYMENTS TO STATE AND LOCAL GOVERNMENTS – 1999-2000 (millions of Australian dollars)



Note : Direct transfers to local governments are included under *Other*.

Source : Australian government, Budget Paper number 3, Federal Financial Relations 2001-2002.

Specific transfer programs affect, above all, the state health and education sectors (a portion of funding received by the states is transferred to local governments). The amounts paid directly by the Commonwealth to the

¹⁹ Australian Bureau of Statistics, *Government Financial Estimates, 2000-2001*, Document 5501-0.

²⁰ Government of Australia, *Federal Financial Relations 2001-2002, Budget Paper Number 3*.

²¹ Australian Bureau of Statistics, *Government Financial Estimates, 2000-2001*, Document 5501-0.

municipalities account for only a tiny portion of specific transfers, i.e. less than 3%, and are intended to fund day care centres.

The amount of specific transfer payments is tied to the programs for which such payments are intended. Funds are allocated under certain programs in light of historic considerations at the time the programs were established. Funds under other programs are earmarked according to the needs of the regions receiving them or their demographic weight. Most of the specific transfer programs make provision for an indexing mechanism that reflects inflation.

Equalization

Australia was one of the first federations to adopt a formal equalization system. Financial Assistance Grants, unconditional transfers abolished by the 2000 tax reform and, since then, the sharing of GST revenues, are intended not only to narrow the gap between the levels of state revenues and spending but also to remedy horizontal fiscal imbalance between the states stemming from differences in fiscal capacity.

These transfers reflect the two key sources of imbalance when equalization payments are established, i.e. differences in the cost of delivering public services because of population density and demographic structure, and discrepancies in the fiscal capacity of the states, especially because of natural resources endowments.

The Australian equalization mechanism functions as indicated below.

- 1) Establishment of total unconditional transfers:
 - set by the federal government prior to the 2000 tax reform (Financial Assistance Grants);
 - proceeds from the GST since the year 2000.
- 2) Distribution of the funds among the states according to the per capita rule proposed by the Commonwealth Grants Commission (CGC):
 - this distribution rule, designated by the term “relativity,” is established each year in the wake of complex calculations in respect of which the methodology is reviewed every five years;²²
 - the CGC’s recommendations (and the federal government’s proposals on total transfer payments, before 2000) are discussed at annual state and territorial premiers’ conferences.

²² The CGC considers 41 expenditure and 18 revenue categories when calculating financial relativity (the method is discussed in detail in the *Report on General Grant Relativities*, CGC, 1999, Volume II, Appendix A).

3) Establishment of per capita relativities:

- calculation of the standardized per capita expenditures of each state, i.e. the spending that the state must cover to provide the average level of public services of the states overall, bearing in mind the cost of delivering such services;
- calculation of the standardized per capita revenues of each state, i.e. the revenues that each state could obtain were it to apply the average taxation structure of the states overall to its own tax bases;
- calculation, using these standardized amounts, of the funding that each state requires to provide a level of public services equivalent to the average for the states overall;
- calculation of the difference between this amount and the amount of specific federal transfers paid to the state (the result is the shortfall or the state's net financial requirement, covered by a transfer payment).

COMMONWEALTH GRANTS COMMISSION

Established in 1933, the CGC is a quasi-autonomous agency set up through legislation in order to monitor and coordinate the distribution of equalization grants paid to the states. The CGC is mainly responsible for determining the relativities employed to distribute equalization payments among the states and territories.

Before the agency hands down a decision, it collects information from the parties concerned by means of consultations and public hearings. The agency's decisions are not legally binding but the federal government usually implements the CGC's recommendations. The CGC's reports are submitted to the federal government and made available to the state governments.

Since the reform in the year 2000, the CGC has assumed essentially the same tasks, i.e. the distribution of funds paid to local governments, funding for the external territories and the establishment of relativities, although with a view to ensuring the redistribution of proceeds from the federal GST.

Per capita assistance in the form of equalization thus comprises an equal per capita portion of unconditional federal transfers *plus* an adjustment in respect of the cost of delivery *plus* another adjustment that reflects fiscal capacity.

It should be noted that equalization in Australia must satisfy the principle whereby each state must have the capacity – not the obligation, without which equalization payments would be conditional – to offer services at a level similar to that prevailing in the other states were the state in question to apply the average taxation rates of the states overall and conduct its affairs with a similar degree of efficiency.

The 2000 tax reform

The 2000 tax reform, or *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, has led to:

- the implementation of a value added tax, or goods and services tax (GST), initially set at 10%;
 - The Commonwealth and state parliaments must unanimously approve any change in the tax.

- the replacement of unconditional transfers by proceeds from the GST (the CGC establishes the parameters governing sharing by the states) and the maintenance of specific transfer programs;
- the abolition of compensatory payments in the wake of the 1997 High Court decision;
- the implementation of transitional compensation that ensures minimum transfers (Guaranteed Minimum Amounts, GMAs), running until 2006-2007, to protect the states against any loss of revenue stemming from the reform;
- the establishment of the Ministerial Council for Commonwealth-State Financial Relations, comprising all finance ministers, to manage financial relations between the Commonwealth and the states.

Outlook

The introduction of the uniform GST, combined with the abolition of certain taxes, ensures that the states have access to a more stable tax base that is less susceptible to tax competition between states. The states' determination to ensure adequate, stable funding of services such as health, education and public security was a key impetus for the reform. While the reform has reduced the states' own-source revenues, it has given them a right of veto over any change in the GST and, consequently, a veto over any change affecting the volume of transfers.

The GMAs, combined with the sharing of the GST, guarantee the states income levels equivalent to the ones they would have obtained in the absence of the reform. In its *Update Report* of 1999, the CGC predicts that GST should generate nearly A\$28 billion in 2001-2002, which, combined with the A\$2 billion to be paid in the form of GMAs, will offset the losses sustained in the wake of the abolition of certain taxes (A\$11 billion) and unconditional transfers (A\$19 billion). At the end of the transition period, the total revenues of each state are expected to exceed the revenues they would have obtained without the reform.

The reform is likely to significantly affect intergovernmental relations and the funding of transfers, although it is still too early to assess the impact.

BELGIUM

Institutional framework

Belgium is a constitutional monarchy. The King is the official chief of state, and the prime minister is the head of government. The 1831 Belgian Constitution was amended substantially in 1993 in order to make the country a federation. This change marked the fourth stage in the federalization process undertaken over 30 years ago.

SNAPSHOT

Official name: Kingdom of Belgium
Capital: Brussels
Population: 10.2 million
Federation: 1993
Official languages: German, French and Dutch
Currency: the Belgian franc (BF), to be replaced by the euro as of 2002: 1 EUR = 40.3399 BEF
Public spending (2000): 47.0% of GDP

The federal parliament comprises the chamber of representatives and the senate. The 150 members of the chamber of representatives are elected by direct universal suffrage and through proportional representation by province.²³ The senate has 71 members, 40 of them elected by direct universal suffrage (25 Flemish-speakers and 15 French-speakers, elected by their respective linguistic communities), 21 are appointed by Flemish (10), French (10) and German-speaking (1) Community councils, and the remaining members are co-opted by the preceding group and sit in separate linguistic groups.

Senate approval is required, especially in respect of constitutional amendments and special legislation of concern to the Communities. As for other draft legislation, the senate enjoys a 60-day right of suspensive veto, although it does not exercise any power over budgetary matters.

Belgium no longer has national political parties as each traditional political family has split up on a regional basis. However, until now, government coalitions have assembled all elected representatives of a given political family.

The government is accountable to the chamber of representatives and has not more than 15 members, half of whom must come from each linguistic community.

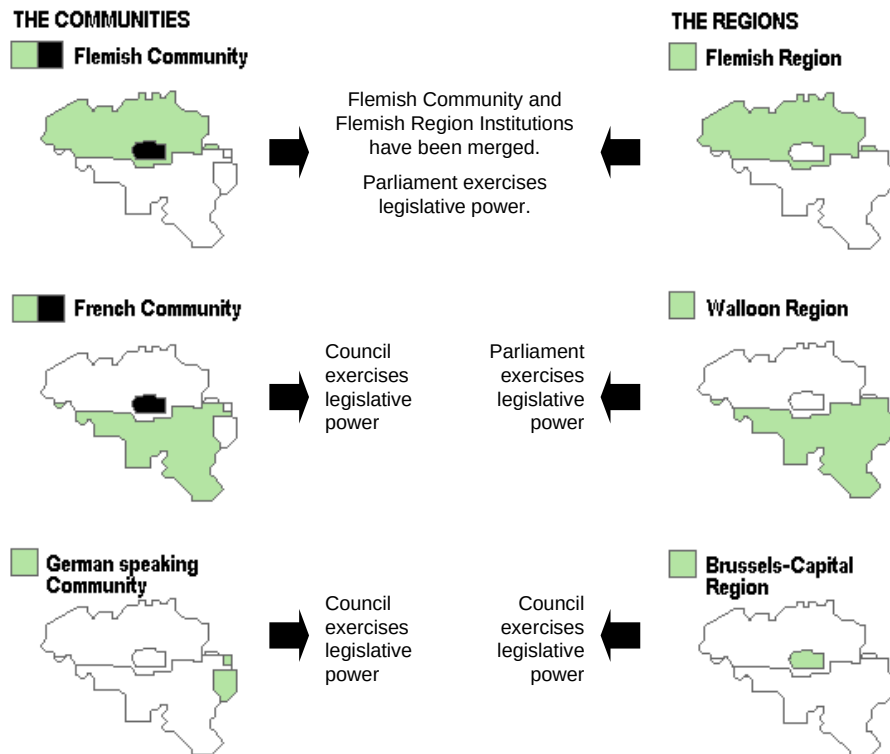
²³ Belgium is divided into 10 provinces and 589 communes. Federal legislation organizes the provinces and communes.

The Belgian federation simultaneously encompasses two types of geographically superimposed federated entities, the Communities and the Regions. The Regions are strictly geographically defined while the Communities are, in principle, defined by culture and language.

In practice, however, the Flemish Community controls Flanders and the Brussels-Capital Region. The German-speaking Community has jurisdiction in nine communes in the Walloon Region. The French-speaking Community has jurisdiction in the Brussels-Capital Region and in the Walloon Region, except in the German-speaking communes. The presence of a single Flemish government and two French-speaking governments (the French-speaking Community and the Walloon Region) make Belgian federalism asymmetrical.

DIAGRAM 2

THE FEDERAL BELGIUM



Source : Service fédéral d'information de la Belgique.

The bilingual nature of the Brussels-Capital Region, whose population is roughly 85% French-speaking and 15% Flemish-speaking, has led to the establishment of a complex system to manage the jurisdictions of the French-speaking and Flemish-speaking Communities, which are responsible for health and education services, among others.

This division of powers creates problems from the standpoint of service delivery and, above all, the collection of revenues. Taxing Brussels residents based on language is especially problematical.

BRUSSELS INSTITUTIONS

Brussels is the heart and capital of the Brussels-Capital Region, the only bilingual region in Belgium. Its status has made it necessary to establish special institutions to exercise community jurisdictions in the region, i.e. the French (COCOF) and Flemish (COCOM) community commissions, which together, form the joint community commission (COCOM).

These bodies oversee questions for which the two communities are responsible and COCOM is responsible for questions of concern to the two communities.

However, only COCOF may vote on decrees in those areas of jurisdiction delegated to it by the French-speaking community. COCON votes on regulations alone, while COCOM may vote on rulings in those areas in which the communities' fields of jurisdiction cannot be exercised in Brussels, in particular health and social assistance.

Division of responsibilities

General division of powers

The Belgian Constitution does not explicitly indicate the fields of jurisdiction of the federal parliament, which instead has competence over broad sectors of activities. Without being prejudicial to the jurisdiction of the Communities and Regions, the federal parliament has jurisdiction over national defence, justice, foreign policy and social security.

All facets of social security, except public social aid centres, are funded through specific contributions from employers and employees governed by the federal government (health care, family allowances, work injuries, unemployment and pensions). Broadly speaking, the federal government is responsible for social security.²⁴

Articles 127 to 130 of the Constitution stipulate that the Communities are responsible for cultural affairs, education (with some restrictions, in particular minimum conditions for granting diplomas), "personalized" services,²⁵ language policy, cooperation between Communities, and international cooperation, including the conclusion of treaties in realms that fall exclusively under their jurisdiction. The federal parliament also has jurisdiction in most of these fields, especially health, with respect to which it maintains important prerogatives (organic legislation, health and disability insurance and funding).

²⁴ With the exception of certain subsets in the social security system, e.g. policy respecting the elderly, social assistance and occupational training and re-training, which are the communities' responsibility, and job placement, for which the regions are responsible.

