

2008 IACFS CONFERENCE  
Barcelona, September 19-20

**Decentralizing and re-centralizing trends  
in the distribution of powers within federal countries**



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Edició digital: abril de 2009  
ISBN: 978-84-393-8018-4

## **PAPERS GIVEN TO THE ANNUAL CONFERENCE OF The International Association of Centers for Federal Studies (IACFS). BARCELONA 2008**

### Presentation

The IACFS held its annual meeting in Barcelona on 19 and 20 September. The *Institut d'Estudis Autonòmics* (IEA), which has been a member of the IACFS since 1993, was for the first time hosting the Association's principle activity, which brings together members of institutes dedicated to the study of federalism and allows them to exchange experiences.

The theme around which the meeting was based was the workings in practice of federal systems, beyond the constitutional texts, of the different systems of distribution of powers in federal countries. It dealt with the subject from the perspectives of the main recentralizing and decentralizing tendencies.

In this way, the various papers gave a country-based overall assessment depicting the recent and historical decentralizing and recentralizing trends of the system, indicating the main factors that promoted them and, chiefly, assessing and evaluating the importance of the effects and consequences of these factors in shaping the political system's actual institutional direction.

So, in the majority of cases it included the analysis of issues such as the extent of the expansiveness of federal powers through the use of framework, concurrent and overlapping competences; the federal governments' spending power and its consequences upon the states' competences; the attribution of powers through the argument of constitutional concepts or principles (i.e., the claim for "general interest", the supra-territorial effects of a rule,...); the supranational membership and its effects on the domestic distribution of powers; the constitutional courts' rulings affecting the distribution of powers, and the different devolution mechanisms.

By analysing all or some of these phenomena, or focusing on one of them to study it in depth, or even pointing out others that are characteristic of a particular system, the annual meeting served as a way of exchanging a large number of experiences relating to the issue described. Some 34 experts from 21 institutes in 13 federal and compound countries took part, and 13 papers were presented. Over the following pages, the majority of the presented papers are made available; these will offer the best proof of what has just been said.

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## TABLE OF CONTENTS

CENTRALISATION AND DECENTRALISATION OF FISCAL FEDERALISM IN GERMANY

Gisela Färber; Kira Baranova

THE DISTRIBUTION OF COMPETENCES AND THE TENDENCY TOWARDS CENTRALIZATION  
IN THE ARGENTINE FEDERATION

Antonio M. Hernández

CENTRALISED POWER AND DECENTRALISED POLITICS IN THE DEVOLVED UK

Akash Paun; Robert Hazell

THE IMPACTS OF THE NEW COOPERATIVE AND TRIPARTITE FEDERALISM ON THE TRADITIONAL  
DISTRIBUTION OF COMPETENCES IN AUSTRIA

Peter Pernthaler

1948-2008: THE UPS AND DOWNS OF A 60 - YEARS – LONG DECENTRALIZATION (?) PROCESS  
IN ITALY

Giancarlo Pola

PRESENT CENTRALIZATION IN RUSSIAN FEDERALISM: ECONOMIC EFFECTS AND INTERACTIONS

Viacheslav Seliverstov

CENTRALISATION AND DECENTRALISATION TRENDS IN SPAIN. AN ASSESSMENT OF THE PRESENT  
ALLOCATION OF COMPETENCES BETWEEN THE STATE AND THE AUTONOMOUS COMMUNITIES

Carles Viver

THE EVOLUTION OF POWERS IN THE CANADIAN FEDERATION

Ronald L. Watts

## Centralisation and Decentralisation of Fiscal Federalism in Germany

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### 1. Introduction

German federalism shows among the countries with a federal constitution a comparably high degree of centralisation because the concept of administrative or executive federalism gives large legislation powers to the federation whereas the execution of federal laws generally is decentralised to the states. The recent – first – federalism reform has shifted some important competences to the states – among them the salaries and pensions of the civil service – and has completely abolished the so called frame legislation.<sup>1</sup> Most of the crucial subjects of the fiscal constitution were together with questions of administration excluded from the negotiations of the –first– commission but restarted two years ago in a second commission in which representatives of federal and state parliaments and governments intend to find solutions.

To understand the political discussion and the proposals submitted by politicians and academic experts – this time not members of the commission<sup>2</sup> – in this paper, the state of German fiscal federalism is explained and empirically enlightened analyzing whether the issues after German unification have lead to centralisation or to decentralisation. The paper only exceptionally focuses on the federal patterns of expenditures but more on the revenue side, particularly on tax receipts, fiscal equalisation and public debt. In these fields, there is a dominant influence of the federation from the side of tax legislation although for all changes of taxes of which the Länder and local governments receive the revenues the approval of the Bundesrat is necessary. State fiscal equalisation in Germany is an equalisation of tax capacities and not one of special financial needs. With regard to the rather inflexible expenditure, side of the state and local budgets and their high degree of determination of federal and European law and the tax revenues also

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<sup>1</sup> See [http://www.bundesregierung.de/nr\\_66130/Content/DE/StatischeSeiten/Breg/Reformprojekte/foederalismusreform-2006-08-09-modernisierung-der-bundesstaatlichen-ordnung-top.html](http://www.bundesregierung.de/nr_66130/Content/DE/StatischeSeiten/Breg/Reformprojekte/foederalismusreform-2006-08-09-modernisierung-der-bundesstaatlichen-ordnung-top.html), Scharpf, Frotz W.: Weshalb wurde so wenig erreicht? in: aus politik und zeitgeschichte 50/2006, pp. 6 and Reutter, Werner: Regieren nach der Föderalismusreform; in: aus politik und zeitgeschichte 50/2006, pp. 12.

<sup>2</sup> For details see <http://www.bundestag.de/Parlament/gremien/foederalismus2/mitglieder.html>.

determined by federal law public debt is the remaining last factor of public sector receipts. The paper therefore intends to show the fatal logic of the fiscal constitution and the changes which can be expected from the different proposals of reform.

The next part of the paper gives a brief introduction into the pattern of the German fiscal constitution and its history after German unification respectively the integration of the new Länder into the fiscal equalisation regime. The third chapter gives deeper insight into the developments of federal tax revenues, fiscal equalisation and public debt after German unification respectively the inclusion of the new Länder into the fiscal equalisation scheme and some changes of the regime in the recent years. The questions for centralisation and decentralisation of powers and the effects on efficiency and accountability of the respective governments in these fields are to be demonstrated by statistical indicators. Chapter 4 presents the most important proposals of change for the federal rules of public revenues and discusses their expected effects. The paper finishes by a speculation which proposals for change will be adopted and – probably of more importance – why only minor changes can be expected.

## **2. Basic features of fiscal federalism in Germany and the needs of reform**

The German fiscal constitution exists in its main features since in 1969/70 the ‘big budgetary and financial reform’ was implemented. In 1974, the legal base for local governments was adapted to the rules for federal and state governments regarding the competence of the Länder to establish their ‘local constitutions’ in detail as the Grundgesetz determines municipalities and their associations as part of the states. However, municipalities and districts are important parts of the multi-level system of execution of European and federal legislation. Their budgets are in a similar degree as those of the states determined by compulsory expenditures from the legislation of super ordinate layers. Therefore, it is consequent that the inter-linkage of the expenditure side is continued with regard to revenues (taxes and public debt)<sup>3</sup> and fiscal equalisation.

Tax competences are – particularly since the great budgetary and financial reform in 1969/70 – highly interlinked in the German fiscal constitution. The legislation power lies almost exclusively at the federal level. Already in the Herrenchiemsee conference in 1948, the arguments of Popitz from the 1920s<sup>4</sup> in favour of equal tax laws were accepted. Also taxes of which the revenue belongs in total or in part to state or local jurisdictions are subject of the concurrent legislation of the Federation: The revenues of the smaller taxes are exclusive for the federal and state governments whereas local government possess the revenue competence of the so-called “real taxes” on local business and real estates. The “big” taxes, the personal and the corporate income tax and the turnover tax that contribute by more than 70 % to total tax revenues, are vertically

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<sup>3</sup> Although there is also a federal and state regulations for fees and charges these types of revenues are not subject of this papers.

<sup>4</sup> See Popitz, Johannes: Der Finanzausgleich; in: Gerloff, Wilhelm; Meisel, Franz (Hrsg.): Handbuch der Finanzwissenschaft, 1. Aufl., Tübingen 1927, Bd.2, p.362.

shared among the tiers according to the scheme in table 1. In the recent years from 1998, the federation has received an increasing share of the turnover tax by cutting in advance special shares before applying the key of 50.5 / 49.5 for Bund and Länder with the result that the share of the federation is increasing more and more.

	Federation	States	Local governments
Personal income tax			
- wage tax	42,5%	42,5%	15%
- income tax	42,5%	42,5%	15%
- interest income tax	44%	44%	12%
- withholding tax	50%	50%	-
Corporate income tax	50%	50%	-
Turnover tax	54,18% + 2,263 billion €	43,83% -2,263 billion €	1,99%

Table 1: Vertical shares of joint taxes 2008

Special arrangements exist for tax administration. State administrations execute most of the all over Germany uniform tax laws. The federal custom administration and the Federal Office of Finance collect the special consumption taxes and the import turnover tax. The income taxes and the value added tax – the domestic part of the turnover tax – are administered by state fiscal offices under the regime of federal mandate administration which means that the prescribed rules of applying the tax laws are strictly regulated by decrees and other regulations. If one tier levies taxes, which are revenues of other jurisdictions, it transfers the intakes. There are also rules of horizontal dissection in case that taxpayers work and reside in different states or municipalities.

Fiscal equalisation in Germany includes horizontal as well as vertical transfer payments. It is in the first dimension a system of vertical and horizontal tax sharing across the three levels of government. In the second dimension, financial needs are incorporated. While local fiscal equalisation includes both aspects including a compulsory and a voluntary share of state tax revenues into the “equalisation mass” and defining special needs indicators besides the pure or a valuated size of population, the state fiscal equalisation is separated in a tax capacity equalisation plus tax deficiencies compensating supplementary grants and supplementary grants for special needs. Besides, there are many specific purpose grants with and without matching of the recipients. Transfer payments from the federation to local governments are since 2006 explicitly forbidden, but were before that date always transferred by the states.

The tax equalisation among the states starts with the distribution of the revenues of the turnover tax after all other tax revenues are assigned and have been dissected according to the origin principle. 75 % of the turnover tax is then distributed according the number of population because a per capita equal consumption is assumed and another key according to the origin principle is technically impossible. The remaining 25 % of the state share of the turnover tax is distributed in order to fill the per capita state tax capacity to the average of all states. This mechanism is called the VAT-pre-equalisation. The

proper – horizontal – intergovernmental equalisation is based on transfer payments from the states of which the tax capacity is above the financial needs indicator to those states with a fiscal capacity below. The local tax capacity is partly included into the state tax capacity. Financial needs are calculated in a very global way by valuating the population of the city-states, of the communities and, since 2005, of the small and sparsely populated states higher than 100. These population factors serve as divisors of the total state tax capacity to determine the fiscal needs of the respective Länder. Finally, deficiencies of the tax capacity after horizontal fiscal equalisation are filled by (general) federal supplementary grants (FSG) by a high degree.

Special financial needs are globally covered by other FSG's. According to their financial importance, first the FSG's for the new Länder are to be mentioned designated to compensate the extremely low local fiscal capacity and to modernize and build up the public infrastructure in Eastern Germany. Of minor importance are the grants for compensating the above average costs for political institutions for the fiscally weak states. From 1994 to 2004, Bremen and the Saarland received FSG's in order to bring them out of their budget emergencies.

Significant revenue source for all levels of government are borrowings. Despite of federal structure the public debt regulation in Germany is a rather centralised one. Article 115 of the German Constitution determines debt rules at the central level. According to this article, borrowings only are permitted for the investment expenditure. Exceptions exist in order to provide the stabilisation of national economy. The article 115 exists in the same wording from the "big" financial reform implemented in 1969/70. The German states have implemented almost exactly the same regulations as the federation in their constitutions. Before 1970, a differentiation between current and capital budget was established. Borrowing then was only allowed in the capital budget.

Since the European contract of Maastricht, an additional borrowing limit is set at 3 % of the GDP for public sector borrowing respectively 60 % of GDP for total public sector debt amount. Germany has until now no agreement how to share the allowed borrowing volume among the federal tiers. Since the Federalism Reform I however, the shares of potential financial sanctions are to be 65:35 for Bund and Länder.

Communities are with regard to fiscal constitution part of the German states that are therefore responsible also for the regulation for local credits. However, the local borrowing rules are determined in the so-called 'local constitutions' of different German states in a rather similar way. They require

- balanced current and capital budgets; deficits in the current account have to be closed the next but one budget;
- borrowing only for the financing of public investment expenditures in the capital budget,
- the reimbursement of the credits by expenditures of the current account.



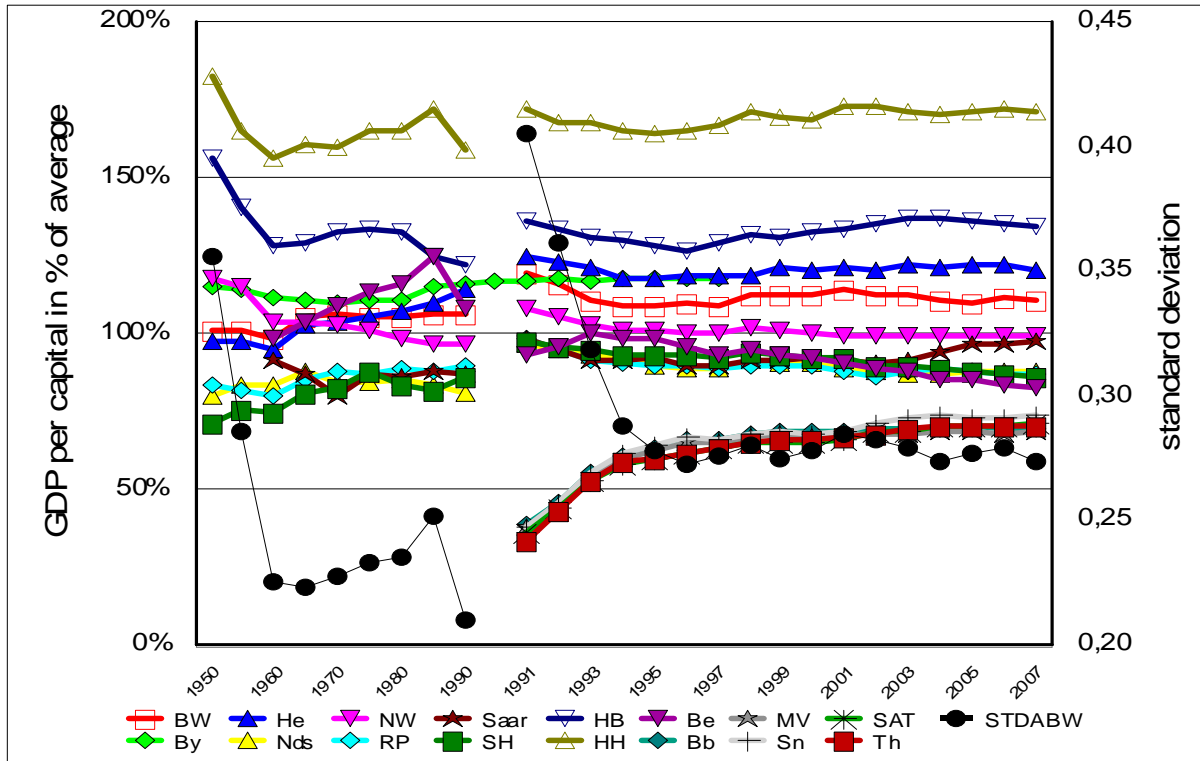


Fig. 1: Gross domestic product of the German Länder in % of the average (until 1990 only West Germany) and standard deviation

Source: Federal Statistical Office; proper calculations

The local control authorities of the states have to approve to local budgets particularly with regard to the volume of net borrowing and to whether they follow these rules.