²⁵ Includes health policy, especially prevention, and certain facets of family and child assistance policies.

Moreover, the Constitution does not explicitly indicate the Regions' fields of jurisdiction, which are instead specified through special legislation that requires a two-thirds majority in both chambers of parliament. The Regions now assume responsibility for several economic questions such as economic policy, employment, transportation, public works, agriculture, external trade and international relations in areas falling under their jurisdiction. In some instances, including external trade,²⁶ they share jurisdiction with the federal parliament.

Since 1993, residual jurisdiction has been vested in federated bodies.²⁷ However, in practice, the federal government is assuming this power until such time as its powers are clearly enunciated in a new article in the Constitution, which has yet to be done.

The division of competencies gives rise to some confusion. The Regions exercise some fields of jurisdiction vested in the Communities, and vice versa. Moreover, in certain areas, such as health and unemployment insurance, the simultaneous presence of different orders of government can lead to harmful overlapping.²⁸

Federal spending power

Federal spending power is vague insofar as the Constitution still does not specify the federal government's exclusive fields of jurisdiction. While the Constitution explicitly attributes to the Communities broad fields of jurisdiction, it makes no such provision in respect of the Regions, whose existing powers result from political negotiations and special federal legislation calling for the devolution of powers.

When the federal government wishes to spend in areas that fall under the jurisdiction of another order of government, it may do so by means of special legislation that requires a two-thirds majority in each chamber of the federal parliament and a majority in each linguistic group in each chamber.

Spending

Despite federalization in Belgium, the federal government engages in most of the country's public spending. In the broad social policy sector, including health, family allowances, social insurance systems and the minimum guaranteed income, the federal government and the *Office national de la sécurité sociale* (ONSS) are, by and large, responsible for spending. The ONSS is governed by federal legislation and funded by payroll contributions and federal government grants.

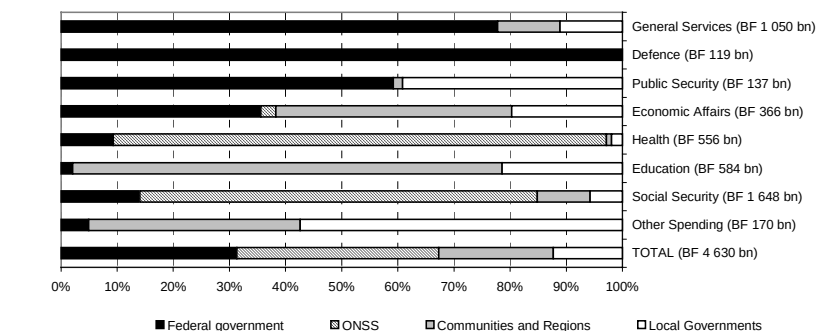
²⁶ The 2001 reform calls for a broadening of the regions' jurisdiction in this field.

²⁷ Article 35 of the Constitution.

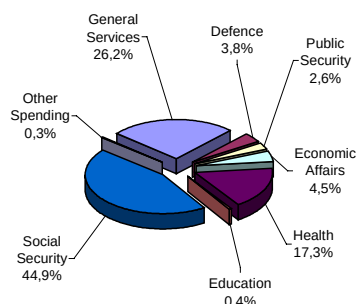
²⁸ See, in particular, Cattoir (1998) in this respect.

CHART 8

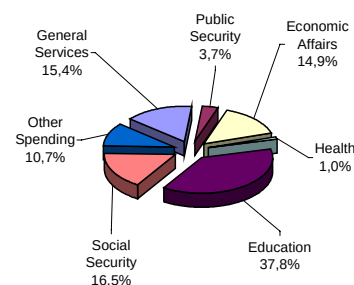
BREAKDOWN AND MIX OF PUBLIC SPENDING – 1998 (Percentage of total)



Federal government and ONSS: BF3 117 billion



Communities, Regions and Local gov.: BF1 513 billion



Notes : All amounts in Belgian francs (BF). Even if local governments fall under federal jurisdiction, they are included with the Communities and Regions in order to present a view similar to the one in the other chapters of the document. Transfers between public administrations are counted as expenditures for the beneficiary but not as expenditures made by the government granting the money since the latter does not carry out the final spending.

Source : National accounts of the *Banque nationale de Belgique* (2001).

However, the federal government's predominance overshadows the presence of other orders of government in the realms of health, social assistance and unemployment insurance, as noted earlier.

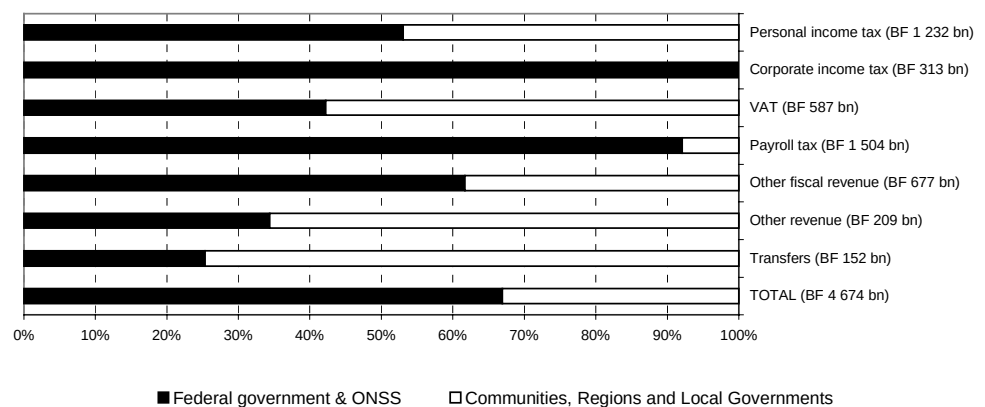
Education is the Communities' biggest expenditure item, followed closely by social protection. Economic affairs are a key spending item in the Regions' budgets.

Taxation

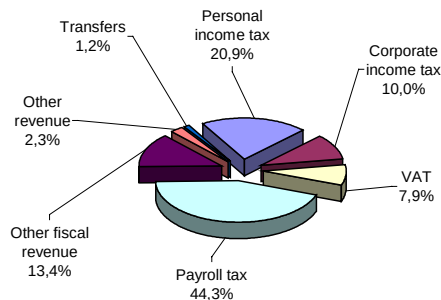
In Belgium, the federal government sets and collects most taxes. Personal income tax is, by far, the government's main source of revenue, followed by the value added tax (VAT). As is the case in all member countries of the European Union (EU), the federal government collects customs duties and remits them to the EU.

CHART 9

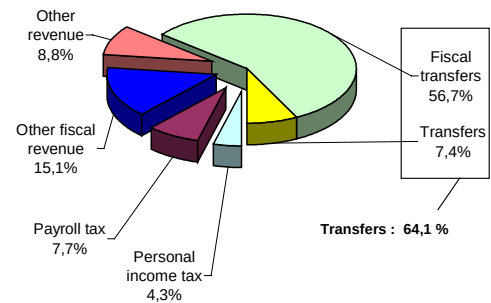
BREAKDOWN AND MIX OF REVENUE – 1998 (Percentage of total)



Federal government and ONSS: BF3 127 billion



Communities, Regions and Local gov.: BF1 547 billion



Notes : All amounts in Belgian francs (BF). Even if local governments fall under federal jurisdiction, they are included with the Communities and Regions in order to present a view similar to the one in the other chapters of the document. Fiscal transfers to the Communities and Regions are included in their respective categories in the bar chart and included in *Fiscal transfers* in the pie chart (therefore, they are subtracted from the federal government revenue in the pie chart). In the pie charts, transfers between public administrations are consolidated.

Source : National accounts of the *Banque nationale de Belgique* (2001).

The federal government collects and legislates in respect of most taxes levied by the other levels of government and remits such taxes to the latter. While the Constitution does allow the Regions and Communities to levy their own taxes, the *Loi spéciale de financement*²⁹ stipulates that the Regions may not levy taxes in areas already subject to a federal tax.

The Communities do not enjoy any fiscal autonomy since they do not establish and levy taxes. While they do receive the full amount of the radio-television fee, they do not exercise any jurisdiction in setting the fee because of the double jurisdiction in effect in the Brussels-Capital Region, where proceeds from the fee are divided between the French and Flemish Communities, in a proportion that approximately reflects the size of the two linguistic groups in the Region, i.e. 80% and 20%. The Communities are mainly funded through federal transfers, made up of VAT and personal income tax.

The Regions enjoy slightly more leeway since, with the consent of the federal government, they are authorized to add their rate to the personal income tax or grant a rebate equivalent to up to 3.25%. However, to date, no Region has done so.

The Regions receive a portion of registration fees³⁰ and, in the form of a ceded tax, proceeds from the ecotax. They also share with the federal government and the communes a portion of the property tax and may participate in determining the tax. They may also levy additional duties on the radio-television fee, proceeds from which normally go the Communities. Moreover, the Regions levy a number of specific taxes, i.e. the tax on gaming and gambling, the tax on entertainment devices, the tax on the opening of licensed drinking establishments, and the tax on inheritance and transfers of immovable property.³¹

Intergovernmental financial relations

A special federal statute covers the funding of federated entities. Special statutes require the approval of two thirds of the members of each chamber of the federal parliament and a simple majority in the French and Flemish linguistic groups in each of the chambers.

Federal government transfers are the main source of revenue of the Communities and Regions, mainly the sharing of VAT and personal income tax, to which are added small specific transfers aimed, in particular, at the Regions.

²⁹ Adopted on January 23, 1989.

³⁰ Since 1993, this portion must be modified by special legislation. The Regions may levy additional fees or provide refunds on this tax.

³¹ The federal government establishes the tax base in respect of this tax.

Transfer programs

Federal fiscal transfers are the Communities' main source of revenues. The Communities receive the full proceeds from the radio-television fee collected by the federal government. Moreover, they receive part of personal income tax, which is now apportioned according to a historic breakdown of the amounts and indexed according to the GNP.

However, proceeds from VAT account for the bulk of the Communities' revenues. For example, in 1999, the French-language Community derived nearly two thirds of its revenues from this source.³² Apportionment among the Communities is established according to the number of students for which they are responsible.

Funding of the Regions depends in great part on the proceeds from personal income tax. Special federal legislation determines how the funds are apportioned. The rule changes over time, according to established indexing rules.

The *Loi de régionalisation* adopted in August 1988 transferred to the Regions fields of jurisdiction equivalent in the federal budget at the time to roughly BF235 billion. It was decided to provide funding in this respect through proceeds from personal income tax (28% of such tax was transferred to the Regions). The overall amount of the transfer was then indexed to inflation and, starting in 1994, gradually indexed to growth in GNP. Initially, the breakdown of funds among the Regions was identical to the regional breakdown of federal spending, but Belgium has gradually shifted to a method of apportionment tied to the yield of personal income tax in each Region. The per capita yield of personal income tax in the Walloon Region was lower than that in the Flemish Region and this shift made the apportionment less and less favourable to Wallonia, a situation that was partially remedied by the equalization program aimed at the Regions.

Small specific (conditional) transfers also exist. They fund, in particular, employment and foreign student programs (Communities) and labour market reinsertion programs (Regions).

The federal government makes a specific transfer to Brussels intended to offset the costs borne by the city in its capacity as a national and international capital. However, the funding, which stood at BF3.2 billion in 1996, is paid directly to the municipality and does not appear in the Region's accounts.

Equalization

The only mechanism designed to reduce discrepancies in financial capacity between the federated entities in Belgium is a fairly modest program called the *Intervention de solidarité nationale* (ISN). Under the program, those

³² Marcel Gérard, *Le fédéralisme fiscal en Belgique*, manuscript, 2001, based on data from the *ministère des Finances belge*.

Regions in which the average per capita yield of personal income tax falls below the national average are entitled to an unconditional transfer from the federal government.

The amount paid to each Region reflects the gap in the yield of personal income tax in the Region in relation to the national average, weighted by an indexing factor and a factor pertaining to the amounts received by beneficiaries when the ISN was introduced. In the fiscal year 1999, Wallonia and the Brussels-Capital Region received payments in respect of the ISN of BF23.9 billion and BF1.4 billion, respectively.

Dispute settlement mechanisms

Interdepartmental conferences, gathering representatives of different orders of government, are periodically organized with a view to coordinating, harmonizing and implementing policies.

The *Conseil d'État* provides a uniform, consistent interpretation of legislation and gives opinions on draft legislation and decrees to ensure that each order of government does not overstep its jurisdiction. The advisory body is made up of experts in various fields to which the federal government must submit draft legislation in certain fields, such as constitutional amendments.

The *Conseil d'État* can also refer to a *Comité de concertation* jurisdictional conflicts noted in draft legislation. The committee, made up of representatives of all governments, is responsible for reaching a consensus on the question in order to provide a single opinion in this respect.

As for dispute settlement, the *Cour d'arbitrage* is empowered to settle jurisdictional disputes between the federal government, the Communities and the Regions stemming from legislative measures. The court is governed by a special federal statute and comprises 12 jurists and former parliamentarians, i.e. six French-speakers and six Flemish-speakers. A representative of each group chairs the court alternately from year to year.

Outlook

In recent decades, Belgium has developed a complex political and administrative structure that is changing constantly. A succession of political agreements leading to changes in the federation are either adopted rapidly or renegotiated. The most recent agreement, the so-called Saint-Polycarpe agreement, was concluded in January 2001.

This agreement increases funding for the Communities by a set amount for the period 2002-2006, then by an amount partly tied to economic growth for the period 2007-2011, then by an additional amount fully indexed to growth in federal revenues after 2011. This reorganization of funding for the

Communities became necessary, especially because of the problems experienced by the French-language Community in the realm of education.

The fiscal autonomy of the Regions has also been enhanced under this agreement, especially with regard to personal income tax, registration fees and the radio-television fee, proceeds from which have been transferred from the Communities to the Regions.

While the autonomy of the Regions is on the agenda, the Communities are also facing major challenges, particularly from the standpoint of the funding of public services, mainly in the Brussels-Capital Region. The complex system adopted in recent decades bodes well for original solutions to current problems, which is part of an ongoing process of change regarding existing structures.

SPAIN

Institutional framework

Spain's constitution is relatively recent, having been adopted in the fall of 1978, after the end of General Franco's regime. Under its constitution, Spain is not a federation in the strict sense, but rather, defines itself as a "state of autonomies."³³

The Constitution guarantees the right of communities to constitute themselves as "autonomous communities", a privilege that every Spanish community exercised from 1979 to 1983. As a result, Spain's territory is divided into 17 autonomous communities (AC) of varying size and wealth. Each one has one or more provinces (of which there are a total of 50), which are the administrative divisions of the central state and whose borders date back, in most cases, to the 19th century.

The King is the head of the Spanish state. Executive power is exercised by the government, responsible to the Congress of Deputies, the first chamber of the Spanish Parliament. The Congress has 350 members elected by proportional representation on a provincial basis. Accordingly, the autonomous cities of Ceuta and Melilla each have one deputy, while the 348 other deputies are distributed among the 50 provinces in proportion to their population, though each province has at least two.

The second chamber of the Parliament (*Cortes Generales*) is the Senate, which has 259 members divided into two categories. Most (208) are elected by direct universal suffrage, with four per province. The other 51 are appointed by the legislative assemblies of the ACs. The Senate holds an absolute veto over constitutional amendments, but has only a suspensive veto over bills.

In each AC, legislative power rests in a single assembly elected by direct suffrage according to a form of proportional representation. A government

SNAPSHOT

Official name: Kingdom of Spain
 Capital: Madrid
 Population: 39.9 million
 Constitution: 1978
 Official national language: Spanish (Castilian)
 Official regional languages : Basque, Catalan, Galician and Valencian
 Currency: the peseta, to be replaced by the euro in 2002 (1 EUR = 166.386 PTA)
 Public spending (2000): 38.7% of GDP

³³ Article 2 of the Constitution "recognizes and guarantees the right to autonomy of the nationalities and regions which make [...] up [the Spanish nation] and the solidarity among all of them."

council holds executive power, to which the government and its president, elected by the assembly, are responsible.

Division of responsibilities

General division of powers

The 1978 Constitution sets out the exclusive powers of the Spanish Parliament, including defence, customs and justice. It also lists the fields in which the ACs may exercise their jurisdiction, without explicitly attributing such jurisdictions to them. The statutes of autonomy³⁴ of the ACs list the jurisdictions each of them exercised when its statute was passed. Five of the 17 ACs hold residual power, which is held by the central state for the other 12.

There are three different regimes of division of powers in Spain, corresponding to the three groups of ACs. The first group, the so-called article 143 group, includes the ACs that exercise basic jurisdictions (see Table 1). Article 151 ACs exercised from their creation the same jurisdictions as the article 143 ACs, but also have authority over health and education. Eventually, all the ACs will exercise the same jurisdiction over spending matters, namely those exercised by the article 151 ACs. This process is proceeding by means of “transfers of jurisdiction”, an on-going operation under Spain’s institutional framework.

TABLE 1

JURISDICTIONS OF AUTONOMOUS COMMUNITIES OVER SPENDING

Group	Jurisdiction
Article 143	Forestry, agriculture, livestock and inland fisheries Urban planning and housing Roads Ports and non-commercial airports Hydraulic exploitation, canals, and irrigation Environmental protection AC heritage (cultural promotion of regional languages, libraries and museums) Self-government institutions Internal commercial fairs, tourism, sports promotion
Article 151 and <i>foral</i> regime	<i>All the above jurisdictions plus:</i> Education (management of the system at all levels) Health (medical assistance at all levels)

Source: Castells (2001).

³⁴ The statute of autonomy of an AC is passed by the *Cortes Generales* as an “organic law” and plays the role of a constitution for the AC. However, it should be noted that it is essentially a statute of the central state, which passes it (further to an agreement with the provinces concerned) and that has the power to amend it.

The last regime, the so-called “foral” regime, corresponds to the highest degree of autonomy obtained by an AC. It confers all the jurisdictions of article 151 in addition to allowing the AC to collect all taxes within its territory, including national taxes. This historical status is recognized under the Constitution for two ACs, namely the Basque Country and Navarre.

The fiscal, financial and administrative arrangements between the central state and the regional governments as well as the specific division of powers generally differ from one AC to another. The possibility of asymmetry in the attribution of powers in Spain is an important characteristic of the country. In practice, in the common regime, there is a strong similarity in the jurisdictions effectively exercised by the autonomous communities.

Spending power

The concept of spending power is difficult to apply to Spain since the exclusive jurisdictions of the ACs stem from laws, in particular the statutes of autonomy passed by the *Cortes Generales*. However, to the extent that the statutes of autonomy of the ACs have constitutional value, it may prove difficult for the central state to justify spending in fields that lie outside its jurisdiction.³⁵

Be that as it may, sections 1.1 and 1.13 of article 149 of the Constitution assign to the central state exclusive competence over the regulation of the basic conditions which guarantee the equality of all Spaniards in the exercise of their rights, and authority over bases and coordination of general planning and economic activity. In the past, the central state has invoked these provisions of article 149 to intervene in fields that do not fall expressly within its jurisdiction.

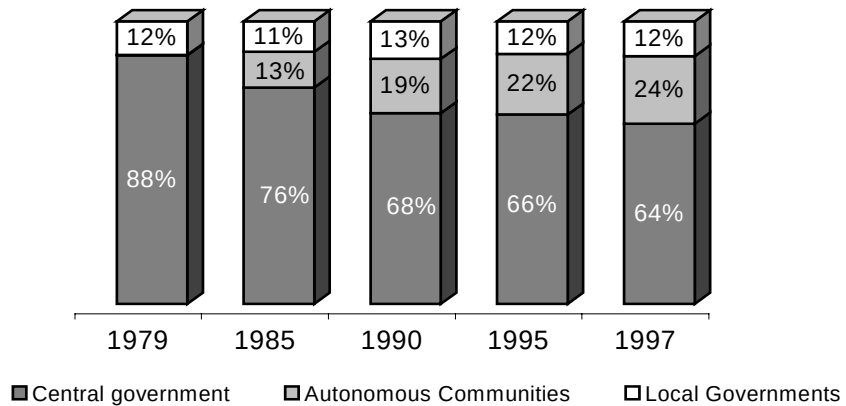
Spending

The central government is responsible for most public spending in Spain. However, ACs are playing an increasing role in the public sector. Their share of public spending has risen from 19.2% to 23.9% in seven years. Since 1997, their share of public spending has again risen with the completion of the transfer of jurisdiction over education to article 143 ACs by the end of 1999 and similarly the transfer of health within the next few years. In 1998, the central government estimated that the ACs would account for 34% of public spending once the process is complete.

³⁵ In one of its decisions, the Constitutional Court decided that these statutes have constitutional value.

CHART 10

BREAKDOWN OF PUBLIC SPENDING – 1979-1997
(Percentage of total)



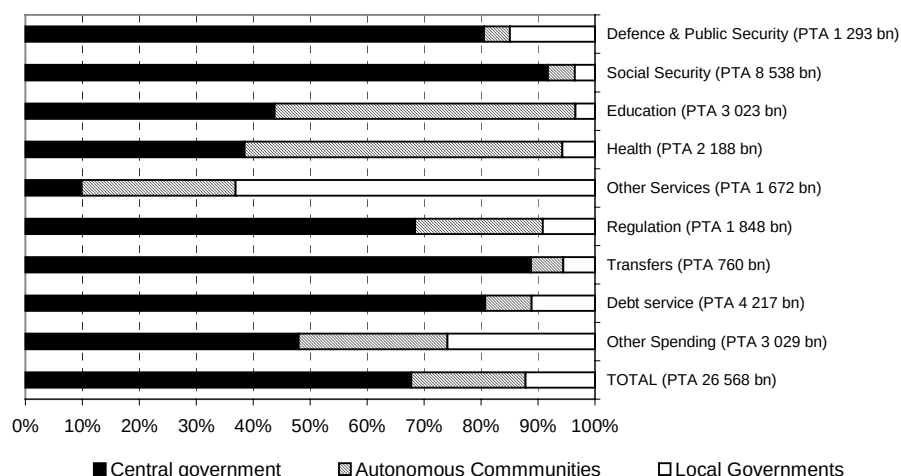
Source : Castells (2001).

The spending mix of each order of government remains fairly different. Health and education are the two main spending items for ACs, while the central state's spending is concentrated on social programs and its debt,³⁶ whose size and growth are subject to the provisions of the Maastricht Treaty on the European Union.

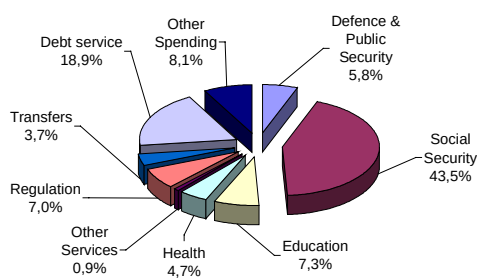
³⁶ It accounts for 18.9% of spending by the central state.

CHART 11

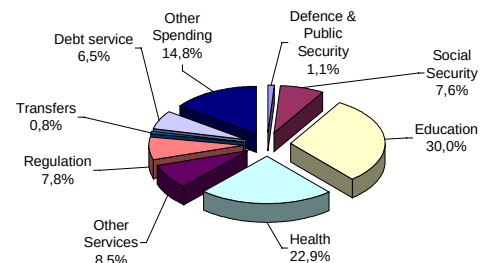
BREAKDOWN AND MIX OF PUBLIC SPENDING – 1993 (Percentage of total)



Central government: PTA17 997 billion



Autonomous Communities: PTA5 323 billion



Notes: All amounts in pesetas (PTA). The total of the amounts shown in the lower charts does not correspond to that of the upper chart because the breakdown of spending by local governments is not included. The category *Other public services* includes culture and other social services. *Economic regulation* corresponds to public measures to regulate markets. Lastly, *Other spending* includes, among other things, communications.

Source : Castells (2001) using data from *Dirección General de Coordinación con las Haciendas Territoriales* (1995).

Taxation³⁷

All orders of government in Spain are authorized to levy taxes. For instance, the ACs can apply surtaxes to taxes levied by the central government. Generally, however, levying of taxes by the ACs is strictly regulated by the Constitution³⁸ and the LOFCA.³⁹

Personal income tax (PIT), corporate tax and the value-added tax account for almost 70% of the revenue of the central government, which redistributes part of it to the ACs.

Estate taxes are the only category of revenue collected mostly by ACs and local governments. These taxes, along with inheritance and gift taxes and taxes on gaming, provide own-source revenue for the ACs.

Article 151 ACs receive 75% of their funding from the central government, including a share of PIT that alone accounts for 11% of their total revenue.

THE BASQUE COUNTRY AND NAVARRE

For historical reasons, the Basque Country and Navarre enjoy special status. These two ACs are governed by the *foral* system of administration, which is the modern version of the older decentralized (by province) management system in force prior to the regime of General Franco.

Their funding stems from a strict application of the territoriality principle in fiscal matters since they collect all the taxes within their territory, including national taxes, with the exception of customs duties and the proceeds of the central government's fiscal monopolies. This application of the territoriality principle is guaranteed by bilateral agreements.