As tax receipts and to a certain degree also public expenditures are strongly determined by the economic situation of a jurisdiction, the economic development of the Länder is to be mentioned in the end of this informing chapter. Figure 1 demonstrates the position of the per capita GDP of each Land to the average, until 1990 only West Germany, from 1991 including the new Länder. The standard deviation in addition indicates the convergence or divergence of the economic capacities. The very high differences of economic capacity in West Germany after the World War II converged only one decade. From 1965 until the mid 1980s, it diverged again because of the structural economic crises of steel, coal and wharf industries. German unification in 1990 brought to some of the 'poorer' German Länder remarkable economic growth so that the standard deviation of per capita GDP strongly declined.

After unification, the new Länder started with an average per capita GDP of only one third of the average. Emigration of people who had lost their jobs and the restructuring of enterprise brought a sharp increase of economic capacity during the first five years. Since 1995 however, the relative economic capacity of the new Länder increases only very slowly while the divergence of the old Länder has grown again and reached the level of the mid 1980s before unification boom. The spread of economic capacity is still

higher than before German unification. This development stands against the expectations of the early 1990s when the German chancellor Helmut Kohl had conducted the 1990 election campaign with the promise of 'flourishing territories'.<sup>5</sup> Economic divergence among the old Länder also burdens the fiscal equalisation scheme because there is no release from the economic development respectively an increase of transfer payments by the economic decline of some big states like North Rhine-Westphalia today with a per capita GDP of less than 100 %.

### **3. Recent centralisation and decentralisation trends**

Three main subjects have shaped the fiscal relations on the revenue side in German federalism:

- federal tax policies and their consequences for state and local tax revenues,
- a formal change of the fiscal equalisation scheme in 2005, and
- a strong increase of public debt which almost brought Germany under European sanctions.

With regard to the question of centralisation and decentralisation, these developments can be analysed whether it means an increase of power for one of the federal tiers bringing unfavourable consequences or additional costs to other tiers, which means a shift of accountability among the layers if one regards federal systems of communicating tubes. For the negotiations of the Federalism Reform Commission II these shifts are insofar important as they determine the interests and positions of the seventeen members (Bund and 16 Länder) and therefore also the costs of conciliation for the Federation and of the states attending the higher advantages from the reform.

#### **3.1 Tax assignment and federal tax policies**

The federal tax system has undergone dramatic changes in the recent years due to the challenges of globalisation and to the economics of integration after German unification. The latter on the one hand provided doubt that the tax system, which had been developed for a prosperous modern economy in West Germany, was "exported" to the economy and administration of the transition economy in East Germany. Special exemptions like personal tax allowances for East German citizens or the non-existence of the trade tax on enterprise capital for East Germany were closed in the second half of the 1990s. Until today however, there are important income tax subsidies for investments in the new Länder, which – because of the vertical tax sharing schemes – not only reduce the tax revenues of the Federation but also those of the East German states and communities.

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<sup>5</sup> Helmut Kohl, during a TV-speech about the state contract of German unification on Juli, 1<sup>th</sup>, 1990 (Bulletin des Presse- und Informationsamtes der Bundesregierung. Nr. 86 3.7.1990, p.741).

	Bund	Länder	Communities	EU	Total
	- in million € -				
1990	142,753	98,077	35,359	7,271	283,460
1991	164,284	118,906	39,871	11,855	334,916
1992	181,150	131,905	43,686	13,529	370,270
1993	179,228	136,661	44,603	15,030	375,522
1994	189,955	140,057	44,857	17,139	392,008
1995	196,313	153,851	43,904	16,815	410,883
1996	186,898	155,921	44,117	16,799	403,735
1997	184,778	154,631	44,840	17,806	402,055
1998	191,460	162,982	48,602	18,296	421,341
1999	209,078	171,553	51,029	17,098	448,758
2000	216,309	176,310	51,912	18,430	462,961
2001	210,773	169,855	49,065	16,540	446,233
2002	212,187	162,355	47,493	15,663	437,698
2003	211,793	161,740	46,762	18,049	438,344
2004	206,849	164,481	51,176	16,554	439,060
2005	211,780	165,200	54,321	18,333	449,634
2006	225,634	179,763	61,033	18,262	484,692
2007	251,747	199,897	66,311	18,266	536,221
	- in % of GDP -				
1990	11.3%	7.8%	2.8%	0.6%	22.5%
1991	10.7%	7.7%	2.6%	0.8%	21.8%
1992	11.0%	8.0%	2.7%	0.8%	22.5%
1993	10.6%	8.1%	2.6%	0.9%	22.2%
1994	10.7%	7.9%	2.5%	1.0%	22.0%
1995	10.6%	8.3%	2.4%	0.9%	22.2%
1996	10.0%	8.3%	2.4%	0.9%	21.5%
1997	9.6%	8.1%	2.3%	0.9%	21.0%
1998	9.7%	8.3%	2.5%	0.9%	21.4%
1999	10.4%	8.5%	2.5%	0.8%	22.3%
2000	10.5%	8.5%	2.5%	0.9%	22.4%
2001	10.0%	8.0%	2.3%	0.8%	21.1%
2002	9.9%	7.6%	2.2%	0.7%	20.4%
2003	9.8%	7.5%	2.2%	0.8%	20.3%
2004	9.4%	7.4%	2.3%	0.7%	19.9%
2005	9.4%	7.4%	2.4%	0.8%	20.0%
2006	9.7%	7.7%	2.6%	0.8%	20.9%
2007	10.4%	8.3%	2.7%	0.8%	22.1%

Tab. 2: Tax revenues and tax ratios to GDP of the federal tiers in Germany 1990–2007

Source: Federal Statistical Office; proper calculations

Globalisation on the other hand has set out pressure to reduce tax burdens for economically important enterprises and persons all over the world. Social insurance contributions were to be lowered because of their character as labour costs. Countries with high tax ratios to GDP tried to lower this indicator. Therefore, also in Germany the new red-green federal government undertook tax reforms with high tax reductions expecting that the economic recovery in the beginning of the 21<sup>st</sup> century as well as the higher growth rates that would come after tax reductions would rebalance the public budgets in a short period.

A third factor initiated additional pressure for tax reforms. In the middle of the 1990s, the Federal Constitutional Court had required the tax exemption of the minimum living income for adults and for children and had judged the wealth and the inheritance tax of which the revenues belonged to the Länder to be unconstitutional because assets from

real estates and other properties would be taxed unequal. The Federal Minister of Finance decided to leave the wealth tax unconstitutional, and until today, it has remained “on the federal ice” because there is no majority to revitalise it. Since January 1<sup>st</sup>, 1996, the system of family allowances was changed to basic tax-free amounts according to minimum living income; for children the former system of equal expenditures out of the federal budget for children and of deductions from the parents’ tax base was changed to equal deductions from tax payments. There was an additional positive side effect by the way federal expenditure of an amount of 17 billion Euros was exchanged against tax deductions decreasing the tax ratio by more than one point of percent. Meanwhile the children allowances have reached a volume of 34 billion Euros and an amount to more than 1.8 % of GDP.<sup>6</sup>

Federal tax reforms caused high losses of tax revenues not only for federal government but also for state and local governments while the shares of the EU are calculated according to a different scheme independent from national tax policies (share of turnover tax on a standardized tax base plus a ratio to GDP). Federal tax reforms not only decreased the amount of taxes in relation to GDP but in some years also the absolute tax revenues leaving states and municipalities without any influence on their tax intakes. After 2001, the losses of tax revenues from tax reforms coincided with the effects of the economic recession. Only for the last two years, a recovery of the tax receipts can be observed for all tiers. An increase of the turnover tax rate from 16 to 19 % by January 1<sup>st</sup>, 2007 helped to balance most public sector budgets in Germany.

Besides the painful effects of federal tax reforms on the revenues of the subordinate tiers there were horizontal changes of the “tax spread” among the Länder and municipalities.

The effects can be structured into the influence of economic capacities respectively those of tax laws (changes of tax bases and tax rates), the regionally unequal amount of tax expenditures and – an unequal tax administration. The two first factors can be assigned to the Federation; the latter is part of the political governance of the states.

### **3.1.1 Federal tax policies and regional tax capacities**

The analysis of tax capacities of subordinate federal tiers in this paper has been based on statistical regressions. The idea is that the tax revenues of a jurisdiction come from its economy. Therefore, “rich” jurisdictions have a bigger tax base than “poor” ones. If the regression coefficient of a regression of tax revenues on GDP per capita is 1 then the tax capacity exactly follows the economic capacity. If the coefficient is bigger than 1 there is a progressive incidence: the tax revenues are relatively higher than the relative economic capacity. Values of the regression coefficient near 0 indicate a per capita equal distribution of tax capacities, values between 0 and 1 show that the tax revenues

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<sup>6</sup> See Statistisches Bundesamt: Steuerhaushalt 2007, Fachserie 14 R.4, Wiesbaden 2008, Tabelle 1.5.

follow the economic capacity sub proportionally. Negative coefficients indicate a regressive tax capacity, that the tax receipt decrease with a growing economic capacity.<sup>7</sup>

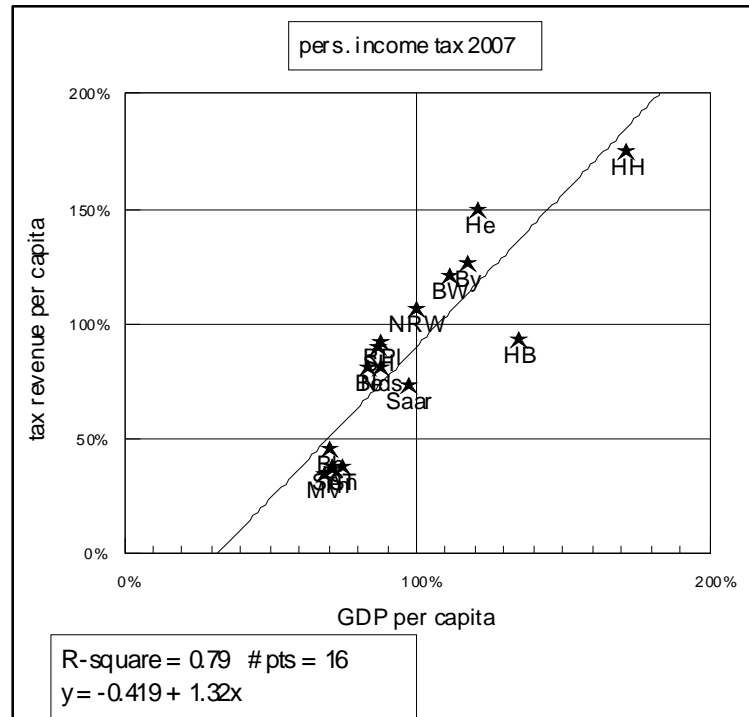


Fig. 2: The regional incidence of the personal income tax 2007

Source: Federal Statistical Office; proper calculations

Figure 2 shows the regional incidence of the personal income tax 2007.  $r^2 = 0.79$  indicates a comparably good coherence of income tax and economic capacities of the states, the regression coefficient of 1.32 a progressive relation. That means that a state where the GDP per capita is 10 % above respectively under average collects income tax revenues of an amount of 32 % above respectively under average. The regression indicates that the federal tax law favours the rich states and provides lower tax intakes for the poor states. The main reason for the progressive regional incidence of the personal income tax are the progressive tax rates and the indirect progression of the high and increasing tax free income allowances by which the Federation covers a big part of its income redistribution policies.

<sup>7</sup> See Färber, Gisela: Asymmetrischer Steuerföderalismus in Deutschland: Eine Folge falscher Zuordnung der Besteuerungskompetenzen?; in: Europäisches Zentrum für Föderalismusforschung Tübingen (Hrsg.): Jahrbuch des Föderalismus 2007 - Föderalismus, Subsidiarität und Regionen in Europa, Baden-Baden 2008, pp. 161f. and Die regionalen Auswirkungen dezentralisierter föderaler Steuersysteme - Probleme und Perspektiven für Deutschland und Österreich – in: Europäisches Zentrum für Föderalismusforschung Tübingen (Hrsg.): Jahrbuch des Föderalismus 2006 - Föderalismus, Subsidiarität und Regionen in Europa, Baden-Baden 2006, pp. 160.

	Personal income tax								Corporate income tax after dissection		Pers. and corp. income tax after dissection	
	Wage tax after dissection		Income tax after dissection		Interest income tax after dissection.		Withholding income tax after refunding					
	r-square	A <sub>1</sub>	r-square	A <sub>1</sub>	r-square	A <sub>1</sub>	r-square	a <sub>1</sub>	r-square	a <sub>1</sub>	r-square	a <sub>1</sub>
1991	0.912	1.100	0.857	1.530			0.775	1.730	0.941	1.680	0.955	1.250
1992	0.902	0.937	0.897	2.050			0.827	2.290	0.896	1.980	0.959	1.240
1993	0.852	0.933	0.899	2.500	0.792	1.670	0.813	1.840	0.878	1.890	0.917	1.230
1994	0.833	0.934	0.858	2.850	0.953	1.710	0.897	2.310	0.561	1.920	0.903	1.260
1995	0.792	0.722	0.819	5.280	0.926	1.680	0.825	2.370	0.561	2.090	0.888	1.120
1996	0.822	1.050	0.814	6.140	0.857	1.630	0.801	2.300	0.848	1.940	0.876	1.410
1997	0.810	1.060	0.804	13.200	0.907	1.520	0.710	1.960	0.793	1.940	0.879	1.450
1998	0.771	0.960	0.892	8.880	0.924	1.400	0.659	1.840	0.483	1.460	0.835	1.335
1999	0.800	1.090	0.872	5.590	0.870	1.340	0.698	2.060	0.771	1.700	0.876	1.510
2000	0.787	1.140	0.880	5.060	0.806	1.460	0.726	2.610	0.903	1.970	0.871	1.610
2001	0.741	1.040	0.833	6.090	0.821	1.390	0.667	1.720	0.412	10.300	0.828	1.520
2002	0.709	1.010	0.863	7.460	0.855	1.760	0.700	2.010	0.263	3.760	0.797	1.500
2003	0.713	1.040	0.854	10.700	0.917	2.020	0.543	1.670	0.516	2.820	0.856	1.650
2004	0.717	1.010	0.848	9.220	0.800	1.600	0.417	1.630	0.814	2.440	0.878	1.630
2005	0.715	0.999	0.808	4.830	0.772	1.470	0.616	1.700	0.791	2.820	0.827	1.480
2006	0.724	0.997	0.822	3.010	0.680	1.380	0.647	1.910	0.861	2.480	0.847	1.470
2007	0.704	0.946	0.800	2.270	0.574	1.320	0.699	3.400	0.482	1.060	0.782	1.290

Table 3: Correlation and regression coefficients of the components and the total revenues of the personal and corporate income tax 1991–2007

Source: Federal Statistical Office; proper calculations

The result for 2007 is typical for the dominating personal und corporate income tax. However, there are certain changes over the time since 1990. Therefore, the correlation has decreased not only with regard to the aggregated tax revenues, but also to the components of the income tax (see table 3). Beginning from 1996, the coherence of income tax revenues to economic capacity has become weaker and the progressive effects on the regional tax revenues stronger. Between 1999 and 2004, rich Länder received tax “primes” of 50-65 % above their relative economic capacity from the federal tax legislation, which was not undertaken in order to secure the financial base of state and local budgets but to achieve certain political goals of federal tax policies. So the growing divergence of regional tax revenues is a result of centralisation of tax policies according the political interests of the Federation.

A comparison of the coefficients of all Länder to those of only the “old Länder” in West Germany helps to isolate the influence of economic capacities on the horizontal tax spread. Figure 3 presents the values for the total personal income tax. The income tax revenues of the old Länder show a weaker and declining coherence but also a lower regional progression – most of the years lower than one! – than total Germany. However, the regional progression for the old Länder increases after 1995 when the federal tax reforms were undertaken. It also becomes obvious that most of the increasing tax spread results from the new Länder; the reasons for it are to be analysed in the next chapter.

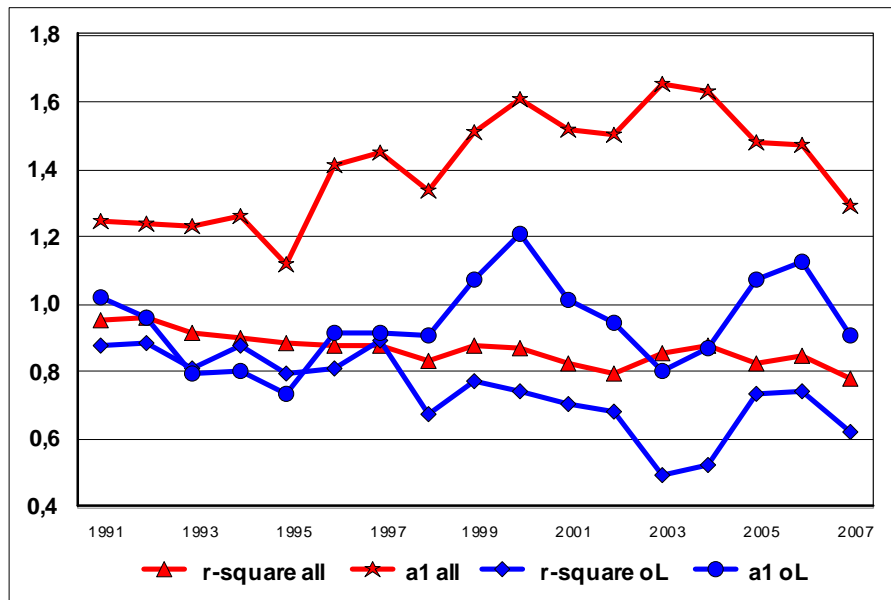


Fig. 3: The regional incidence of the total personal income tax 1991-2007 for all Länder and for the “old Länder”

Source: Federal Statistical Office; proper calculations

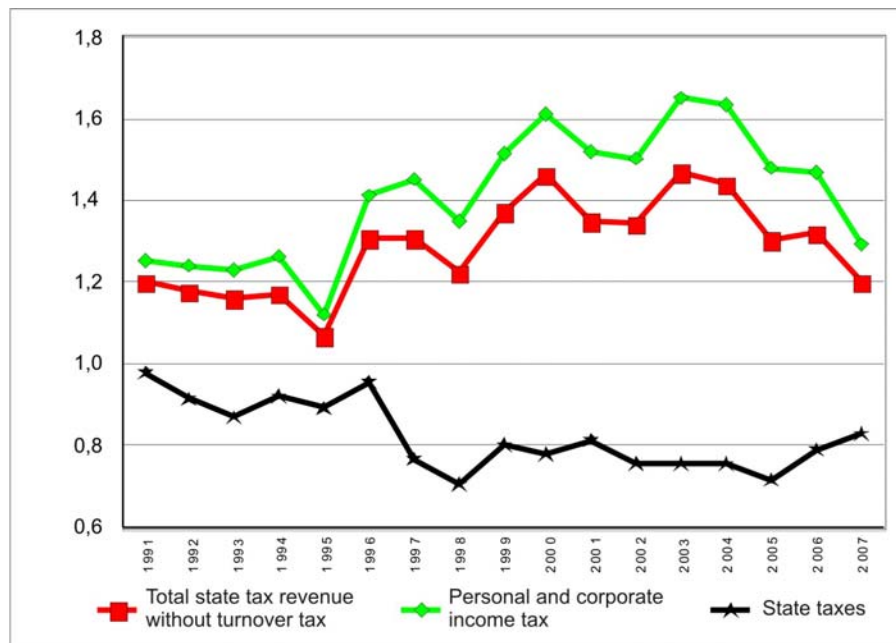


Fig. 4: The regional incidence of the personal and corporate income tax, the proper state tax revenues and the total state tax revenues without turnover tax 1991-2007

Source: Federal Statistical Office; proper calculations

The regional incidence of the revenues from the state taxes is slightly under proportional. Particularly since the wealth tax has been judged unconstitutional, a decline of the regression coefficient by about 0.2 is obvious. The fiscal dominance of the shares of income taxes for the state tax revenues however leaves the total incidence of the state taxes a progressive one and rewards rich states as it victimises Länder with a low economic capacity per capita. In another perspective, besides the differences of economic capacity, the federal tax legislation provides the criticised amount of fiscal equalisation.

### 3.1.2 Tax expenditures and regional tax capacities

One instrument of federal tax policy is the use of tax expenditures. Tax expenditures are subsidies on the revenue side of the public budgets as the government abstains from levying taxes if certain criteria for promotion are declared and proved. Economic theory indicates tax expenditures as favoured policy instruments because they do not receive so much control as expenditures in the budgets as they are not budgeted in proper items. In Germany, there is a second reason for their popularity because of the tax sharing system as the federation is not obliged to cover the full costs for tax expenditures but only its share of the respective tax revenues and tax exemptions are set off the “gross” tax payments.

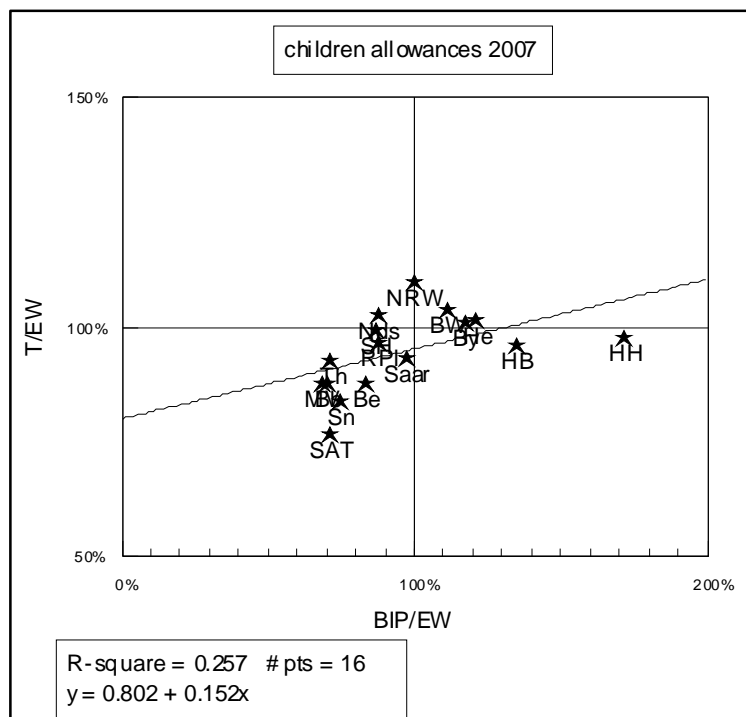


Fig. 5: The regional incidence of the children allowances 2007

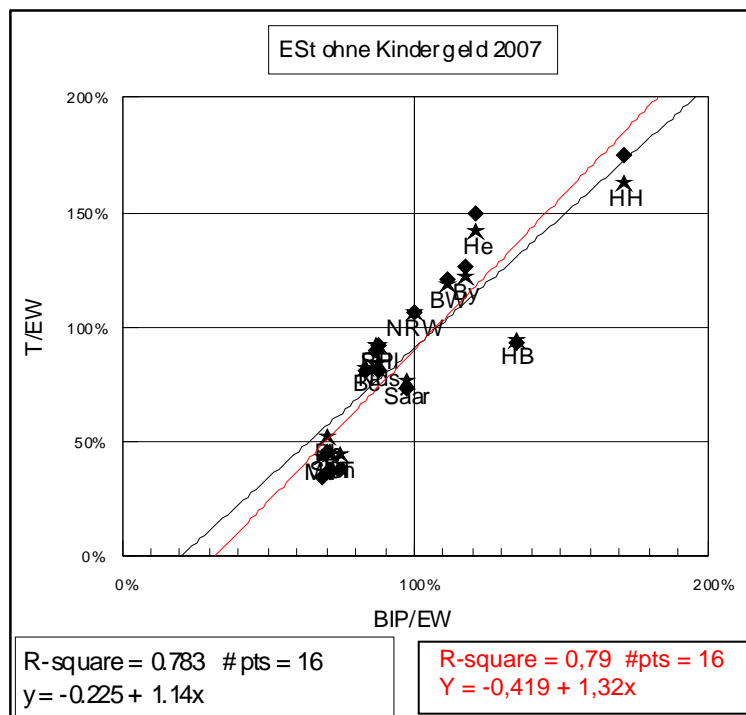
Source: Federal Statistical Office; proper calculations

Tax expenditures show regional patterns completely different from tax revenues. They follow the regional distribution of the promoted economic and social activities. The children allowances e.g. show the highest tax losses per capita of the population in North



Rhine-Westphalia, the lowest in Saxony-Anhalt. In the city-states Hamburg (HH), Bremen (HB) and Berlin (Be) the number of children is lower than in the spatial states and according to this lower losses from the allowances. Without children allowances in the form of tax expenditures – e.g. if they are spent directly from the federal budget like before 1996 – the regional incidence of the personal income tax would be different: The regression coefficient would value by 1.14 instead of 1.32 (see fig. 6). Therefore, the children allowances increase the regional progressive tax revenues of the income tax by almost 0.2 percent points. They contribute to the regional income tax progression by 14 %, which also results in the financial weight of the allowances: They amount to 18.7 % of the total personal income revenues and are therefore able to cause these important inter-regional distortions.

There are other important tax expenditures in the German tax legislation: The housing allowance, which contributed 40,000 Euros within 8 years for a family with two children buying a house or an apartment before 2006 amounted in tax losses of almost 11 billion Euros in 2005. Enterprises receive special regional investment allowances for investment activities in the new Länder. Taxpayers aged less than 65 years receive since 2002 allowances for payments into additional private pension plans; 11.5 million contracts have existed until summer 2008.<sup>8</sup> All these allowances show particular regional patterns of tax revenue losses and deteriorate the regional incidence of the personal income tax.



<sup>8</sup> See Reuters: Zahl der Riester-Verträge steigt auf 11,5 Millionen, Montag, 25. August 2008, 13:25 Uhr, <http://de.reuters.com/article/domesticNews/idDEKOE54114120080825>.

Fig. 6: The regional incidence of the personal income tax with and without children allowances 2007

Source: Federal Statistical Office; proper calculations

Figure 7 shows the regression coefficients of the personal income tax under the assumption that the sundry tax expenditures would not be accorded. Rather small effects come from the East German investment and the old age pension allowances, which is a result of their comparably small amount. The children and the housing allowances have an important effect in the regional progression on the regional incidence of the personal income tax because without the first one the regression coefficients would have had values between 1 and 1.4, without the latter even between 0.6 and 1. The cumulative effect of the considered allowances would shift the personal income tax from a moderate regional under proportional distribution to a high progression. This is not surprising with regard that the total amount of the state share of these tax allowances to the total income tax revenue was 24 % in 2007 and had been almost 32 % in 2004 and 2005.