Each AC remits a share to the central government – the “cupo” or “economic contribution” – that depends on the “amount of the central government's charges and relevant territorial adjustments for the AC » (Cattoir 1998). Accordingly, this amount does not depend on the tax receipts collected in the AC, but rather on the extent of the services provided by the central government in the AC and nationally.

Since 1997, the central government remits 30% of the regional proceeds of PIT to the ACs, half as an unconditional transfer⁴⁰ – of which tax the ACs can change neither the rate nor the base – and the rest as a partial cession of the tax field, a field in which the ACs⁴¹ that agreed to the 1997-2001 funding model can set their own rates and certain non-refundable tax credits.⁴²

If an AC fails to regulate this tax space, the central government will impose a standard national “complementary rate” and return this portion of the proceeds to the AC, in which case the AC receives 30% of the proceeds of PIT determined entirely by the central state. Note that, to date, no AC has changed the rate on its portion of PIT.

³⁷ This section applies generally to the 15 ACs funded under the common regime (articles 143 and 151 of the Constitution). The Basque Country and Navarre, under the *foral* regime, are discussed in a sidebar in this section.

³⁸ Article 157-2 of the Constitution.

³⁹ LOFCA: *Ley Orgánica de Financiación de las Comunidades Autónomas*, or Organic Law respecting the Funding of Autonomous Communities, 1980. Article 6 of the Law prohibits ACs from taxing what has already been taxed by the central government or local authorities.

⁴⁰ Madrid's share of the proceeds of PIT is only 10% in this regard.

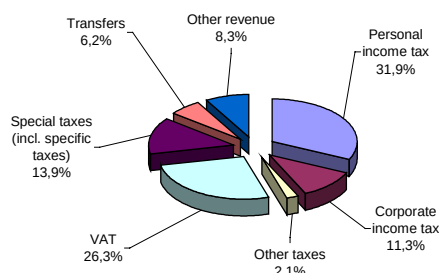
⁴¹ Andalusia, Castile-La Mancha and Extremadura have not signed this agreement; they receive their funding according to the provisions of the preceding agreement.

⁴² The leeway available to ACs in this regard is, however, subject to certain limits.

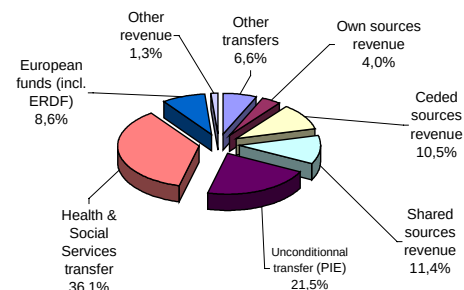
CHART 12

MIX OF TOTAL REVENUE – 1998 (Percentage of total)

Central government: PTA16 656 billion



Autonomous Communities: PTA5 970 billion



Note: All amounts in pesetas (PTA). Only the revenue of article 151 ACs is shown. *Ceded taxes* are collected and legislated by the central government but paid to the ACs. The PIE is the participation in the sharing of the general revenue of the central state (*Participación en los Ingresos generales del Estado*). For the central government, the *Transfers* category includes the *cupo* of the Basque country and Navarre, and transfers from other economic agents. For the ACs, *Other transfers* include amounts from the Inter-regional Compensation Fund (FCI).

Sources: *Ministerio de Economía y Hacienda* (1998) and Castells (2001).

Intergovernmental financial relations⁴³

Article 156-1 of the Constitution stipulates that “the ACs shall enjoy financial financial autonomy for the development and exercise of their competencies.” To comply, the central government periodically negotiates funding agreements with the ACs: the *concierto* ou *convenio económico* with the *foral* regime ACs and the funding agreements with the common regime ACs. These agreements govern the funding of the AC, both with regard to ceded or shared taxes and to transfers and their calculation mechanisms.

The main components of the funding agreements for ACs under the common regime are generally proposed by a committee of the Fiscal and Financial Policy Council⁴⁴ then approved by the regional governments and by the plenary session of the Council. Lastly, the specific details of each AC's funding are negotiated item by item by the central government with each regional government.

⁴³ This section focuses on article 151 ACs and solely those under the common regime. The ACs under the *foral* regime were discussed in a separate sidebar.

⁴⁴ A cooperation and coordination body consisting of representatives of the central government and all the ACs concerned.

Transfer programs

The major unconditional intergovernmental transfers in Spain correspond to the ACs' share in the central government's general revenue (*Participación en los Ingresos generales del Estado*, PIE) and their share of PIT collected in their territory. There are also significant transfers tied to social security, including health, conditional on the delivery of various funded services. The share of the PIE and of social security transfers each AC receives is based on a list of weighted variables,⁴⁵ which can lead to a relatively high degree of redistribution.

There is also an Inter-regional Compensation Fund (*Fondo de compensación interterritorial*, FCI) that provides less affluent regions with assistance to get closer to the national standard of living. ACs whose per capita income is less than 75% of the European Union (EU) average are eligible to receive payments from the FCI. This criterion corresponds to the one used by the EU to determine whether a region of a member country is eligible for EU regional development funds.

The following variables are used to determine how the FCI is distributed among recipient ACs: population (87.5%), area (3%), unemployment (1%), net migration (1.6%) and population dispersion (6.9%). This result is then weighted according to per capita income and insularity, for which a higher value leads to a decrease in the AC's share. In 2001, 10 of the 17 ACs received FCI payments. However, the FCI is relatively small, providing a redistribution of less than 2% of the ACs' total revenue. By comparison, sums received from the European Regional Development Fund (ERDF) amounted to 8.6% of the revenue of ACs in 1998. Amounts paid by the central government under the FCI are conditional, in the sense that they must be allocated to specific investment projects.

Lastly, revenue guarantee mechanisms for the ACs were set up in accordance with the provisions of the 1997-2001 funding agreement. The central government maintains a special fund, whose maximum size is determined in advance, that guarantees that the growth rate of all the resources of an AC will not be less than 90% of the average growth rate of these resources for all the ACs.

Equalization

There is no system of unconditional transfers designed to equalize the financial capacities of the ACs. However, the transfers mentioned above, the FCI in particular, have an equalizing effect because of their distribution rules. Equalization takes place almost exclusively by redistributing a portion of the central government's revenue (PIE) among the ACs. This revenue is raised by means of a standard tax system applied throughout Spain and whose per capita yield varies considerably from one AC to another.

⁴⁵ The variables used to calculate the shares of each AC for these various transfers are: population, area, insularity, administrative units, dispersion, relative wealth, fiscal effort.

Dispute settlement mechanisms

While all the stakeholders affected by draft legislation are generally consulted on an informal (and optional) basis during the legislative process, disputes can develop between the various jurisdictions.

Although preventive bodies such as the State Council⁴⁶ do exist, the Constitutional Court holds a major position in the development of the Spanish system. It has heard a number of disputes between the two orders of government over the years.⁴⁷

In spite of existing mechanisms, relations between the central state and the ACs are often difficult. Cattoir (1998) maintains that “the uncertainty surrounding the calculation of transfers between entities lead to various conflicts and raises many technical problems.”⁴⁸ Similarly, Castells (2001) states that “nowadays, in Spain, the absence of effective institutional mechanisms is a major problem in the relations among different levels of government.”

On April 11, 2001, the government announced that a seminar would be held to begin drafting an “autonomous cooperation law” to be introduced in 2002, once “the parties, ACs and political parties, have reached a broad consensus [on the issue].”⁴⁹

THE CONSTITUTIONAL COURT

Spain's Constitutional Court is the guardian of the Constitution and of the fundamental rights and freedoms it enshrines. Any legal proceeding may ultimately end up before the Court, provided constitutional arguments are raised in the dispute.

The Court has competence in cases involving opposition to laws or regulations, abuse against individuals by authorities, conflicts between constitutional bodies of the central state (government, Senate, Congress of Deputies and General Council of the Judiciary) and conflicts of jurisdiction between orders of government (central state and AC).

The Court consists of 12 magistrates divided into two chambers and appointed for a nine-year term. Membership is renewed on a rotating basis, three every three years. The Senate and Legislative Assembly each appoint four members, while the government and the General Council of the Judiciary each elect two magistrates. The latter is an independent body that administers justice in Spain.

⁴⁶ The State Council is a structure inherited from the former monarchy and nowadays plays a purely advisory role with the government. Its members are experts in law or economics or former politicians, and it provides an opinion when it is consulted on a specific issue. In some cases, the government is required to seek the view of the Council before proceeding with an initiative.

⁴⁷ On July 9, 1999, the central government issued a press release mentioning that since the 1978 Constitution became effective, there had been almost 1000 cases concerning the division of powers.

⁴⁸ Translation.

⁴⁹ Translated from a press release issued by the central government and dated April 11, 2001.

Outlook

Spain's development has continued since the 1978 Constitution became effective. Over the years since the statutes of autonomy were adopted, a growing number of responsibilities over spending have been transferred to the ACs. While the fiscal autonomy of the ACs has not kept pace with their prerogatives over spending, progress in this regard has been made. A new funding agreement for ACs under the common regime was reached on July 27, 2001 and will become effective in 2002.⁵⁰ This agreement provides for a major increase in fiscal autonomy for ACs and in their overall resources.

Under the new agreement, the ACs obtain, among other things, a higher share of PIT collected within their territory (from 30% to 33%), full transfer of the proceeds of taxes on registration and electricity, 35% of the proceeds of the VAT and 40% of the proceeds of taxes on tobacco, alcohol and hydrocarbons. Furthermore, they obtain the right to set taxes on hydrocarbons and broader jurisdiction regarding the collection of other taxes (inheritance taxes, estate taxes, etc.).

Some see this development leading logically to Spain's becoming a federation. Jauregui (2001) mentions this possibility as a potential solution to the situation in the Basque Country. Castells (2001) also supports this position as a way to improve Spain's institutional structures, which he feels are inadequate. He notes that "(...) state legislation in many cases sets limits to the autonomous margin for manoeuvre; autonomous finance create a high degree of financial dependence; the responsibility of the autonomous governments over the administration of their own territories is only limited; there are no mechanisms to facilitate the participation of the autonomous governments in determining the state's will."

⁵⁰ This is the first agreement in 10 years to be ratified by all the autonomous communities concerned.

UNITED STATES

Institutional framework

The United States of America is the oldest federation in existence. The Constitution, in force since 1789, was written in 1787 in Philadelphia by the delegates of the thirteen original states. It replaced the *Articles of Confederation* that created the United States of America in 1781.

Snapshot

Official name: United States of America
Capital: Washington, D.C.
Population: 281.4 million
Federation: 1789
Main language: English
Currency: American dollar
Public spending (2000) 29.4% of GDP

The country has 50 states and the District of Columbia, as well as associated states and territories such as Puerto Rico, the U.S. Virgin Islands and the Northern Marianas. This gives rise to a wide variety of local administrative structures. For instance, in 1997, there were 87 453 local government entities: 3 043 counties, 36 001 local jurisdictions, 13 726 school districts and 34 683 districts for specific purposes (natural resources, fire prevention, housing and community development, etc.).

The American system of government is based on the principle of strict separation of powers among the executive, the legislative and the judiciary. Executive power is held by the President, elected by an Electoral College whose 538 members are elected by the people of each state and the District of Columbia. The members of the College vote as a bloc for the candidate who obtained the largest number of votes in the entity they represent. Within the College, each state has a number of votes equal to the number of its representatives and senators, while the District of Columbia has only three votes.

The administrative duties of the executive are handled by 14 departments⁵¹ (ministries), each headed by a secretary (minister). There is also a large number of agencies, including regulatory bodies.

Federal legislative power is held by the Congress, formed of the House of Representatives and the Senate. The House of Representatives has 435 members elected in their electoral district by universal suffrage every two

⁵¹ These departments are Agriculture, Commerce, Defence, Education, Energy, Health and Human Services, Housing and Urban Development, Interior, Justice, Labour, State, Transportation, Treasury and Veterans Affairs.

years. The number of representatives from a state depends on its population. Each state is entitled to at least one seat.

The American Senate has 100 senators, two from each state. Senators are elected by the people of their state for a six-year term. One third of the Senate is renewed every two years. The equal number of seats for each state is an important feature of American federalism. The Senate and the House of Representatives have the same legislative powers, except on issues concerning the raising of revenue. In this case, draft legislation must first be passed by the House before it is introduced in the Senate.

In each state, executive power rests in a Governor, elected directly by universal suffrage. The state's legislature consists of two houses elected by universal suffrage and endowed with equal powers, except in Nebraska, which has only one.