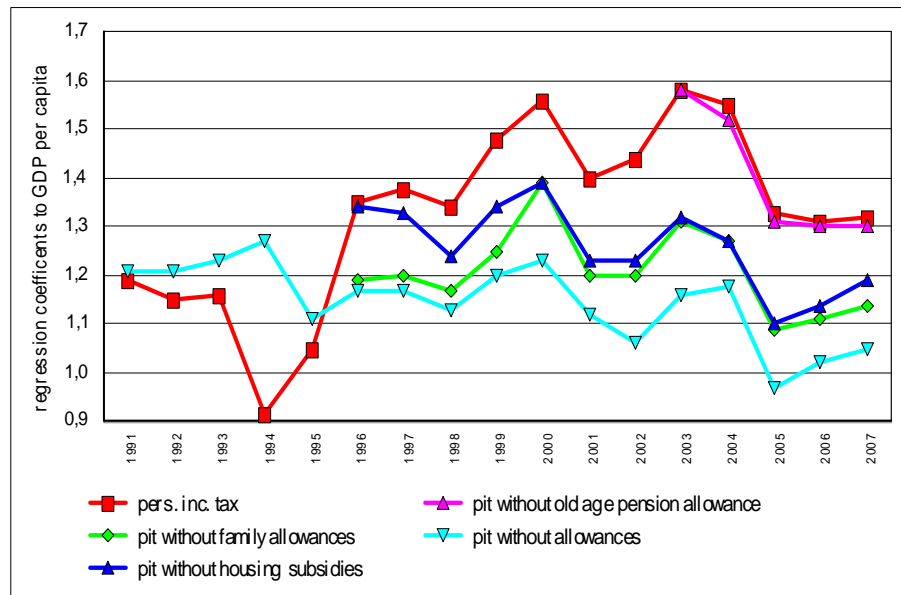


Fig. 7: The regional incidence of the personal income tax with and without special allowances 1996 - 2007

Source: Federal Statistical Office; proper calculations

Although one could argue that citizens and enterprises located in the respective states and municipalities receive favours by the allowances. There are also investigations of the total regional outcomes of federal grants and allowances, which give empirical base for the assumption that the additional incomes from federal budget and tax allowances are reallocated to other regions by the inter-regional process of demand-based income

multipliers.<sup>9</sup> With regard to the degree of centralisation and decentralisation of the German federalism it has however to be stated critically that with the size of tax expenditures not only the total revenues of the state and the local tier have suffered from more determination by the federation but also the differences of the regional and local tax revenues. By these tax gifts, the federation attracts voters in the federal elections. No voter will give their vote for tax expenditures in state or even in local elections although jurisdictions of both tiers pay for these policies with less revenues. The increase of the interregional divergence of tax revenues makes the conflicts between paying states and receiving states in fiscal equalisation become sharper although the economic divergence is almost unchanged for more than ten years.

### **3.1.3 State tax administration and the uniformity of tax laws**

Two years ago, the Federal Court of Audit has brought a very sensible subject to the political discussion: the unequal tax administration of the German states. It is a very old discussion. Already 1984 the Federal Court of Audit stated that the Land Hessen had undertaken tax audit controls for the big banks in Frankfurt by the fiscal authorities very scarcely.<sup>10</sup> For many years, until the early 1990s, the states refused the audit by the Federal Court of Audit, although federal and joint tax revenues were collected by the state administrations. Until today, the Ministry of Finance does not receive information about the intensity of tax audits by the states and other statistical indicators by which the activities of state tax administration can be compared and evaluated.

In 2006, the Federal Court of Audit undertook a comparative investigation of the tax administration of the states and found out remarkable differences of the state tax administrations.<sup>11</sup> One state government even had set the explicit goal not only to follow the fiscal aims of tax collection but to conduct a 'modest execution of tax laws with regard to fixation and to collecting taxes'.<sup>12</sup> The tax offices receive the instruction to abstain from records and controls. When the enterprises came to know these instructions, the Ministry of Finance sent a letter to the tax offices that "there was no reason to fear to undertake an obstruction of punishment in office".<sup>13</sup> The Federal Court of Audit found out other irregularities: Only scarce explicit controls of income millionaires, an uneven exchange of information and a low level of audits in the collection of the turnover tax, different and expensive interpretations of tax laws, abdication from tax returns for agricultural enter-

<sup>9</sup> See Arndt, Olaf; Dalezios, Harald; Färber, Gisela; Steden, Philip: Die regionale Inzidenz von Bundesmitteln; in: Mäding, Heinrich (Hrsg.): Geld regiert die Welt - Öffentliche Finanzströme und räumliche Entwicklung, Hannover (forthcoming).

<sup>10</sup> See Unterrichtung durch den Bundesrechnungshof: Bemerkungen des Bundesrechnungshofs 1984 zur Haushalts- und Wirtschaftsführung; BT-Drs. 10/2223, S. 111f.

<sup>11</sup> See Der Präsident des Bundesrechnungshofs als Beauftragter für Wirtschaftlichkeit in der Verwaltung: Probleme beim Vollzug der Steuergesetze, Stuttgart 2006, pp.34.

<sup>12</sup> See Der Präsident des Bundesrechnungshofs als Beauftragter für Wirtschaftlichkeit in der Verwaltung: Modernisierung der Verwaltungsbeziehungen von Bund und Ländern; Stuttgart 2007, p. 52.

<sup>13</sup> Ibid.

prises against explicit obligations in the federal tax law, an uneven prosecution of defraudations of taxes on interest and dividend incomes abroad.<sup>14</sup>

The most recent example of a not uniform execution of tax laws became public in the late summer of this year. The fiscal authorities of Saxony do not execute the progression clause for the parents' transfer incomes, which means that particularly couples with only one and high income before the birth of a child pay less taxes than the law requires. The tax revenues of Saxony therefore are lower than they should be, and the Land receives higher fiscal equalisation payments from the other states and federal supplementary grants (FSG) from the Federation so that the total amount of revenues are almost unchanged compared with a correct execution of the income tax law.

The reason for these problems is an incentive dilemma of the fiscal constitution:

- On the one hand, all Länder – the fiscally poor as the fiscally rich ones – can compensate the losses from 'light' tax collections by fiscal equalisation almost by 100 %. The state governments can favour citizens and enterprises located in the Land by this and attract voters at the costs of other Länder.
- On the other hand, the state governments have to cover the costs for the personnel of the fiscal offices from their own revenues therefore reducing their net tax revenues in the case of an expensive and correct execution of the more and more complicated tax laws.

From these 'individual' disincentives results the collective problem that the total tax revenues are systematically lower than they should be and that particularly the Bund suffers the highest net losses because at the superior level there are no advantages from comparatively satisfied voters or from enterprises changing their location from rigorously to generously taxing states. Although the tax revenues of all states are also lower as federal law determines there can be a net advantage for them due to the lower costs of administration. In any case, the situation is very unsatisfying because the equality of taxation, which results from the principle of equality, laid down in art. 3 of the constitution is required. It is unclear whether taxpayers can refuse their tax payments with the argument that the constitutional principle of equality is not considered by most of the states.

With regard to the continuing cut back of state personnel – also in the tax offices – on the one hand and of the tax laws becoming more and more complex and complicated as a measure against tax avoidance on the other hand the deficient and uneven execution of tax laws has increased during the last ten years. This development deserves an interpretation as a 'creeping' decentralisation although the states here de facto appropriate competences in the field of taxation not foreseen by the constitution. Besides the danger of increasing legal and illegal hidden tax avoidance, also a further growing resistance against fiscal equalisation transfers will result from it at least in the moment when the

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<sup>14</sup> See *ibid.* pp.49.

differences of tax administration among the states and their financial outcomes are measured exactly.

### **3.2 The reform of state fiscal equalisation in 2005**

The decision of the Federal Constitutional Court in November 1999 to change the system of horizontal fiscal equalisation among the German States became the first attempt at all to change the system of fiscal federalism since the German unification in 1990. The decision was taken after proceedings instituted by three “rich” states (Hessen, Bavaria and Baden-Württemberg) being not satisfied with the huge volume of the financial transfers to the “poor” states mainly located in the Eastern part of the united Germany. The Federal Constitutional Court was asked to judge whether the current system probably leads to the “over-equalisation”<sup>15</sup> and in this case contradicts the German Constitution.

Although the Federal Constitutional Court not explicitly stated the fiscal equalisation to be unconstitutional, it asked for the establishment of transparent and clear criteria in a special ‘measure law’. Otherwise, the fiscal equalisation would not be valid after 2004. Therefore a new scheme was negotiated and laid down in a general, so-called ‘measure law’ and in an according to the new principles revised fiscal equalisation scheme.

Although the former structure of the fiscal equalisation scheme (equalisation of tax capacities by VAT-pre-equalisation, horizontal transfer payments and federal supplementary grants, and a very restricted number of special needs grants) has been maintained some changes of the formulas took place.<sup>16</sup>

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<sup>15</sup> Under an „over-equalisation“ is understood the change of the ranking position of a state after the equalisation procedure

<sup>16</sup> For details see Bundesministerium der Finanzen: Solidarität im Bundesstaat: Die Finanzverteilung; Berlin 2005  
([http://www.bundesfinanzministerium.de/nn\\_54338/sid\\_B82F0D70BFF734053A75D95886C08EF7/nsc\\_true/DE/BMF\\_Startseite/Service/Downloads/Downloads\\_5/27451\\_1.templateId=raw.property=publicationFile.pdf](http://www.bundesfinanzministerium.de/nn_54338/sid_B82F0D70BFF734053A75D95886C08EF7/nsc_true/DE/BMF_Startseite/Service/Downloads/Downloads_5/27451_1.templateId=raw.property=publicationFile.pdf))

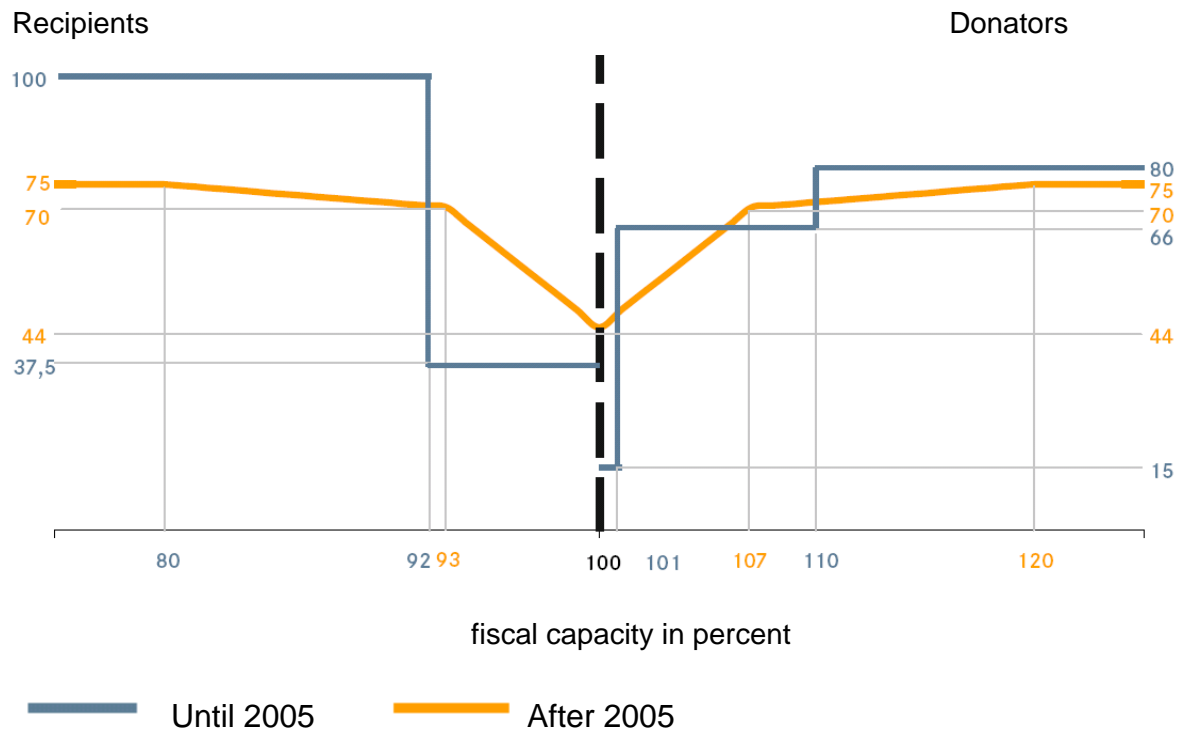


Fig. 8: Comparison of the “old” and the “new” scales of equalisation  
 Source: Bavarian Ministry of Finance

- The VAT-pre-equalisation does no longer fill deficient tax capacities by 100 % until a capacity of 92 % of the average but by 95 % to 60 % according to the distance from the average capacity.
- The scale of the horizontal fiscal equalisation also follows a new design between 44 and 75 % (see figure 8 below). Donators must never pay more than 72.5 % of their excess of the average.
- As a ‘prime’ for good economic policies 12 % of the above average tax capacity growth remains equalisation free.
- The general federal supplementary grants compensate the remaining deficiencies up to 99.5 % by 77.5 %.
- The local fiscal capacity is included into the state fiscal capacity by 64 % instead of 50 % formerly.

Since 2005, special needs federal supplementary grants exist in three categories (see table 4):

- For the remaining infrastructure deficiencies from the German division and the above average deficient local tax capacity in favour of the new Länder,
- a reduced scale for the compensation of the costs for political institutions of the small and fiscally weak states, and

- 1 billion Euros from 2005-2010 for the compensation of their burdens from structural unemployment in favour of the new Länder except Berlin.

million €	FSG for the costs of pol. institutions		FSG for the compensation of the costs of German division					FSG for the burdens of structural unemployment
	before 2005	since 2005	1995-2001	2002-2004	2005	2006	2007	2005-2010
RP	112	46						
Saar	78	63						
SH	84	53						
HB	68	60						
Be	112	43	1,361	1,493	2,004	1,994	1,974	
Bb	84	55	1,015	1,113	1,509	1,502	1,487	190
MV	84	61	756	1,113	1,110	1,104	1,094	128
Sn	0	26	1,870	2,752	2,746	2,733	2,706	319
SAT	84	56	1,129	1,661	1,657	1,649	1,633	187
Th	84	56	1,027	1,510	1,507	1,500	1,485	176
<b>total amount</b>	<b>790</b>	<b>1,516</b>	<b>7,158</b>	<b>9,642</b>	<b>10,532</b>	<b>10,481</b>	<b>10,379</b>	<b>1000</b>

Table 4: Special needs federal supplementary grants before, during and after reform of fiscal equalisation

Source: Federal Ministry of Finance

In both cases of FSG exclusively in favour of the new Länder, the absolute amounts of these federal supplementary grants have increased (see table 4). The bias in favour of the new Länder is easy to identify. The federal supplementary grants for the compensation of the costs of the German division not only have increased by 2005, they have already grown in 2002 when the negotiations about the new equalisation scheme were accomplished. In 2005, the FSG in favour of the new Länder because of the German division reached a maximum; hence, they decline and intend to phase out until 2019. For the period of reform and the next years, however a shift of revenues from federal to the budgets of the ‘poor’ East German states is obvious. The ‘poor’ West German states have until 2005 suffered additional losses not only from the decrease of the compensation grants for the costs of political institutions, but also by no longer receiving the – from 1995 to 2004 decreasing – grants for compensation of their losses by the integration of the new Länder into the fiscal equalisation system in 1995. So compared with the period before reform, a significant shift of revenues from federal and ‘poor’ West German states in favour of the new Länder can be stated which can be interpreted as an “uneven” decentralisation.

The new Länder have to report each year about the use of the revenues and the progress of their economies. The public is now discussing that most of the states – except

Saxony – do not use the majority of the grants for the intended investment purposes.<sup>17</sup> They argue that their budgetary structures from their high debt burdens are so bad that they are not able to bring the grants to the intended use. Until now, neither the legal status nor the political will of the Federation are strong enough to claim the misused resources back or even to reduce the new grants to the level of the investments of the last year.

States / billion Euros	1990	1994	1995	2000	2001	2002	2003	2004	2005	2006	2007
Hesse	-0.74	-0.93	-1.10	-2.73	-2.63	-1.91	-1.88	-1.52	-1.60	-2.20	-2.88
Baden-Württemberg	-1.26	-0.21	-1.43	-1.96	-2.12	-1.66	-2.17	-2.15	-2.21	-2.21	-2.32
Bavaria	-0.02	-0.34	-1.30	-1.88	-2.28	-2.05	-1.86	-2.30	-2.22	-1.86	-2.31
Hamburg	-0.00	+0.03	-0.06	-0.56	-0.27	-0.20	-0.66	-0.57	-0.38	-0.30	-0.37
North Rhine-Westphalia	-0.03	+0.08	-1.76	-1.14	-0.28	-1.63	-0.05	-0.21	-0.49	-0.32	-0,04
Schleswig-Holstein	0.31	0.04	-0.07	0.19	0.06	0.11	0.02	0.10	0.15	0.13	0.14
Saarland	0.19	0.22	0.09	0.17	0.15	0.14	0.11	0.11	0.11	0.12	0.12
Rhineland-Palatinate	0.25	0.34	0.12	0.39	0.23	0.42	0.26	0.19	0.28	0.34	0.34
Bremen	0.33	0.29	0.29	0.44	0.40	0.40	0.35	0.33	0.37	0.38	0.47
Mecklenburg-Vorp.	-	0.00	0.40	0.50	0.43	0.44	0.40	0.40	0.43	0.47	0.51
Lower Saxony	0.99	0.49	0.23	0.57	0.95	0.49	0.39	0.44	0.36	0.26	0.32
Brandenburg	-	0.00	0.44	0.64	0.50	0.54	0.50	0.53	0.58	0.60	0.67
Thuringia	-	0.10	0.52	0.60	0.57	0.57	0.50	0.51	0.57	0.61	0.64
Saxony-Anhalt	-	0.10	0.57	0.71	0.59	0.61	0.52	0.53	0.58	0.58	0.63
Saxony	-	0.10	0.91	1.18	1.03	1.05	0.94	0.92	1.00	1.08	1.16
Berlin	-	-	2.16	2.81	2.65	2.68	2.64	2.69	2.44	2.70	2.90
<b>volume of transfers</b>	<b>2.01</b>	<b>1.57</b>	<b>5.65</b>	<b>8.27</b>	<b>7.57</b>	<b>7.45</b>	<b>6.61</b>	<b>6.75</b>	<b>6.87</b>	<b>7.24</b>	<b>7.92</b>

Table 5: The volume of the horizontal intergovernmental transfers among the German states 1990-2007, billion Euros

Source: Federal Statistical Office; Federal Ministry of Finance

In order to identify patterns of centralisation and decentralisation in the ‘regular’ fiscal equalisation grants the development of the transfer payments is to be analysed. Since January 1<sup>st</sup>, 1995 the West German Länder have had losses by paying more or receiving less transfer payments by integrating the extremely ‘poor’ new Länder into fiscal equalisation. Since then, the number of intergovernmental grants increased rapidly during a short period. In 1995, the transfer volume accounted 5.7 billion Euros, in 2000, 8.3 billion Euros (see table 5). The main recipients became all “new” states of East Germany, all the first, the new German capital, Berlin. The poor states in north and west of West Germany, the recipients in the former equalisation system, claimed the losses of the substantial financial support not only from the horizontal payments but also from deficiency compensation federal supplementary grants (see table 6).

<sup>17</sup> See Seitz, Helmut: SoBEZ-Verwendungsrechnung für 2006; [http://www.tudresden.de/wwwlemp/publikation/Seitz\(Mai2007\)\\_SoBEZFehlVerwRech2006\\_2007511.pdf](http://www.tudresden.de/wwwlemp/publikation/Seitz(Mai2007)_SoBEZFehlVerwRech2006_2007511.pdf) (download Sept. 16th, 2008).



million Euros	1990	1994	1995	2000	2001	2002	2003	2004	2005	2006	2007
Nds	664	901	347	841	796	731	589	669	195	123	164
NW	2	0	0	0	0	0	0	0	0	0	0
RP	287	471	175	430	344	398	389	286	152	183	179
Saar	187	180	102	114	107	105	104	106	52	57	59
SH	262	264	0	264	89	167	23	153	79	64	73
HB	131	151	62	84	73	70	77	42	121	132	153
Be	-	-	434	481	451	443	440	449	763	848	909
Bb	-	-	237	277	259	253	250	256	222	236	258
MV	-	-	171	190	176	171	169	172	160	178	190
Sn	-	-	429	475	441	429	422	430	381	412	442
SAT	-	-	258	281	260	251	246	250	220	223	242
Th	-	-	235	260	242	235	231	235	214	508	243
total amount	1,533	1,966	2,450	3,697	3,238	3,253	2,940	3,048	2,559	2,965	2,912

Table 6: Deficiency compensating – ‘general’ – federal supplementary grants 1990–2007

Source: Federal Statistical Office; Federal Ministry of Finance

As in that period the economic diversity of the states did not increase but slightly decreased the increasing transfer payments and grants cannot be the result of economic development. They come from the increasing progression of the state tax revenues by federal tax policies and particularly by the intensive use of East German investment allowances and other tax allowances in East Germany.<sup>18</sup> Most of the increased divergences were compensated by the VAT-pre-equalisation (see fig.8 below) which is indicated by the extreme regression of the turnover tax after 1995. The slight recovery of the regression indicator since 2000 shows that the 25 %-volume of the turnover tax reserved for the pre-equalisation was not longer sufficient to bring all states to 92 % fiscal capacity before equalisation. In total, after the distribution of the turnover tax, the regional incidence of the state tax capacities has become a bit more equal which is mainly a result that the progression of state tax revenues before turnover tax has declined since 2003.

It is, however, a very astonishing fact that the transfer payments either in TVA-pre-equalisation or in the horizontal or by general federal supplementary grants do not decrease after 2005 although all scales and equalisation degrees were lowered. There are single states like the Saarland where the transfers decreased for the reasons of a very good economic development of steel industries. However, Bremen e.g. had an increase of transfers without losses of relative economic capacity (see fig. 1). Therefore, the explanation for the remaining volume of fiscal equalisation lies in the system itself. Here particularly the higher valuation of local fiscal capacity during a period of recovery of the local tax revenues since 2005 has increased the fiscal capacity indicators of the ‘rich’ states strongly above average with the effect that transfer payments remain high. The effect of the equalisation free 12 % of the above average growth of tax revenues of which the new Länder might have profited due to their increase of the receipts of their

<sup>18</sup> See chapter 3.1.2

income tax revenues for which the reduction of tax allowances is responsible for a minor quantitative importance. Finally, the potential higher divergences remaining after horizontal equalisation lead to higher general federal supplementary grants at the burden of the Federation.

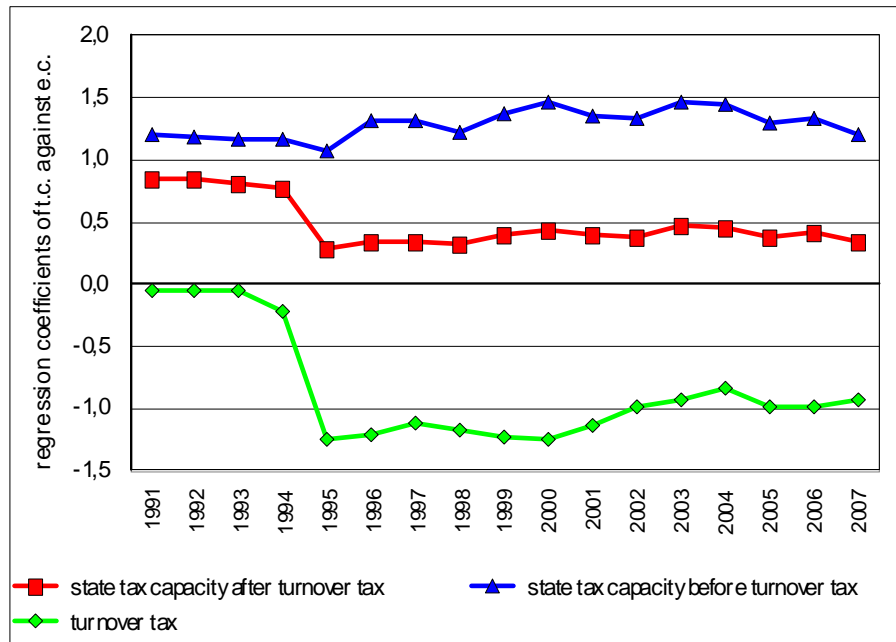


Fig. 8: Regression coefficients of distinctive tax capacities to economic capacities (GDP per capita) 1991–2007 and the (regressive) equalisation effect of the turnover tax distribution

Source: Federal Statistical Office; proper calculations

For an answer to the question of centralisation and decentralisation, the two fields of federal tax policies on the one hand and the changes of fiscal equalisation on the other hand have to be brought together. Under these combined perspectives, a picture of asymmetrical changes arises: The federation has had the approval of the Länder for several costly tax reforms and a high amount of tax allowances since 1996, which means a centralisation of powers. The new Länder have received high compensations by the means of federal supplementary grants without losing their amounts of horizontal transfer payments and general federal supplementary grants. They continue to receive compensations for their above average benefits from tax expenditures from the West German Länder. So the West German Länder are again the losers of reforms and have lost revenues and by this powers to finance autonomous expenditures. Though the 'rich' states can show political gains by getting a formally reduced equalisation scale accepted which until now has not brought relief with regard to the high equalisation payments the 'poor' old Länder suffer from losses of revenues without compensations. They took their 'revenge' in the field of public debt.

### 3.3 Public debt crisis and budgetary rehabilitation

The German unification has brought the sharpest increase of public debt in the history of the Federal Republic just doubling the volume between 1990 und 1995.<sup>19</sup> During the period of economic recovery from 1998 to 2001, the idea of balanced budgets became popular under the newly elected red-green Federal Government.<sup>20</sup> The coincidence of revenue losses from tax reforms and economic crisis after 2001, however, caused an opposite development leading to a public sector deficit of more than 74 billion Euros and a net borrowing of 67 billion Euros violating the European Pact of Stability and Growth with a deficit ratio of 3.4 % of GDP in 2001 and 3.6 % in 2002.<sup>21</sup> Only with the recent economic recovery from 2005, the public sector deficit became again conform to European law. In 2007, many states and local governments even realised a net redemption of public debt (see table A1 in the appendix). Only the Federation and some Western states (BW, NW, RP, Saar, SH HB) and many over indebted communities took new net credits.

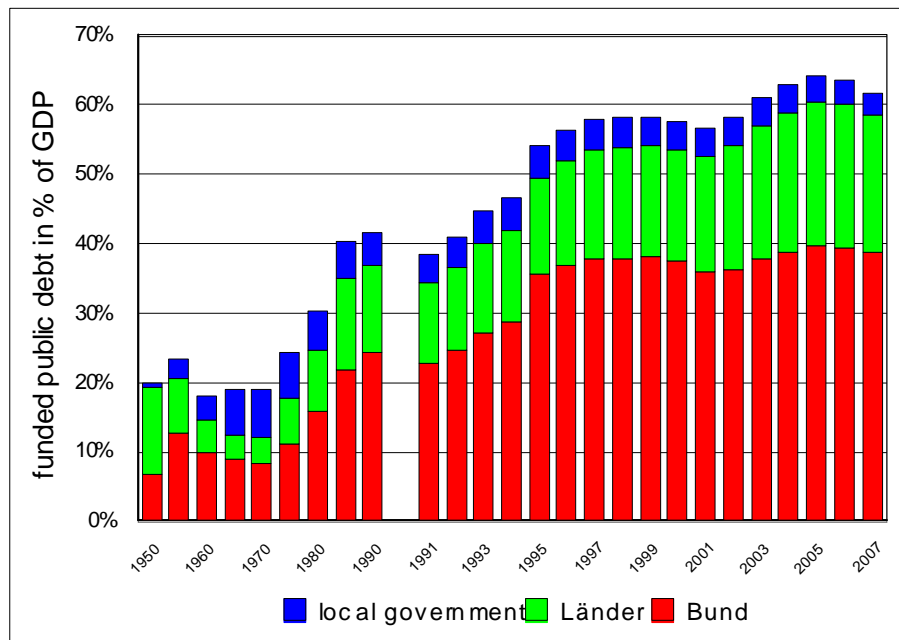


Fig.9: Increase of total funded debt of federal tiers, in percent of GDP  
Source: Federal Statistical Office

With regard to the question of centralisation and decentralisation, the perspective of the total amount of net borrowing or public debt in Euros or in percent of GDP is not very

<sup>19</sup> From 536 billion Euros in 1990 to 1009 billion Euros in 1995. See Statistisches Bundesamt: *Schulden der öffentlichen Haushalte 2007*, Fachserie 14 R.5, Wiesbaden 2008 (Tabelle 1.2.1.)

<sup>20</sup> See Bundesministerium der Finanzen: *Finanzpolitische Leitplanken Bundesministerium der Finanzen: Finanzpolitische Leitplanken. Sieben Wegweiser für eine zukunftsfähige, gerechte und europataugliche Finanzpolitik*. Berlin 2000.

<sup>21</sup> See Europäische Zentralbank: *Zehn Jahre Stabilitäts- und Wachstumspakt*; in: *Monatsberichte der Europäischen Zentralbank* 10/2008, p. 63.

informing because these indicators exclude the ability to pay interest payments or redemptions of the federal tiers or even of distinctive states and communities. This ability depends on the autonomous power to create – additional – revenues to cover these expenditures or to cut back expenditures for public goods and transfer payments. In a horizontal perspective, the economic capacity creates despite the highly equalising equalisation schemes differences of total revenues per inhabitant, which – with regard to the low flexibility of public expenditures – provides remarkable differences of the federal tiers as well as of the distinctive states and communities to manage the consequences of their individual public debt.