The Supreme Court, consisting of nine judges appointed for life by the President and confirmed by the Senate, is the highest court of justice in the country. It is competent to decide any dispute regarding intergovernmental relations and constitutional matters.

Division of responsibilities

General division of powers

The Constitution indicates which fields lie within the exclusive jurisdiction of the states and which of the federation, as well as those in which intervention by the other order of government is prohibited. Accordingly, Congress has exclusive jurisdiction over national defence and commerce, for instance. The federal government is also attributed certain areas of jurisdiction explicitly, though intervention by the states in these fields is not banned. In such cases, the states and the federal government have concurrent jurisdiction with federal precedence. The huge field of taxation falls into this category. Finally, "the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."⁵²

Federal spending power

The general federal spending power of the American federal government is substantial. The Federation can extend its economic and social interventions under four principles written into the Constitution:

- The "*supremacy clause*": federal law always has primacy in areas of concurrent jurisdiction.⁵³

⁵² Amendments to the Constitution, article 10.

⁵³ Article 6, paragraph 2 of the Constitution.

- The “*necessary and proper clause*”: Congress can do whatever it wishes if the purpose is constitutionally legitimate.⁵⁴
- The “*taxing power*” and the “*spending power*”: Congress can tax what it wishes and fund what it wishes if the purpose is constitutionally legitimate.⁵⁵
- The “*commerce power*”: the Federation can legislate in fields of state jurisdiction to regulate inter-state commerce.⁵⁶

It is mostly by virtue of the fourth principle, the Commerce power, that the federal government can intervene in many of the states’ fields of jurisdiction.

Spending

In sectors of activity not exclusively under federal jurisdiction, the two major orders of government are generally present simultaneously. Federal intervention notably consists of its many programs of specific transfers to the state and to local governments.

The American Constitution makes no explicit provision for federal involvement in social programs. However, the federal government intervenes through its spending power. The federal government’s largest spending sector is income security, which alone accounts for about one third of total federal spending. National defence and the space program, taken together, represent 20% of spending. In the case of social assistance (welfare), the programs are structured and funded in part by the federal government, but the states administer them independently and can change certain significant parameters.

Health is a major spending sector for the federal government, since it funds part of Medicare, a universal health care program for senior citizens, and Medicaid, a health care program for low-income people.

The largest spending item for the states and local governments is education. Primary and secondary education is traditionally an area of local responsibility, but the states are assuming a growing share of these expenditures. However, post-secondary education is essentially a matter of states’ responsibility. The states administer the Medicaid program as well as recent complementary programs for children (Children Health Insurance Program). The states also have responsibility for the implementation of welfare programs.

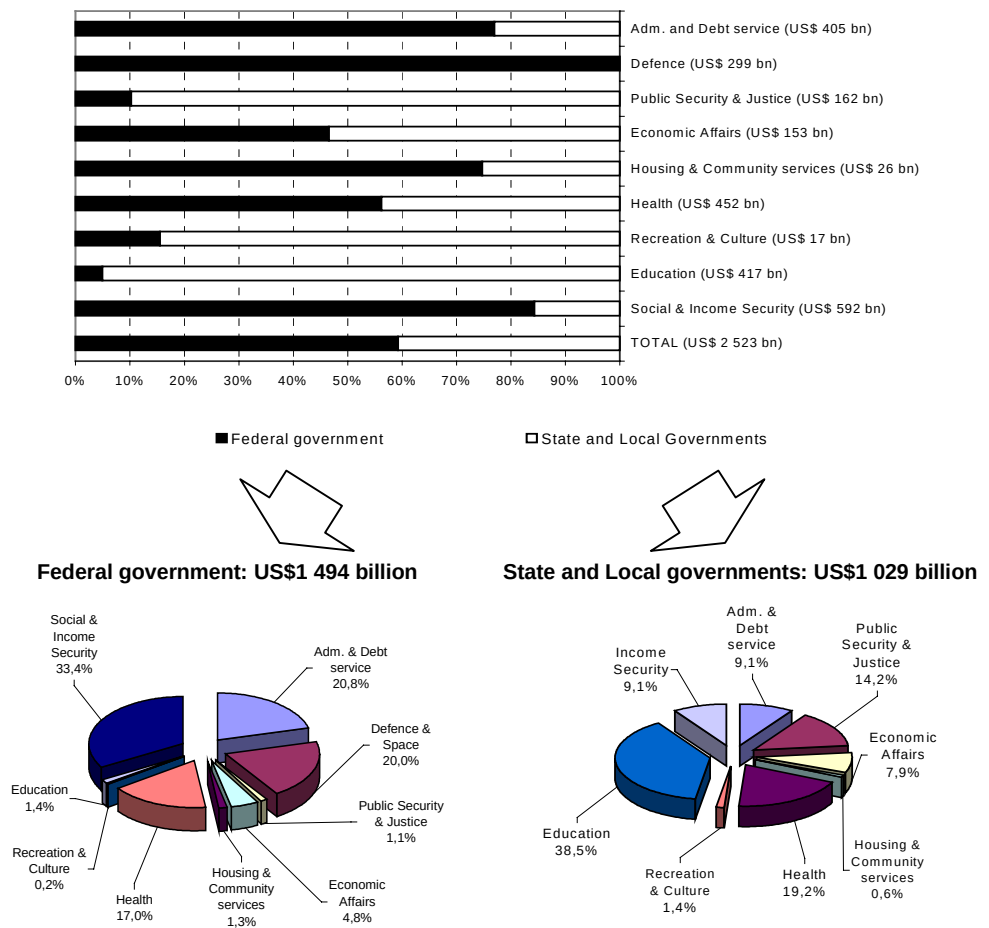
⁵⁴ Article 1, section 8, paragraph 18 of the Constitution.

⁵⁵ Article 1, section 8, paragraph 1 of the Constitution.

⁵⁶ Article 1, section 8, paragraph 3 of the Constitution.

CHART 13

BREAKDOWN AND MIX OF PUBLIC SPENDING – 1998 (Percentage of total)



Notes : All amounts in American dollars (US\$). Federal spending does not include federal specific transfers to state and local governments, which amount to US\$209 billion, since they are included in the spending of the latter who carry out the final spending.

Sources : National Income and Product Accounts (NIPA), Bureau of Economic Analysis.

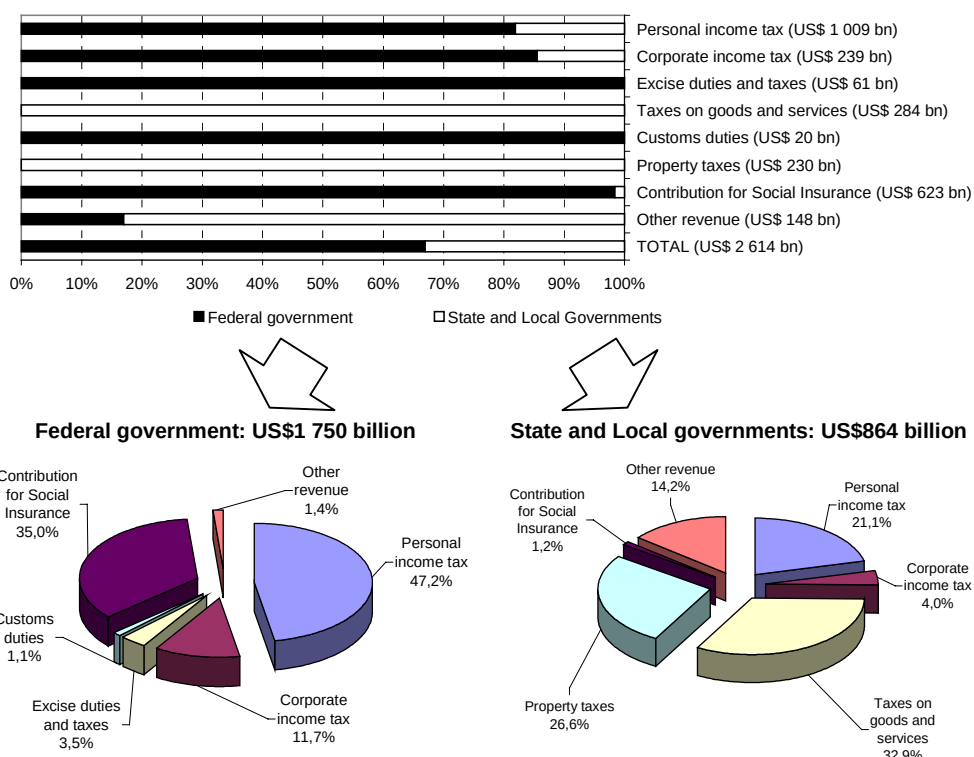
Taxation

The American Constitution assigns independent taxation powers to the federal legislator and to the states, while local governments have rights devolved to them by the states. All taxes are own taxes in the United States, that is, the political entities that levy them are free to define the tax bases and the rates that apply to them.

The federal government, state and often even local governments collect their own taxes. The federal government offered to collect states' income taxes for them in 1972, but the offer has yet to be accepted by any state. As a result, the tax system is decentralized and varies from state to state and locality to locality. In addition, several orders of government often occupy the same tax fields.

CHART 14

BREAKDOWN AND MIX OF REVENUE – 1998 (Percentage of total)



Note : All amounts in American dollars (US\$).

Source : National Income and Product Accounts (NIPA), Bureau of Economic Analysis.

The federal government is authorized to collect revenue from all possible sources, except revenue from property taxation.⁵⁷ It collects over 60% of the revenue collected by all orders of government. Its largest sources of revenue are personal income tax and contributions to social insurance plans, chiefly Social Security and Medicare. Corporate income tax generates about 10% of its revenue.

⁵⁷ Including dividends according to constitutional jurisprudence.

By virtue of their residual authority, the states can not only impose taxes in fields that are not within federal jurisdiction, but also exercise concurrent competence in federal areas of taxation. However, states may not impose customs duties.

State and local governments have varied revenue sources. Sales taxes, both general and specific, were their main source of revenue in 1998, a situation that was facilitated by the fact that the federal government decided not to introduce a general sales tax. Other significant sources of revenue are property taxes, a field dominated by local government, and personal income tax. In this latter field, there is considerable variety among states' fiscal practices: seven states do not impose an income tax, two tax only investment income, while the tax rates of the other states differ from one place to another and close to 4 000 local governments spread over 11 states and the District of Columbia tax personal income.

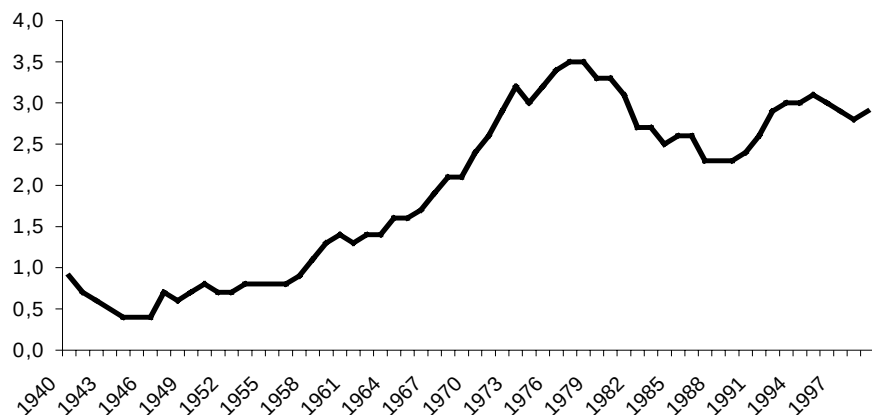
Intergovernmental fiscal relations

Transfer programs

Over the last fifty years, the total volume of transfers from the federal government to the states and municipalities has risen in relation to the size of the American economy, in particular because the role of the federal government in funding social programs administered by the states has grown. After falling as a result of the reductions in transfers ordered by the Reagan administration in the 1980s, this proportion rose to a level comparable with where it stood in 1981, namely 3% of GDP for 2001.

CHART 15

FEDERAL INTERGOVERNMENTAL TRANSFERS – 1940-1999
(Percentage of GDP)



Source : United States budget, 2001.

In 1995, there were 633 different federal transfer programs to state and local governments, 617 of which funded specific programs (75% of total funds transferred) and 16, broader sectors of activity. For all programs, the funds are accompanied by more or less rigid conditions on their use.

Health

The largest portion of the amounts of federal transfers is used to fund health programs administered by the states. The federal and state governments allocate over US\$200 billion to the Medicaid program, which provides health care for about 40 million low-income Americans. The federal portion of the funding for this program ranges from 50% to 83%, depending on the per capita income of the state in relation to the national average.