The second and most important factor of public debt under the existing legal and economic determinants is the political will. One has to distinguish here an individual and a collective dimension.

- The first deals with the budgetary decisions of a single government and the respective parliament – mostly with a majority of the government constituting parties. The decisions about the amount of net borrowing are – besides the above mentioned ‘external’ factors of revenues and expenditures and the relate mid term expectations – a result of political priorities and ideologies, both strongly influenced by the next elections and the government’s strategy to keep the power. At the state level, the decisions about volume, structure and burdening of the local fiscal equalisation is among the most important political issues because a state government is interested to influence a corresponding majority among the local mayors and councils.
- The collective dimension of public debt in German federalism deals with political bailout strategies. The Federation needs the approval of the state governments for many federal laws – among them the costly federal tax reform laws in the field of personal and corporate income tax. As there is no collective limit of public borrowing for the three federal tiers in the constitution or in the European Stability Pact, both state governments as well as the federal government have an incentive to use borrowing and debt for political blackmailing trying to receive a higher (vertical) share of the turnover tax as a compensation of revenue losses or expenditure increases. In case of a failure of the blackmailing however, all participating governments have to pay higher ratios of interest payments from their budgets. Insofar, the danger of a collective rationality trap is very high.

The development of public debt shows these vertical political patterns of political decisions in many cases. The high degree of debt financing of German unification is a result of decisions of the federation:

- The Federal Ministry of Finance established several credits financed off-budget funds and introduced these burdens into the negotiations of the burden sharing after 1995 at the particular costs of the Western Länder.<sup>22</sup> For similar strategic ideas the surcharge income tax introduced to finance the additional burdens of German unification

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<sup>22</sup> The new Eastern Länder received higher FSG for the burdens of the German division. These funds were transferred together with the Fund of German Unification to official public debt (“Erblastentilgungsfonds”) in 1995 and are redeemed by Bund and Länder respectively by the federation alone since 1999 against certain fixed payment of the Länder.

in the mid of 1991 was abolished again in the mid of 1992 because otherwise the federation would have gone without deficits into the negotiations of burden sharing from autumn 1992.<sup>23</sup>

- When in the beginning of the 1990s the Federation was not able to convince the old Länder to shift higher shares of their proper revenues to the new Länder it sent highly ranked civil servants to the latter to convince them to close the financial gap by additional borrowing.<sup>24</sup> They used the argument that the public debt of state and local governments in East Germany strongly lacked behind the level in West Germany and they therefore could speed up their borrowing. The therefore deficient cut back of expenditures particularly with regard to public personnel has lead meanwhile to an even higher degree of public debt in East Germany than in the West (see table A1).
- State and local governments balanced their budgets by an increase of public deficits when the coincidence of economic recession and federal tax reforms brought them high tax revenue losses after 2001. They started the forceful cut back of expenditures only after 2004/5 – most of them at the burdens of investment expenditures – and ‘survived’ until the economic recreation brought recovery for tax revenues and the new federal government helped them (and itself) by an increase of the turnover tax by 3 percentage points. Meanwhile the new Länder including their communities show higher excesses of expenditure without interest payments to revenues without intakes from sales than the old Länder (see table A4).

At the moment, it is unclear whether and how far the fiscal restructuring of the budgets of all tiers will continue if the recession will bring Germany to declining tax revenues and increasing expenditures. The period of increasing revenues was too short and the efforts of cutting back expenditures too weak to re-establish healthy budgetary structures.

Besides the general moral hazard strategies in favour of increasing public debt at all levels of governments, there are specific problems at the state and local tiers. Both are typical forms of budget emergencies. Their reasons and their legal context are different. They are important for the equilibrium of powers between Bund and Länder because they are phenomena of bailing-out, the first between the federation and the states, the second between the states and their local governments.

### **3.3.1 Budget emergencies of German states**

The Constitutional Court was engaged in state budget emergencies first time in 1986 conceding financial aids to Bremen and the Saarland.<sup>25</sup> These estimated 50 billion Euros not for sufficient and brought the subject again before the Federal Constitutional Court which decided in 1992 that the two states should receive transfers in order to

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<sup>23</sup> See Färber, Gisela: Reform des Länderfinanzausgleichs; in: Wirtschaftsdienst 1993, H. 6, S. 305ff.

<sup>24</sup> See Schackmann-Fallis, Karl-Peter: Länderfinanzausgleich und Solidarpakt – ihre Bedeutung für die Länder und Gemeinden insbesondere in Ostdeutschland; in: Hüttig, Christoph; Nägele, Frank (Hrsg.): Neue Maßstäbe? Finanzausgleich und die Zukunft des deutschen Föderalismus, Loccumer Protokolle 74/00, Rehburg-Loccum 2002, S. 108.

<sup>25</sup> See BVerfGE 72, 330.

reach a degree of indebtedness like the next fiscally weak and indebted state, Schleswig-Holstein.<sup>26</sup> From 1994 to 1998 and a second period from 1999 to 2004 both Länder received 8.5 respectively 6.6 billion Euros as federal supplementary grants and had to deliver an annual report informing about their way out of their budget emergencies.

In 2003, Berlin, too, tried to win a proceeding in favour of aid for its budget emergency. The Constitutional Court decided on October 19<sup>th</sup>, 2006<sup>27</sup> that until 2002 Berlin had not reached a budget emergency and therefore had no entitlement of transfers from the federation or the other states. These particular transfers should only be the 'ultimate ratio' in a federal system. Berlin should prove before that it had properly exhausted all other budgetary remedies in favour of its financial restructuring.

The judgement of the Federal Constitutional Court probably was influenced by the fact that Bremen and the Saarland – despite the huge volume of grants of 8.5 respectively 6.6 billion Euros between 1994 and 2004 – have not reached their financial restructuring and have started new proceedings to get more transfer payments. Other fiscally weak states like Schleswig-Holstein und Saxony-Anhalt also require transfer payments in order to reduce their above average public debt. What are the reasons for these diverging developments of the public debt in the German states, which seem to be instruments of blackmailing the federation in favour of increasing grants after bailouts?

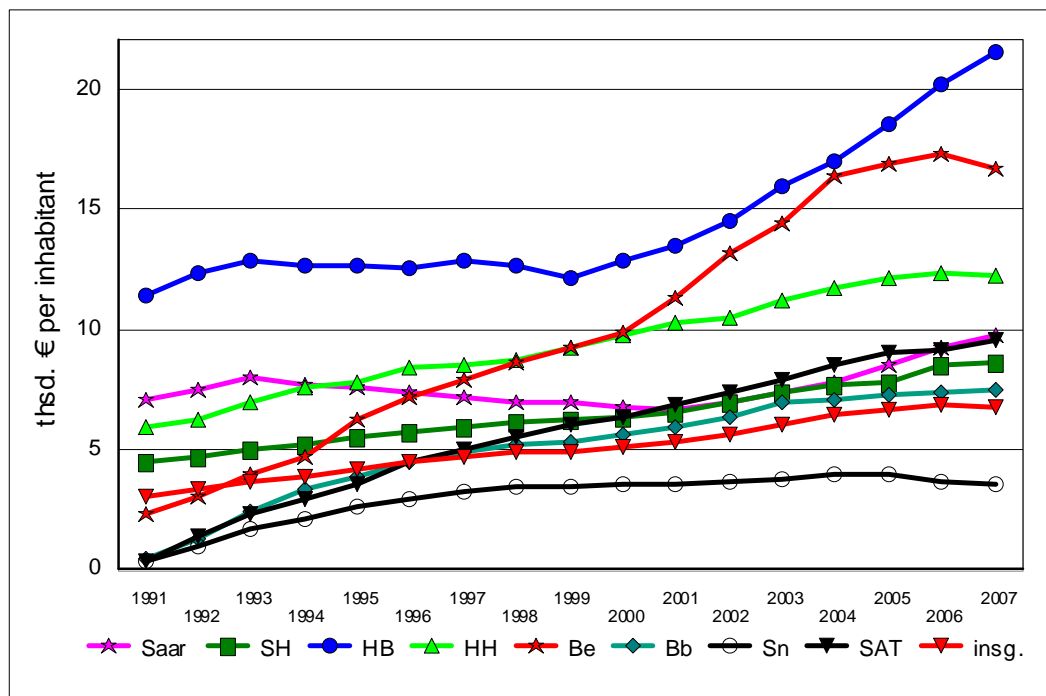


Fig. 11: Public debt per inhabitant of selected German states (including local governments)

<sup>26</sup> See BVerfGE 86, 148.

<sup>27</sup> See Bundesverfassungsgericht: Urteil 2 BvF 3/03, ([http://www.bundesverfassungsgericht.de/entscheidungen/fs20061019\\_2bvf000303.html](http://www.bundesverfassungsgericht.de/entscheidungen/fs20061019_2bvf000303.html)).

Source: Federal Statistical Office; proper calculations

Indeed, the development of per capita public debt of the German Länder (including their local governments to compare city-states and spatial states appropriately) is extremely divergent (see fig. 11 and the data in table A1). On the one hand, Bavaria and Saxony have undertaken a very restrictive debt policy leading to a per capita debt of only 2,938 Euros respectively 3,542 Euros in the end of 2007. Bremen has had the highest public debt with an amount of 21,570 Euros followed by Berlin with 16,634 Euros. Among the spatial states, the Saarland (9,712 Euros) and Saxony-Anhalt (9,518 Euros) show the highest public debt per inhabitant. Although after unification the new Länder were almost debt free, they meanwhile have higher per capita debt than the old Länder. The sharp increase of public debt in the period 2001-2005 has been reduced due to consolidation efforts since the economic recreation and even brought to net redemptions in many states. The sharp consolidation policy of Berlin has led to a remarkable turnaround of the public debt path.

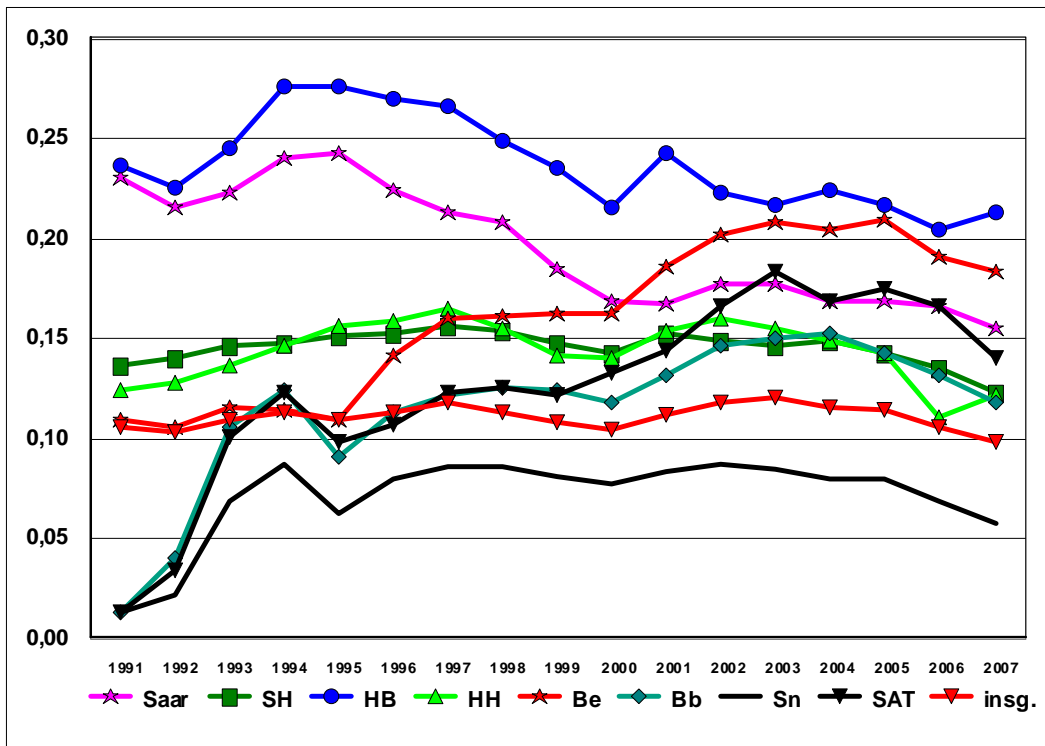


Fig. 12: The relation between interest payments and tax revenues (after fiscal equalisation, without special needs Federal Supplementary Grants in favour of the new Länder) of selected German states (including local governments), in percent

Source: Federal Statistical Office; proper calculations

The simple indicator of per capita public debt however is not sufficient for the diagnosis of a budget emergency. In fact, the ability to pay interests depends on the tax revenues of a jurisdiction; therefore, the ratio between those is decisive for the legal definition of a

budget emergency.<sup>28</sup> Modern public finance prefers the so-called balance of the single year budget,<sup>29</sup> which indicates whether a jurisdiction can cover the expenditures – without interests, which are the result of the deficits of the past – by the ‘regular’ intakes for which sales revenues are excluded from total revenues. A deficit in that balance of the single year budget always leads to a crowding out of expenditures for public goods provision; inversely, a budgetary deficit needs excess in the following single year budgets to cover its costs and to regain the former ratio of public debt to GDP.

The interest-tax-ratios vary among the German states significantly from less than 5 % in Bavaria to 22 % in Bremen (see figure 12). In Berlin, the indicator has been stabilised since 2002-2003 after the sharp increase since 1995. Saarland and Saxony-Anhalt also show successful consolidation efforts although their ratios are about 50 % higher than the average. All states have by the way consolidated their budgets after 2003 by cuts of expenditures and increase of tax revenues on the one hand and by the decrease of interest rates on the other hand.

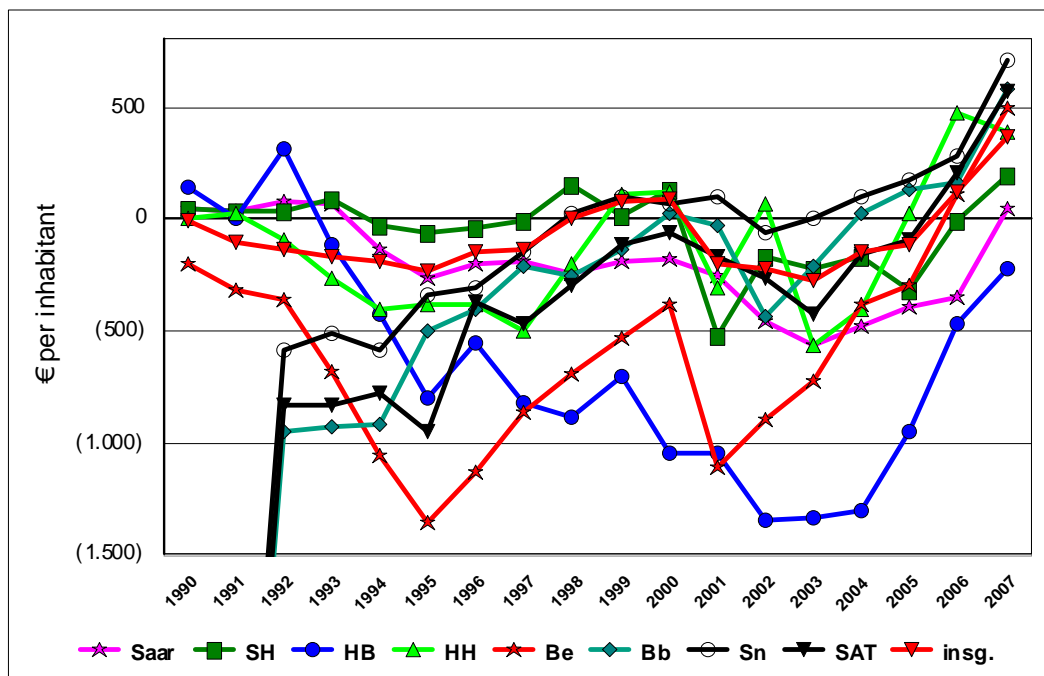


Fig. 13: The balance of the single year budget of selected German states, in Euros per capita  
Source: Federal Statistical Office; proper calculations

The interest-tax-ratio of Bremen and the Saarland from the beginning of the 1990s clearly indicates the exceptional budgetary situation of the two states. During the period of 1994–2004 when both received emergency grants, they attained a certain decrease

<sup>28</sup> As the tax revenues do not depend on economic capacity but on the result of the highly equalising fiscal equalisation procedure, the usually used ratio of public debt to GDP is not useful (see BVerfGE 86, 148).

<sup>29</sup> Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung: Staatsverschuldung wirksam begrenzen. Expertise im Auftrag des Bundesministeriums für Wirtschaft und Technologie. Wiesbaden 2007, p.20 ff.



of the ratio until 1999 not only in absolute terms but also in relative ones. After 2000, the ratios increased again and remained on the above average level. In relative terms, the ratios have continuously increased the recent years. The reason for this is an inadequate budgetary policy, which is indicated by the balances of the single year budget (see fig. 13). Had the two states balanced single year budgets until they received emergency grants they showed increasing deficits after 1994, Bremen in particular the highest deficits of all states. The single year budget deficits reached with 1,350 Euros per inhabitant more than 30 % of the single year revenues in the beginning of the 2000s indicating that Bremen had expenditures far beyond its means. The Saarland, too, had single year budget deficits up to almost 20 % of the revenues without sales instead of the necessary surpluses. Both states have practised without any doubt a budgetary policy leading them deeper or – in the case of the Saarland that had almost reached the goal of financial restructuring – again into budgetary calamities.

The question arises whether the Federation and the other states have agreed to that practice, the more as so the two emergency states had the obligation to report their annual progress in debt reduction to the financial planning committee, where the Bund and the states are represented and had to agree to these reports. The Federation gave, however, an explicit permit to spend the 'interest gains' of the realized redemptions for investment projects. Even the scopes of the declining interest rates since 1994<sup>30</sup> were not used to lower the public debt but to finance additional expenditures. Besides the misconstruction of the obligations imposed to the two emergency states that were only focussed on a limited growth of expenditures and not on the attainment of the interest-tax-ratio of Schleswig-Holstein, a political reason provided the failure of inter-federal emergency management. As the federal government needed the approval at least of Bremen, in some cases also that of the Saarland for tax reforms and other federal laws in the Bundesrat, they neglected the poor performance of the use of the emergency grants. The governments of the two states conserved the hope for continuing financial support and even have tried to obtain them by new claims at the Federal Constitutional Court as well as in the negotiations of the Commission of Federalism Reform II.

The debt crisis of the majority of the German states and the despite the voluminous grants continuing budget emergency at least of Bremen<sup>31</sup> highlights the ambivalent relation of Bund and Länder with regard to efficient budgetary policies and a sustainable amount of public debt. The centralisation of tax legislation competences with revenue losses for state and local governments on the one hand and the disastrous vertical competition to blackmail the other tiers by highly deficient budgets on the other hands have

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<sup>30</sup> The average interest rates for the public debt decreased from 7.45% (Saarland) respectively 7.40 % (Bremen) in 1994 to 4.78 % respectively 4.28 % in 2007.

<sup>31</sup> Whether the Saarland is still in a budget emergency is doubtful because the interest-tax-ratio amounts 'only' 59 % higher than the average of the states and the per capita non-interest-expenditures have exceeded the average expenditures of the other spatial states by +/-10 % since 1999 after the change of government neglecting the extremely high interest obligations. Therefore, the return to increasing interest-tax-ratios is a result of explicit political decisions, which – according to the Federal Constitutional Court – cannot lead to aids from the Federation and the other states (see BVerfGE 86, 148).

provided an amount of public debt which threatens the international competitiveness of the German economy and restrains the political measures to counteract against the financial crisis and the upcoming recession. The high divergences of per capita public debt among the states and the as well diverging interest payments determine significant differences to finance the provision of those public goods that strengthen the regional and local economies in the international competition and with regard to the demographic challenges.

### **3.3.2 Local government's imbalanced current budgets**

The picture of the total funded public debt of German jurisdictions hides serious current budget deficits of local governments in some states. The increase of local debt from 63 billion Euros in 1990 to 82 billion in 2007 is rather harmless in comparison to the growth of the central debt from 306 billion Euros in 1990 to 935 billion in 2007. However, behind the façade of even net redemptions of local funded debt in most German Länder there are tremendous deficits of the current budgets of which many will not be covered within the next decade.<sup>32</sup>

The problems caused by unification and revenue losses from federal tax reforms were consequently 'transmitted' from the upper levels to the lower ones. The lack of resources in federal and state budgets caused the shift of unfounded mandates to the states and localities. The local authorities were pushed to do expenditure of which they had no proper preferences (e.g. places at the kindergarten for all children starting from 3 years). The recession after 1993 as well as tax reforms in the middle of the 1990s and again between 2000 and 2005 decreased tax revenues and local authorities had to cut the expenditures and/or make more borrowings. Insofar they have similar problems like the Länder. Because the state local constitutions only allow borrowings for the investment expenditures, many local current budgets remained unbalanced although the state laws regulating local debt require that the current budgets have to be balanced the latest in the next but one year. However, many localities were not able to do this.

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<sup>32</sup> See e.g. Innenministerium des Landes Nordrhein-Westfalen: Kommunalfinanzbericht August 2008, Düsseldorf 2008, pp. 36.

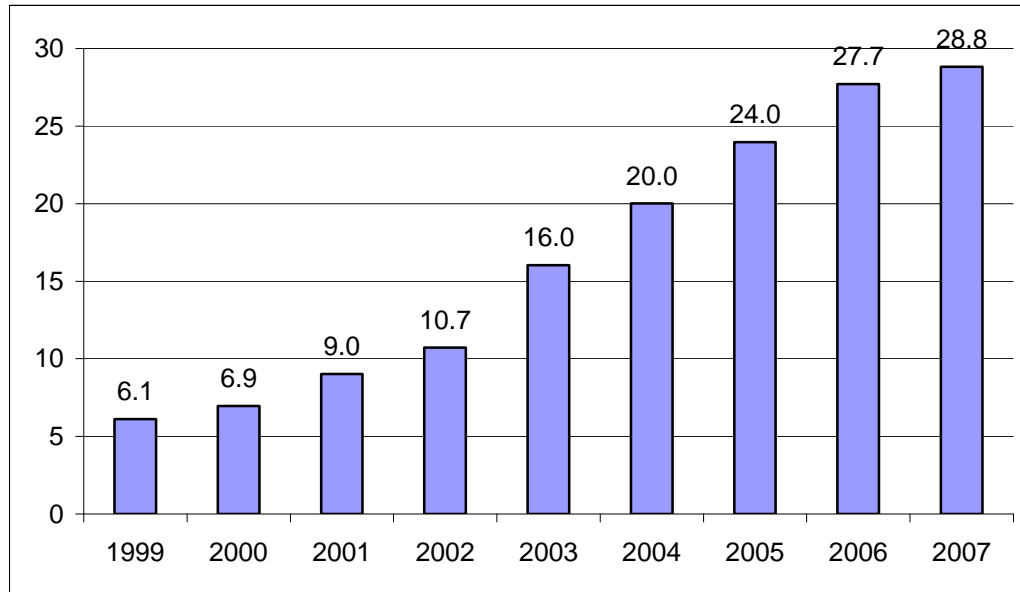


Fig.13: The increase of local current budget deficits from 1999, billion Euros  
Source: Federal Statistical Office

However, not all communities are affected in an equal way. Figure 13 figures the big differences in the amount and the structure of local debt by German states. The highest per capita funded debts show localities in Hessen (1,364 Euros per inhabitant), North Rhine-Westphalia (1,294 Euros), Saxony-Anhalt (1,250 Euros) and Rhineland-Palatinate (1,207 Euros). The highest local current budget deficits per capita are measured in municipalities in the Saarland (1,116 Euros per inhabitant), Rhineland-Palatinate (811 Euros), North Rhine-Westphalia (763 Euros), Lower Saxony (522 Euros) and Hessen (516 Euros). In the new Länder, the current budgets deficits are lower and reach only in Saxony-Anhalt (401 Euros), Mecklenburg-Vorpommern (325 Euros) and Brandenburg (303 Euros) a remarkable amount. Communities in Bavaria, Baden-Württemberg, Saxony and Thuringia have balanced or almost balanced current budgets. Of generally minor importance are local debts from other public budgets and reach only in Mecklenburg-Vorpommern (294 Euros), Hessen (227 Euros) and Schleswig-Holstein (166 Euros) a considerable size. In most states however, securities are of importance for the local budgets. In Baden-Württemberg they have a per capita amount of 951 Euros and value 56 % higher than funded debt. Total local liabilities differ from a per capita amount of +/- 2,500 Euros in Hessen, Saarland, North Rhine-Westphalia and Rhineland-Palatinate across 1,500 – 2,000 Euros in Mecklenburg-Vorpommern, Saxony-Anhalt, Lower Saxony, Bavaria and Baden-Württemberg to less than 1,500 Euros in Schleswig-Holstein, Thuringia, Saxony and Brandenburg.

The reasons for these different volume and structure of local public debt lie in the specific local equalisation policies of the states on the one hand and in the diverging legal approvals of the states control of local budgets in the case of current budget deficits on the other hand.

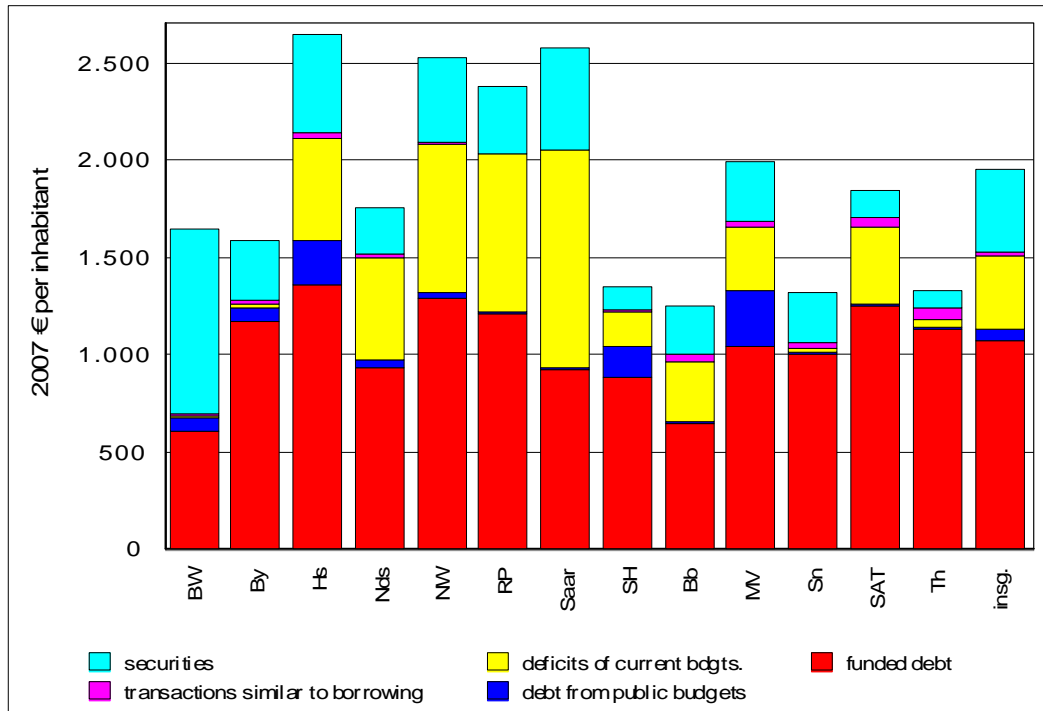


Fig.14: The structure of local debt, 2007, in Euros per capita

Source: Federal Statistical Office

- The formulas in the thirteen local fiscal equalisation schemes, by which the generally, i.e. after vertical tax sharing of tax revenues deficient local tax capacity is diluted, provide diverging vertical and horizontal financial capacities among local governments of comparable size and structure.<sup>33</sup> The above analysed federal tax reforms therefore have had very uneven results for communities in the different states. Additional distortions have resulted by the burdens of the costs of the German unification, which are transferred besides the general – uniform – increase of the trade tax apportionment by different formulas in the states.
- Particularly the ‘chronic’ increase of local current budget deficits in some states results from a very ‘generous’ approval of unbalanced current budgets for many years. The supervision of local budgets in these states has started too late a more restrictive application of local debt rules, possibly because the budgetary situation of the Land was as well burdened by losses from the tax reforms, which had provided cuts of other transfers in favour of local governments.