States have considerable leeway in how they implement the program (eligibility conditions, range of benefits, etc.) but they must satisfy certain conditions set by the federal government.

In particular, the federal government requires that some categories of individuals (recipients of certain welfare benefits, pregnant women and infants living in families whose income is 133% or less of the official poverty line and children of families whose income is below the official poverty line) be automatically admitted to the program.

In addition, under the Children Health Insurance Program (CHIP), children of families whose income is below 200% of the poverty line are eligible for the Medicaid program. The federal government pays block funding grants to the states, its participation ranging from 65% for affluent states such as Connecticut, to 84% for a state such as Mississippi.

Other transfer programs

Federal transfers also fund welfare programs, which are increasingly under state responsibility since the 1996 reform (*The Personal Responsibility and Work Opportunity Reconciliation Act*). In particular, this reform brought about the replacement of 44 federal programs with five programs providing the states with lump-sum transfers.

The amounts paid to the states depend on the amounts of federal transfers previously received, during the 1992-1995 period, under certain programs replaced⁵⁸ by the Temporary Assistance to Needy Families (TANF) program. The overall envelope paid to the states for the TANF program is US\$16.8 billion a year for the period from 1998 to 2002.⁵⁹ There is also an emergency fund of US\$2.5 billion over five years for special needs in states

⁵⁸ Aid to Families with Dependent Children (AFDC) for instance, which was a shared-cost program where the federal government's share varied between 50% and 64%, depending on the state's per capita income.

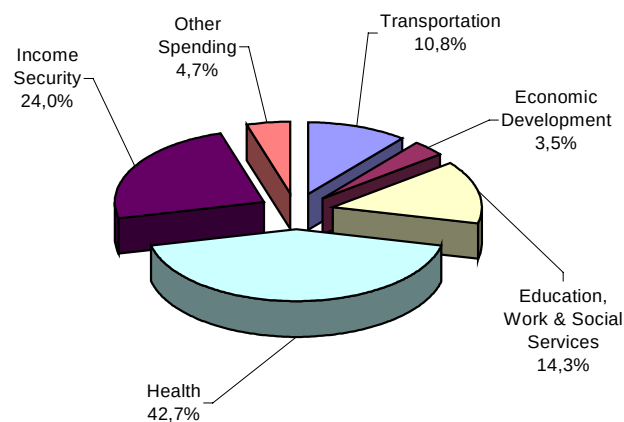
⁵⁹ Neil Bruce, *Public Finance and the American Economy*, 2001.

where unemployment is high and rising. States must cover all the costs associated with an improvement to the program beyond the federal envelope.

Penalties are stipulated in the event of non-compliance with federal conditions and performance bonuses may be paid to states whose efforts to reintegrate individuals into the labour market and to prevent childbirth out of wedlock are successful.

CHART 16

BREAKDOWN OF TOTAL FEDERAL TRANSFERS TO STATE AND LOCAL GOVERNMENTS BY FUNCTION – 1998
(Percentage of total)



Source : Statistical Abstract of the United States 2000, U.S. Census Bureau.

Federal transfers also fund programs in the fields of education (such as funding of programs for handicapped and less-affluent children) and transport (such as public transit and highway infrastructures). In the case of amounts paid by the Highway Trust Fund, the federal share of programs funded this way often reaches 90%.

Equalization

There is no program of unconditional transfers designed to reduce or eliminate disparities in fiscal capacity between states. However, such equalization mechanisms exist in certain states to reduce disparities in resources between school districts, whose funding is based on taxes unequally distributed throughout the state.

Some federal transfer programs lead to a degree of redistribution among states. For almost all programs whose amounts are established by a calculation formula (Formula Grants), federal assistance is granted on the basis of needs (for instance, per capita income in the state). Nonetheless, the General Accounting Office of the United States, in a study published in

1996,⁶⁰ concluded that the American transfer system does not allow states with a low fiscal capacity to provide a level of services comparable with that of states with a greater fiscal capacity.

Dispute settlement mechanisms

There is no formal decision-making mechanism bringing together representatives of the various orders of government in the United States. Direct lobbying of members of Congress is the preferred method by which state governments try to influence the formulation of policies that affect them.

At the federal level, the Senate governmental affairs committee and the House committee on government reform are both charged with studying the impact of legislation on relations between the federation and the states.

There are a number of associations among the states, such as the National Governors Association and the Council of State Governments, through which states exchange information and, in some cases, formulate common points of view in dealing with the federal government.

The Supreme Court can be seized of any dispute involving intergovernmental relations and jurisdictional conflict.

Outlook

The reform of welfare programs and of their intergovernmental funding mechanisms⁶¹ in 1996 helped to change the relative role of the two orders of government in the United States. This reform is part of a broader devolution of federal responsibilities to the states,⁶² accompanied by attempts to reduce federal regulatory interventions.⁶³ As funding for the programs created by the 1996 legislation comes up for renewal, experts are attempting to assess the success of the reform.

When the reform was adopted, some analysts predicted that the move from shared-cost funding to block funding would make states less generous. Today, when a state improves its program, it must bear the entire cost.

However, that is not the conclusion of the General Accounting Office. In a recent study, it shows that many states have maintained, and even increased, spending on various welfare and reintegration programs, taking into account the fact that job creation in recent years has reduced needs. The

⁶⁰ United States General Accounting Office, *Federal Grants: Design Improvements Could Help Federal Resources Go Further*, December 1996.

⁶¹ Most of the budget authorizations funding TANF expire at the end of fiscal year 2002.

⁶² In particular, see Robert Tannenwald, *Devolution: The New Federalism, an Overview*, New England Economic Review, May/June 1998.

⁶³ The *Unfunded Mandates Act* of 1995 is the main example of such efforts and is designed to prevent the federal government from imposing mandates on the states without funding them.

study's authors note that states have often made use of their greater administrative autonomy and the resources made available by the favourable economic situation to implement and fund new social policies.⁶⁴ This appears to support the views of those who forecast that the reform would favour social policy diversity.

More generally, it is difficult to assess the success of the reform. While most analysts maintain that the reform played a role in reducing the number of welfare recipients and in the greater efforts by states to reintegrate them in the labour market, they acknowledge that it is difficult to separate the impact of the reform from that of sustained economic growth.

⁶⁴ United States General Accounting Office, *Welfare Reform: Challenges in Maintaining a Federal-State Fiscal Partnership*, August 2001.

SWITZERLAND

Institutional framework

Switzerland, the second-oldest modern federation after the United States, became a federation in 1848. Today, it consists of 26 Cantons, each having its own constitution, parliament, government and courts.

The federal parliament, called the Federal Assembly, consists of the Council of States (senate), which represents the Cantons, and the National Council (house of representatives), which represents the people. The two houses have equal legislative powers.

Snapshot

Official name: Swiss Confederation
Capital: Bern
Population: 7.3 million
Federation: 1848
Official languages: German, French, Italian, Romansch
Currency: Swiss franc
Public spending (2000): 37.7% of GDP

The Federal Council, a collegial body of seven members elected by the Federal Assembly, exercises executive power. The members of the Federal Council must come from different Cantons. Traditionally, the three major language groups are represented. Each year, one of the seven members is elected President of the Confederation by the Federal Assembly and acts as head of state, but enjoys no significant precedence over the other members of the Federal Council. Since 1959, representatives from the four major parties hold seats on the Federal Council according to the so-called “magic formula” of 2-2-2-1.

The Council of States has 46 members, i.e. two per Canton, except for six small Cantons that have one member each. Members are elected by the people according to rules set individually by each Canton. A majority vote is held throughout, except in the Jura where a proportional system is used. In four Cantons, the members of the Council of States are chosen by the assembly of citizens of the Canton (*Landsgemeinde*). In the National Council, the 200 seats are distributed in proportion to the population of the Cantons, though each Canton is entitled to at least one seat. The members of the National Council are elected according to a proportional system.

Referendums and popular initiatives play an important role in Swiss political life. If asked by 50 000 electors or eight Cantons, any federal law, certain federal decisions and certain international treaties must be submitted to a referendum. Constitutional changes passed by the Federal Assembly are

required to be ratified by referendum, by a majority of the people and by a majority of Cantons. If a draft constitutional amendment is supported by 100 000 voters, it must also be submitted to a referendum.

Each Canton has its own constitution. The form of government is fairly close to what exists at the federal level, and the referendum is common. However, cantonal parliaments have only one house and the members of the collegial executive are sometimes elected by direct universal suffrage.

The Cantons are subdivided into 2 896 political communes. Almost one commune in five has its own parliament, while four out of five still engage in direct democracy, within the commune's assembly.

Division of responsibilities

General division of powers

Under article 3 of the federal Constitution, "the Cantons are sovereign to the extent that their sovereignty is not limited by the federal Constitution and exercise all the rights not delegated to the Confederation." This principle gives rise to the very great importance attached to the application of the principle of *subsidiarity*⁶⁵ in the distribution of responsibilities between the Cantons and the federal government.

The competencies of the federal parliament are set by the federal Constitution.⁶⁶ In particular, the Confederation has jurisdiction over foreign policy, national security, customs, currency, civil law and criminal law. It also has jurisdiction in fields that affect the general interest and can legislate on any matter concerning the national territory as a whole. Tasks not expressly within its jurisdiction are under the responsibility of the Cantons, which accordingly enjoy a residual power.

Even in fields reserved to the Confederation, the Cantons can pass legislation complementary to federal law when the Confederation has not yet exercised its authority. Accordingly, there are many fields of joint (or concurrent) jurisdiction. Furthermore, the Cantons frequently carry out duties assigned to the Confederation. In particular, the Cantons are responsible for education, hospitals and prisons, though the Confederation can provide them with funding in these fields.

The Cantons decide the degree of autonomy of the communes, which can vary considerably from one Canton to the next. The communes assume responsibility for education, social services, energy supply, road infrastructures and land use planning, as well as carrying out a variety of

⁶⁵ Subsidiarity: principle according to which jurisdiction must be attributed to the order of government closest to the citizen and must not be attributed to the distant government (for instance: federal government) unless required for efficient provision of public goods and services.

⁶⁶ Articles 54 to 135 of the Constitution.

tasks assigned to them, such as maintaining the record of residents or civil protection.

Federal spending power

Decisions relating to the exercise of federal spending power in the Cantons' fields of jurisdiction belong to the federal government. However, the latter must consult with the Cantons in certain circumstances and, especially, any federal law can be contested by referendum. As a result, the cantonal governments have an effective influence on the exercise of federal spending power.

Spending

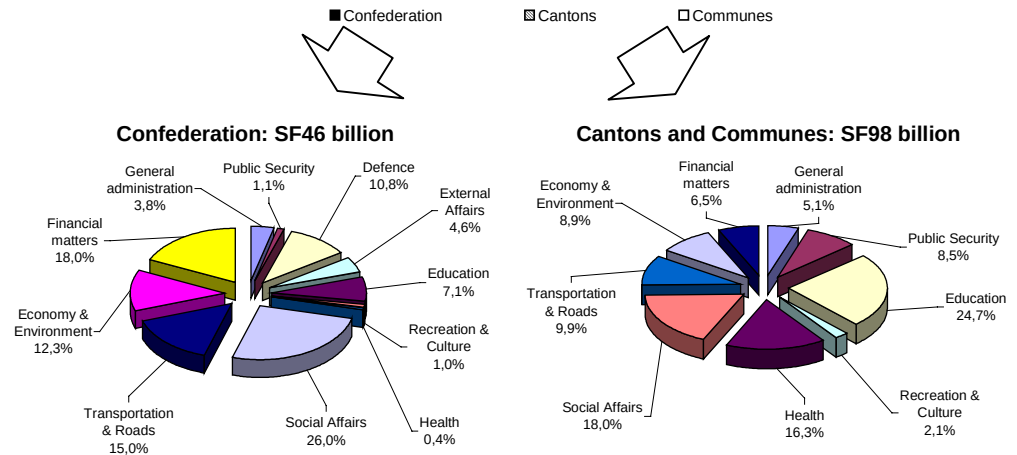
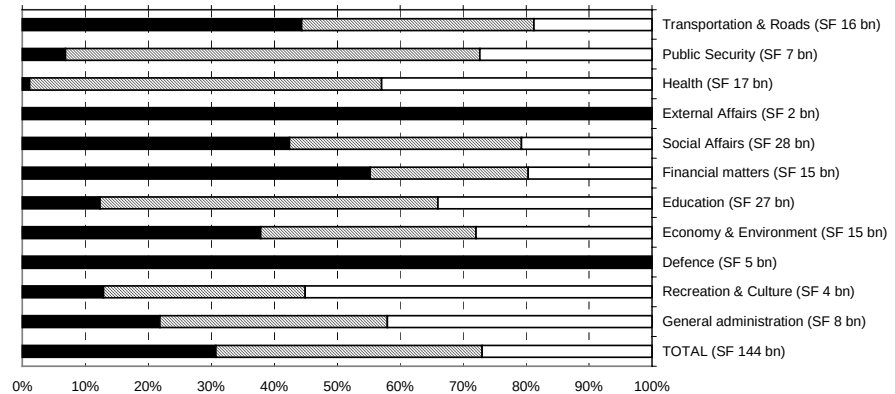
The Cantons carry out most public spending, that is, 42% of all public expenditures. Education, social affairs, and health represent almost 60% of their expenditure budget. Social affairs is also one of the Confederation's largest budget items (26% of spending), followed by financial matters, including debt, and transportation.

Education is a good example of the application of the principle of subsidiarity. In this field, the Communes assume spending tied to kindergartens and public schools, while the Cantons cover the expenses of the college and university system, with little involvement by the Confederation, its share of spending corresponding essentially to some specific transfers. As a result, the Cantons cover 54% of these expenditures, the Communes 34% and the Confederation, 12%.

Some explanation is required for the data regarding health spending, which seem to indicate that the federal government is virtually absent. The Confederation is empowered to pass framework laws that the Cantons and the Communes are charged with implementing.

CHART 17

BREAKDOWN AND MIX OF PUBLIC SPENDING – 1999 (Percentage of total)



Notes : All amounts in Swiss francs (SF). *Transportation & Roads* function corresponds mainly to ground transportation while the *Economy & Environment* function includes land use, tourism, agriculture and energy. Some spending may be counted twice when specific transfers to an item are not recorded as such but rather as expenditures under such item, both for the administration that makes the transfer and the one that receives it. This may inflate either the Confederation's spending or that of the Cantons and Communes because of transfers between these orders of government.

Source : *Administration fédérale des finances*, Switzerland.

Taxation

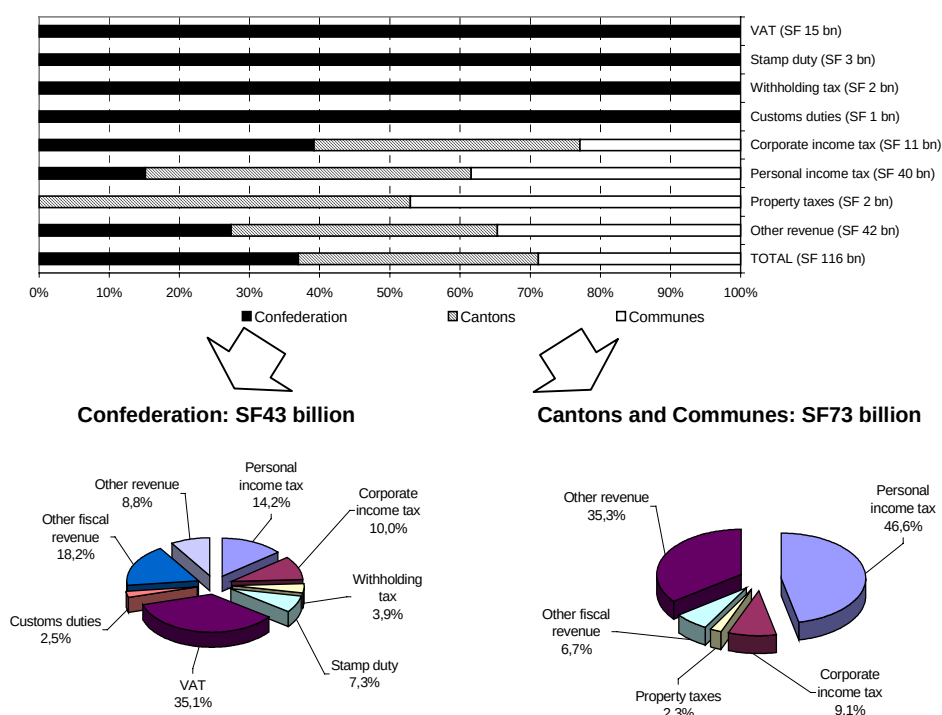
While the Constitution defines the division of fiscal jurisdictions very specifically, many taxes fall into the so-called “parallel jurisdictions” category.⁶⁷ In particular, the Constitution stipulates that the federal government, working with the Cantons, must ensure the harmonization of direct taxes. Accordingly, a tax harmonization law, gradually implemented

⁶⁷ Where the two orders of government can intervene simultaneously and independently.

between 1993 and 2001, allows a degree of coherence among cantonal laws, especially regarding the definition of tax bases.

CHART 18

BREAKDOWN AND MIX OF REVENUE – 1999 (Percentage of total)



Notes : All amounts in Swiss francs (SF). Value added tax (VAT). Shared taxes and specific transfers are excluded from the revenue of Cantons and Communes (SF26 billion). Accordingly there is no double counting of these amounts, unlike in the previous chart. *Corporate income tax* includes tax on corporate profits and on capital. *Property taxes* includes taxes on transfer of immovable property. *Other fiscal revenue* includes: tax on capital gains, gifts and inheritance taxes, taxes on goods and services (excluding VAT and customs duties) and revenue of government's fiscal monopolies. *Other revenue* contains revenue from public property, indemnities and sales of goods and services.

Source : *Administration fédérale des finances*, Switzerland.

In addition, the Constitution stipulates that the Cantons must comply with four major taxation principles: exclusivity of federal taxes, federal immunity, respect for basic rights and the territoriality of tax. It also stipulates that the Cantons are not authorized to collect taxes on objects exempted by the Confederation or already subject to value added tax (VAT), to special taxes, to the federal stamp duty or the withholding tax.

Nonetheless, the Cantons enjoy considerable fiscal autonomy and have relatively broad jurisdiction regarding fiscal policy. Their most important own

taxes are the personal income tax, the tax on the income and capital of corporations, the tax on real property gains, and inheritance taxes.

The Confederation has exclusive jurisdiction over customs duties, the VAT, and a number of specific taxes. The Constitution also stipulates a maximum tax rate for certain taxes levied by the Confederation, such as the VAT and taxes on income, investment return and capital.

In addition, many taxes are shared between the Confederation and the Cantons, namely the federal direct tax⁶⁸ (FDT, shared 70/30% between the Confederation and the Cantons), the withholding tax (90/10%), the military exemption tax (80/20%), the alcohol tax (90/10%) and the tax on games and entertainment (25/75%).

Lastly, the communes have significant prerogatives in the taxation field in view of the importance of their duties. In general, the three orders of government collect their own taxes.

Intergovernmental fiscal relations

Equalization

There are significant fiscal disparities between the Cantons.⁶⁹ In 2000-2001, on the basis of an index of 100, the wealthiest Canton (Zug) had a fiscal capacity of 218, while the poorest (Valais) had a capacity of 30.

To lessen these disparities, equalization is carried out by means of the various intergovernmental transfer programs. The funds transferred under these programs are distributed according to an index of fiscal capacity of the Cantons.⁷⁰ Transfer programs are grouped into three broad categories: specific transfers, cantonal shares of federal revenue, and transfers of federated entities to the Confederation.

Specific transfers

Specific transfers are used to fund projects in some forty spending sectors and are accordingly tied to the spending of the Cantons. The federal government's share of funding is generally defined so that these transfers effect a redistribution of wealth among Cantons.

However, these transfers benefit the wealthy Cantons most since they have greater spending capacity and accordingly receive larger subsidies, even if their funding rate is lower.

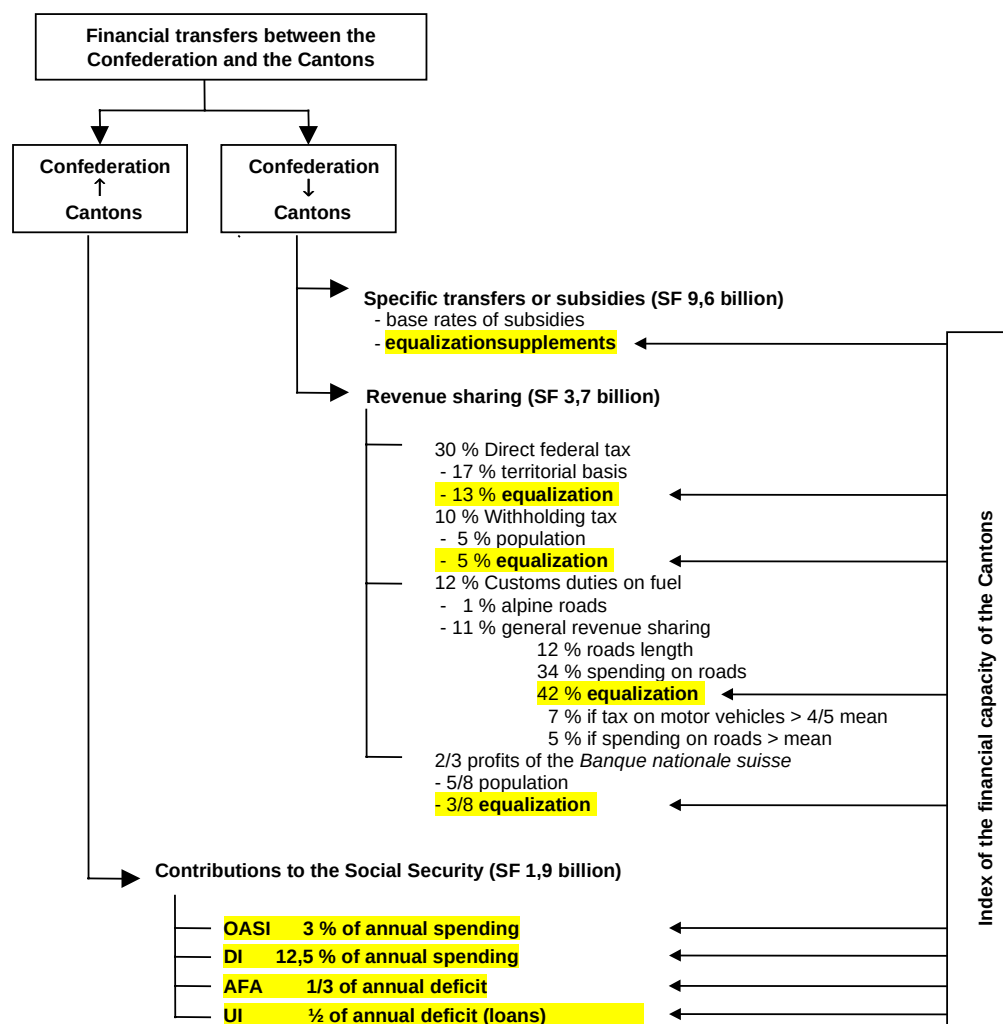
⁶⁸ The FDT includes federal taxes on income, wealth, investment return, capital and capital gains.

⁶⁹ However, the disparity is accentuated by the small cantons.

⁷⁰ Article 135 of the Constitution provides that the Confederation encourages financial equalization among the cantons and that in granting subsidies, it takes the financial capacity of the cantons into consideration.

DIAGRAM 3

TRANSFERS AND EQUALIZATION BETWEEN THE CONFEDERATION AND THE CANTONS



Notes : All amounts in Swiss francs (SF). Components of fiscal relations in which there is equalization are indicated in underlined bold type. Old age and survivorship insurance (OASI), disability insurance (DI), agricultural family allowance (AFA) and unemployment insurance (UI).

Sources : Dafflon (2001), using data from the *Administration fédérale des finances* (2001) and Dafflon (1995), with permission from the author.

Cantonal shares of federal revenue

The Cantons and the Confederation share revenue from the federal direct tax, the withholding tax, earnings of the National Bank and customs duties on fuel. In the latter case, the funds are paid in the form of a refund to the Cantons to compensate them for expenditures imposed by the federal Constitution (e.g.: national highways).

Sharing is as follows:

- 30% of the proceeds of the federal direct tax is paid to the Cantons, with 17% distributed in the territory of origin (territoriality principle) and 13% according to an equalization rule that takes the index of financial capacity of each Canton into account;
- 10% of the revenue from the withholding tax is paid to the Cantons. Half is returned to the Cantons on an equal per capita basis and the other half on the basis of their respective financial capacity;
- up to 12% of customs duties on fuel is paid to the Cantons, with almost half (42%) according to a redistribution criterion;
- two thirds of the earnings of the Swiss National Bank are paid to the Cantons, of which five eighths is on a territorial basis and three eighths on the basis of financial capacity.

Transfers from federated entities to the Confederation

The Cantons contribute to federal spending under four programs, namely old age and survivorship insurance (OASI), disability insurance (DI), agricultural family allowances (AFA) and unemployment insurance (UI).

These cantonal contributions are subject to a certain form of equalization since the financial capacity indices of the Cantons are used to distribute the funds transferred to the Confederation. However, sharing rules vary from program to program.

Financial capacity index

The financial capacity index is used in the distribution formulas of specific transfers, cantonal shares of federal revenue and cantonal contributions to federal spending. The index is calculated by including:

- per capita cantonal revenue (30% weighting);
- potential per capita tax revenue (30% weighting);
- the tax burden (20% weighting);
- the needs of the Cantons (20% weighting).

However, this index has come under severe criticism, especially because of its complexity and lack of transparency. The index of financial capacity takes various forms depending on the program under consideration, which makes it difficult to measure the results of equalization mechanisms.

Dispute settlement mechanisms

There is no official dispute settlement mechanism dealing with the fiscal arrangements between the Cantons and the Confederation. Since there is no distinction between governments' powers to legislate and spend, if a federal law is judged unacceptable by a cantonal government, it can block or slow the process by referendum, either by obtaining the support of seven other governments, or by obtaining a sufficient number of signatures within the Canton.

The country's supreme legal authority is the Federal Tribunal, consisting of 30 members elected by the Federal Assembly for a renewable term of six years. These judges are chosen according to criteria of competence, language, party affiliation and regional considerations. The tribunal is the final authority for deciding disputes between the Cantons and the Confederation. It can declare cantonal, but not federal, laws invalid.

Outlook

The existing equalization system, introduced in 1959, generates so many bi-directional financial flows between the Confederation and the Cantons that it is difficult to determine whether it actually achieves its objectives.

Some experts consider that the chief objective of financial equalization, namely reducing inequalities between wealthy Cantons and poor ones, is not being achieved and that the Cantons, by relying on transfers to fund part of their responsibilities, have lost part of their budgetary and political autonomy. In addition, in many sectors there are incentives that favour increased spending over more efficient management.

In these circumstances, the federal administration and the Cantons came together, in 1990, to set up a joint organization to propose a reform of equalization and review the distribution of functions within the Confederation. If this reform is implemented, each administrative function will be assigned to the order of government best equipped to carry it out efficiently, which would result in greater concern paid to citizens and enhanced efficiency and cost-effectiveness. It will give practical expression to the principle of subsidiarity that is the basis of the Confederation's operation.

However, any reform must be undertaken within the existing system that provides for the use of referendums and petitions. Accordingly, reforms are often lengthy and their results uncertain. For instance, a proposed reform of

conditional transfers failed in 1966. In 1971 and 1978, attempts to introduce a new division of tasks also failed.

In this context, many experts fear that the current proposal, in view of its scope, will meet the same fate. These fears are all the stronger since a number of Cantons have publicly expressed their reticence regarding the reform following the publication of studies, in November 2000, showing that some of them would be financially penalized by the proposed equalization mechanisms.

DESCRIPTIVE TABLES

TABLE A1

THE GERMAN *LÄNDER*

<i>Länder</i>	Date of entry in the Confederation	Population in 2000 Millions of inhabitants	Votes in the <i>Bundesrat</i> Number
13 territorial <i>Länder</i>			
<i>Baden-Württemberg</i> (Baden-Wurttemberg)	1952	10.50	6
<i>Bayern</i> (Bavaria)	1949	12.18	6
<i>Hessen</i> (Hesse)	1949	6.06	5
<i>Niedersachsen</i> (Lower-Saxony)	1949	7.91	6
<i>Nordrhein-Westfalen</i> (North Rhine-Westphalia)	1949	18.00	6
<i>Rheinland-Pfalz</i> (Rhineland-Palatine)	1949	4.03	4
Saarland	1957	1.07	3
<i>Schleswig-Holstein</i>	1949	2.78	4
<i>Brandenburg</i> (Brandenburg)	1990	2.60	4
<i>Mecklenburg-Vorpommern</i> (Mecklenburg-Western-Pomerania)	1990	1.78	3
<i>Sachsen</i> (Saxony)	1990	4.44	4
<i>Sachsen-Anhalt</i> (Saxony-Anhalt)	1990	2.63	4
<i>Thüringen</i> (Thuringa)	1990	2.44	4
3 Cities-State			
Berlin	1949 and 1990	3.38	4
Bremen	1949	0.66	3
Hamburg	1949	1.71	3
TOTAL		82.17	69

Sources : *Bundesrat* 2001.

TABLE A2**THE AUSTRALIAN STATES AND TERRITORIES**

States and Territories	Population in 2000	Disposable income in 2000	Relativity coefficient in 2001-2002	Amount of VAT in 2001-2002
	Number of inhabitants	A\$ per capita	100 Scale	A\$ per capita
6 States				
<i>New South Wales</i>	6 497 259	23 009	92.032	1 267
<i>Victoria</i>	4 795 911	22 486	87.539	1 198
<i>Queensland</i>	3 596 572	19 899	100.269	1 422
<i>Western Australia</i>	1 896 120	21 741	97.516	1 373
<i>South Australia</i>	1 500 353	19 951	117.941	1 688
<i>Tasmania</i>	470 231	17 972	150.095	2 316
2 Territories				
<i>Australian Capital Territory</i>	311 294	29 364	114.633	1 737
<i>Northern Territory</i>	197 364	21 751	402.166	6 666
TOTAL (Continental Australia)	19 265 104	21 904	100.000	1 410

Notes : Australian dollars (A\$). Continental Australia excludes external territories under administration.

Sources : Australian government, Budget Paper number 3, Federal Financial Relations 2001-2002 and Australian Bureau of Statistics.

TABLE A3**THE BELGIAN REGIONS AND COMMUNITIES**

Federated Entities	Year of constitution	Population in 1999	Provinces	Communes
		Millions of inhabitants	Number	Number
3 Regions				
Flemish Region (Flanders)	1980	5.93	5	308
Walloon Region (Wallonia)	1980	3.33	5	262
Brussels-Capital Region	1989	0.95	0	19
TOTAL		10.21	10	589
		Distribution as a % of the total	Number	Number
3 Communities				
Flemish Community	1970	Approx. 60 %	—	327
French Community	1970	Approx. 40 %	—	272
German-speaking Community	1983	Less than 1 %	—	9
TOTAL		10.21	—	608

Note : Both the French and Flemish Communities have jurisdiction over the Brussels-Capital Region. Therefore, the Communes of this region are included twice in the total : 589 + 19 = 608.

Sources : *Service fédéral belge d'information* and OECD (1997).

TABLE A4**THE SPANISH AUTONOMOUS COMMUNITIES AND CITIES**

Regional entities	Year of adoption of the autonomous status	Population in 1998	GDP in 1998	Provinces
		Millions of inhabitants	PTA per capita	Number
17 Autonomous Communities				
- Under the <i>foral</i> regime				
• País Vasco (Basque Country)	1979	2.10	2 637 506	3
• Navarra (Navarre)	1982	0.53	2 695 945	1
- Under the common regime				
Article 151				
• Cataluña (Catalonia)	1979	6.15	2 845 089	4
• Galicia (Galicia)	1981	2.72	1 942 136	4
• Andalucía (Andalusia)	1981	7.26	1 662 807	8
• Comunidad Valenciana (Valencia)	1982	4.03	2 295 223	3
• Canarias (Canary Islands)	1982	1.64	2 244 096	2
Article 143				
• Asturias	1981	1.08	1 964 694	1
• Cantabria	1981	0.53	2 138 849	1
• La Rioja (Rioja)	1982	0.26	2 583 943	1
• Murcia (Murcia)	1982	1.12	1 839 837	1
• Aragón (Aragon)	1982	1.18	2 504 889	3
• Castilla-La Mancha (Castila-La Mancha)	1982	1.72	1 840 467	5
• Islas Baleares (Balearic Islands)	1983	0.80	3 554 649	1
• Castilla y León (Castile and Leon)	1983	2.48	2 109 499	9
• Extremadura (Extremadura)	1983	1.07	1 685 843	2
• Madrid	1983	5.10	2 911 311	1
2 Autonomous cities				
Melilla and Ceuta	1983	0.13	1 707 610	—
TOTAL		39.90	2 301 071	50

Note : Pesetas (PTA).

Sources : Castells (2001) and Ministerio de Administraciones públicas.

TABLE A5

THE AMERICAN STATES

States and Federal district	Year of entry	Population in 1999	GDP in 1999	Relative financial capacity index (avg. 1992-1994)
		Thousand of inhabitants	US\$ per capita	100 Scale
50 States				
Alabama	1819	4 370	26 332	92
Alaska	1959	620	42 505	134
Arizona	1912	4 778	30 072	88
Arkansas	1836	2 551	25 391	90
California	1850	33 145	37 082	95
Colorado	1876	4 056	37 901	102
Connecticut	1788	3 282	46 246	115
Delaware	1787	754	45 980	123
Florida	1845	15 111	29 309	93
Georgia	1788	7 788	35 403	99
Hawaii	1959	1 185	34 527	99
Idaho	1890	1 252	27 177	93
Illinois	1818	12 128	36 747	107
Indiana	1816	5 943	30 658	100
Iowa	1846	2 869	29 712	104
Kansas	1861	2 654	30 461	107
Kentucky	1792	3 961	28 664	96
Louisiana	1812	4 372	29 497	97
Maine	1820	1 253	27 186	94
Maryland	1788	5 172	33 780	102
Massachusetts	1788	6 175	42 520	107
Michigan	1837	9 864	31 256	98
Minnesota	1858	4 776	36 219	107
Mississippi	1817	2 769	23 216	85
Missouri	1821	5 468	31 176	103
Montana	1889	883	23 370	94
Nebraska	1867	1 666	32 259	111
Nevada	1864	1 809	38 620	109
New Hampshire	1788	1 201	36 827	101
New Jersey	1787	8 143	40 715	106
New Mexico	1912	1 740	29 325	90
New York	1788	18 197	41 468	106

TABLE A5

THE AMERICAN STATES (CONT'D)

States and Federal district	Year of entry	Population in 1999	GDP in 1999	Relative financial capacity index (avg. 1992-1994)
		Thousand of inhabitants	US\$ per capita	100 Scale
North Carolina	1789	7 651	33 798	105
North Dakota	1889	634	26 800	102
Ohio	1803	11 257	32 156	101
Oklahoma	1907	3 358	25 724	92
Oregon	1859	3 316	33 080	96
Pennsylvania	1787	11 994	31 931	102
Rhode Island	1790	991	32 842	95
South Carolina	1788	3 886	27 513	92
South Dakota	1889	733	29 510	106
Tennessee	1796	5 484	31 015	100
Texas	1845	20 044	34 288	98
Utah	1896	2 130	29 409	86
Vermont	1791	594	28 896	96
Virginia	1788	6 873	35 242	103
Washington	1889	5 756	36 355	105
West Virginia	1863	1 807	22 515	87
Wisconsin	1848	5 250	31 711	102
Wyoming	1890	480	36 350	121
1 Federal district				
District of Columbia	1791	519	n.a.	n.a.
TOTAL		272 691	34 137	

Note : American dollar (US\$). For states with entry date prior to 1789, the year listed is the year in which they ratified the Constitution written down in Philadelphia in 1787. The relative financial capacity index is the *Total Taxable Resources index*, which is a measure of a state's *per capita* total taxable resource base relative to the U.S. *per capita* total taxable resource base.

Sources : Bureau of Economic Analysis, US Census Bureau and US Department of the Treasury.

TABLE A6

THE SWISS CANTONS

Cantons	Population in 1998	Financial capacity index in 2000-2001	Official languages
	Number of inhabitants	100 Scale	
Appenzell-Outer Rhodes	53 816	59	German
Appenzell-Inner Rhodes	14 873	60	German
Aargau	536 462	100	German
Basel-Country	256 761	120	German
Basel-City	190 505	158	German
Berne	941 144	66	German and French
Fribourg	232 086	52	German and French
Geneva	398 910	130	French
Glarus	38 698	78	German
Graubünden	186 118	75	German, Italian and Romansch
Jura	68 995	31	French
Lucerne	343 254	72	German
Neuchâtel	165 594	58	French
Nidwalden	37 320	124	German
Obwalden	31 989	40	German
St. Gallen	444 891	82	German
Schaffhausen	73 725	106	German
Schwyz	126 479	96	German
Solothurn	243 450	87	German
Ticino	306 179	78	Italian
Thurgau	226 479	87	German
Uri	35 612	67	German
Valais	274 458	30	German and French
Vaud	611 613	95	French
Zug	96 517	218	German
Zurich	1 187 609	157	German
TOTAL	7 123 537	100	

Sources : Dafflon (2000) and Bullinger (2001).

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