Therefore, the situation with current deficits remains alarming despite of significant increase of local tax revenue during the last two years. The communities, which have ‘collected’ current budget deficits over a period of more than ten years are mostly not able to return to a balanced situation within the next ten or even 20 years. These communities have to reduce their expenditures within that period significantly under the level of other municipalities and therefore suffer from disadvantages with regard to the location

<sup>33</sup> See Sauckel, Marika: Inzidenz kommunaler Finanzausgleichssysteme, Berlin 2006.

competition. They also have less means for 'voluntary' local public goods in the field of local self-administration than communities without or with only low debt.

The severe and very uneven imbalances of local budgets at least in some states bring up the idea that there is a need of a fundamental reform of the local financial system. The respective negotiations had failed in 2003 bringing only minor changes, but not a more reliable and more autonomous tax base. Local finance has not been adapted to the topics of the federalism reform commission II although it is an important part of the multi-level fiscal federalism in Germany and highly dependent from federal tax policies.

### **3.4 The German Bund: a 'wise dictator' or an 'overtaxed monopolist'?**

The different parts of the revenue side of the fiscal constitution show a cascade of after-effects of badly designed centralisations. The federation pays a high price for its monopoly in tax legislation shifting an important share of the costs to state and local governments. In return, the subordinate tiers take revenge with their 'proper weapons': uneven and expensive execution of tax laws, 'balancing' their budgets by public debt, and interconnecting their necessary approval to the tax laws and other expensive federal legislation with additional grants. The reform of the fiscal equalisation gives the impression of the fake of a reform because despite a convergence of real state tax capacities in 2007 the transfer payments of the federation remained as high as in 2005 and 2006. There seems to be not relief for the Bund and the donor states. The only reduction of payments results from the continuous decrease of the special needs federal supplementary grants until 2019.

With regard to the high degree of centralisation, the question arises whether the federation is able to bear so much responsibility for the financing not only for its proper budget but also for the state and local budgets. Has the centralisation of revenues power brought the Bund into a position of being continuously blackmailed by the states? Can the Bund really know what type of taxes and what amount of revenues states and communities need to fulfil their constitutional tasks? Is this dispersion of revenue competences in the German fiscal constitution not a constant incentive of shifting financial responsibility and political accountability to other tiers of the federal systems or – in the horizontal directions – to other states or communities or even to future generations? The centralised competences of the fiscal constitution bring the federation in the role of the "wise dictator" from the normative welfare economic approaches.

However, the fatal situation of the German budgets unambiguously proves that it really cannot fulfil that task, for which many more information and a direct reach-through to the subordinate jurisdictions are needed. That model also contradicts the idea of federalism in which all jurisdictions have independent powers providing more freedom and a more efficient public sector. With regard to the general federalism theory as well as to the theory of fiscal federalism, the picture of the federation of an 'overtaxed monopolist' can better describe the German distribution of powers in the fiscal constitution:

## 4. Federalism Reform Commission I and II

The first federalism reform commission has brought very few results for the revenue side of the fiscal constitution. The level of conflict was too high, and the Minister Presidents excluded related subjects like tax autonomy for the states from the agenda at an early stage of the negotiations. In the end, besides some shifts of legislation competences – among them the salaries and pensions for the civil servants and a restricted right to deviate from federal law which can bring some real decentralisation, the states received the right to determine the rate of the land acquisition tax.<sup>34</sup> The important subjects of limits of public borrowing, prevention of budget emergencies, tax autonomies for the states, an efficient and effective tax administration and a benchmarking for state administrations are among other subjects of administrative collaboration on the agenda of the reform commission II. The main proposals in discussion for public sector revenues<sup>35</sup> are in the following presented and evaluated with regard to their outcomes and their impact on centralisation and decentralisation.

### 4.1 New limits for public borrowing and prevention of budget emergencies

As the European pact of stability as the budget emergencies of some states and the extremely high volume of federal public debt, which have been “legally” established under the existing constitutional borrowing limits require a new and more restrictive limit for public borrowing. All partners agree about the necessity of a certain deficits during recession periods and their reimbursements during boom periods. Important actors from the federal tier, particularly the partners in government CDU and the social democrat Minister of Finance, propose a balanced (0 %) or almost balanced budget (0.5 % to GDP) across the economic cycle for the public sector in total. In case, that a positive public debt ratio to GDP will be permitted the federation should absorb 50 %, the states 35 % and municipalities 15 %. Parts of the SPD – member of the Federal Parliament as of state parliaments and governments – however prefer a limited borrowing for financing investment expenditures with a reimbursement according to the depreciation of the infrastructure capital goods. The discussion also deals with a more restrictive borrowing limit to be set up only for the federation if there would be no majority for a new rule in the constitution.

In order to avoid budget emergencies in the future, a council of stability is planned; the council should be similarly composed like the financial planning council where the Federal and the State Ministries of Finance and the Federal Reserve Bank are represented. The council has to indentify budgets emergencies in an early stage by a set of indicators and should then decide about remedies and about sanctions in the case, a Land does

<sup>34</sup> See Gesetz zur Änderung des Grundgesetzes vom 28.8.2006 in: BGBl 2006, Teil I, S.2034 (<http://www.bgblportal.de/BGBl/bgbl1f/bgbl106s2034.pdf>) and Föderalismusreform – Begleitgesetz vom 5.9.2006 in. BGBl I, S. 2098 (<http://www.bgblportal.de/BGBl/bgbl1f/bgbl106s2098.pdf>).

<sup>35</sup> See Eckpunkte zur Modernisierung der Bund-Länder-Finanzbeziehungen Vorschlag der Vorsitzenden FV Dr. Peter Struck, MdB MP Günther H. Oettinger, MdL, Kommissionsdrucksache 128 (<http://www.bundestag.de/Parlament/gremien/foederalismus2/drucksachen/kdrs128.pdf>; download 22.8.2008).

not follow the recommendations and would not stop excessive borrowing. The idea to establish financial aids to the actually poor and highly indebted states seems to be rejected. No majority has the proposal of a far-reaching net redemption of public debt. Indeed, the public debt ratio (to GDP) can easily be reduced by a borrowing ratio below the economic growth rate.

The prevention measures against bailing out are suitable to strengthen the balance of power among the Federation and the states because it establishes a prevention from the risk that one or a few states shift the burden of its/their deficits to all other partners of the federal system. The implementation of a balanced or almost balanced budget rule in the federal constitution committing not only the Bund but also the Lander however provides new problems. Firstly, the evasion to the so-called 'off-budget-borrowing' and other unintended reactions like the decline of public infrastructure<sup>36</sup> cannot be prevented. These phenomena are well known from American states after the implementation of balanced budgets rules in the 1980s.<sup>37</sup> Germany too has very bad experiences with these practises keeping in mind that the federation financed German unification in the first half of the 1990s by off-budget borrowing laying the base of the meanwhile excessive public debt of the Bund. Secondly, the balanced budget itself is not sufficient for a sustainable financial policy because it does not guarantee that no financial burdens are shifted to future generations. In Germany, the uncovered pension payments for the civil service pension have to be included into the concept as well as financial transactions similar to borrowing like leasing contracts particularly the often practiced sale and lease back solutions.

Thirdly, a centrally regulated balanced budget rule burdens an efficient infrastructure investment policy of state and local governments. It does not correspond with the concept of intergenerational justice or pay – as – you - use principle when the taxpayers of the building period cover the full costs of infrastructure that is used for many years. Moreover, with regard to the consolidation efforts of states and municipalities there is a true danger that the volume of infrastructure investment expenditure would shrink to an unsatisfying amount even not enough to maintain the value of the existing infrastructure.

The balanced budget rule not allowing to finance infrastructure investment expenditures by borrowing would influence the investment activities of the federal tiers in an uneven way: States and local governments spent the majority of the public investment expenditures –the first by investment grants to the latter, the latter directly by local budgets or by local enterprises. One can easily imagine what would be the consequences of balanced budgets rules for all German jurisdictions and federal tax reforms at the same time and no state tax autonomy!

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<sup>36</sup> See Wildavsky, Aaron: From chaos comes opportunity: the movement toward spending limits in American and Canadian budgeting; in: Canadian Public Administration, Vol. 26 (1983), p. 175.

<sup>37</sup> See California Debt Advisory Commission: Mello-Rose financing in California; Sacramento 1991, pp. 13. .

## 4.2 State tax autonomy

Indeed the most difficult subject of inter-federal negotiations is tax autonomy for the Länder. At the moment, Bund and Länder seem to have agreed to shift the revenues competence of the motor vehicle tax to the Federation, not in exchange of the insurance tax – as earlier discussed – but of a fixed amount of Euros. A working group still analyses the chances of more tax autonomy with concern of the land acquisition tax and with the – actually local – tax on real assets. The implementation of surcharge taxes on personal and corporate income tax on an experimental status is also under negotiation. Baden-Württemberg still requires tax autonomy for the tax base of the trade tax on profits. The fiscal equalisation scale should be calculated in all these cases across standardized tax capacities.

Although all these proposals would provide distinct decentralisations, they are not very helpful with regard to a ‘functioning’ federal competition among the states and among the municipalities of the different Länder because they do not establish a fair tax competition. An unfair tax competition would arise because rich communities could establish strategic tax bases and attract by this enterprises from locations of low economic capacity. Tax surcharge on the progressive income tax would give competitive advantages to the rich states because they need considerably lower surcharge rates to receive the same revenues as poor states. Decentralisation of tax autonomy for the property tax base would set incentives for attracting citizens particularly in the densely populated metropolitan areas, which contain states frontiers.

Therefore, a consensus for these proposals cannot and should not be expected. The poor states would risk systematic disadvantages and an increase of economic divergence for the economic capacities of the Länder. No federal system can accept that migration incentives for enterprises or citizens result from their fiscal constitution. It is one of the main reasons why tax competences are centralised and the volume of – vertical – fiscal equalisation grants increases in the period of globalisation just to prevent decentralised jurisdictions from unfair tax competition, which does not increase the national welfare but decreases it.

One should thoroughly reflect the questions why no proposals for decentralising surcharge competences on more even tax bases are negotiated - e.g. autonomous tax rates on the tax base of the personal income tax with a dissection in favour of the working places instead on the progressive tax liabilities. Why is there no discussion how the distortions of the tax allowances can be excluded from the surcharge bases? Why can the Federation not completely take over the revenue losses from tax allowances against a higher share of the tax rate scale? The reserve of the Bund is obvious because in that case the federation had to bear the total costs of encouraging and promoting enterprises and citizens by itself and could no longer receive expense loading from states and communities. Also should be mentioned that powerful interest groups are against a workable tax decentralisation of taxation powers: In that case, they would lose their effective influence on tax policies in Germany.



### 4.3 Tax Administration

Shortly after bringing the discussion about the uneven tax administration to the public the Federal Ministry of Finance proposed to shift the tax administration of the joint taxes completely to a strong and competent federal tax administration<sup>38</sup> and to leave the collection of state taxes to the Länder. The federation would also take over the personnel because a federal tax administration would also operate tax authorities in all German regions. A consultant report calculated the marginal revenues of these measures by 11 billion Euros.

The significance of the subject is much beyond the potential financial effects because uniform tax laws in a federation requires its uniform application as a precondition of a broad acceptance of tax burdens. However, nobody really expects an agreement in favour of federal tax administration. The resistance of the states is tremendous; they are not willing to lose this important field of administrative competences. The personnel representations also fiercely fight against their transfer to the federation. They fear that then they are dislocated all over Germany and not only within a state. Anyway, the negotiations will probably provide an agreement about an intense exchange of data about taxpayers' data: The Federation has created the technical and legal preconditions for that data exchange by establishing a more than lifelong personal tax identification number for all taxpayers, which will be valid and conserved from birth until 20 years after their death.

Another probable compromise lies in a far-reaching exchange of information on the tax administration procedures. Besides the data about public debt, which is necessary for the national stability pact, data about the costs and performances of the state tax administrations can provide transparency about the equality of the execution of federal tax laws. These can be supplemented by information and data of the taxpayers' standard costs for preparing their tax declaration. Moreover, the states should have an interest in delivering and receiving comparative information and data about the standard costs of tax administration resulting from the more and more complex and difficult tax legislation. By this way, the total economic (standard) costs of taxation become transparent and lay the base for a public political debate of better and simpler tax laws.

### 4.4 Benchmarking of state policies and administration

A very important subject among the negotiations of Bund and Länder is the introduction of a benchmarking system. Other federal countries have established long ago periodic horizontal reviews of the policies of the states in order to enforce federal competition. One of the best examples is the Commonwealth Productivity Commission in Australia.

Competition within the public sector does not come from a market constitution providing optimal results of self-coordination. It has to be established by institutional structures

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<sup>38</sup> See Der Präsident des Bundesrechnungshofs: Position des Bundesrechnungshofs zur Bundessteuerverwaltung; Kommission von Bundestag und Bundesrat zur Modernisierung der Bund-Länder-Finanzbeziehungen, Kommissionsdrucksache 110, (<http://www.bundestag.de/Parlament/gremien/foederalismus2/drucksachen/kdrs110.pdf>)

and detailed distributions of powers. With regard to the theory of public choice, the coordinating performance of competition is transferred by democratic elections. It is enhanced by the interjurisdictional competition among states and communities because voters not only compare the promises of candidates and parties but also whether the government in its jurisdiction provides better public goods of a lower 'tax price' than the government of the neighbour jurisdiction. As governments do not tend to objective information a benchmark from an institution outside the tier of competing jurisdictions guarantees data and information of better quality and therefore a functional competition.

For the German federal reform, a benchmark for an early warning system detecting budget emergencies in a timely manner to prevent them effectively and the data about tax administration could be supplemented by benchmarks about many other field of state administration and even proper responsibilities of the states. The states benchmark often is called the PISA of administration interlinking the idea with the experience of imposing reform agendas to the education system in state competences. The discussion proposes a voluntary election of subjects of benchmark. An external scientific institution to be selected should build up the academic infrastructure for the benchmark, organise the benchmarks and publish the results. An international council of advisors supervises the quality of the benchmarks.

The German federalism actually has a very weak comparative culture, which is the cause of some of its functional deficiencies. It is not clear whether the states will have the political courage to create more transparency and competition. This will also depend from their expectation of fair benchmarks on a solid and with regard to the scientific methods unassailable approach. In the case of a decision in favour of the Länder benchmark can be expected the most considerable changes of behaviour in the federal system. Because the existing horizontal and vertical gap between the political institutions of the division of powers can be closed.

## **5. Summary and perspectives**

The analysis of the recent developments concerning the revenue side of the German fiscal constitution has shown a considerable increase of the centralisation of taxation powers to the federation on the one hand and a creeping de facto decentralisation in fiscal equalisation and in public debt. This leads to increasing open and hidden costs for the Federation as well as to revenue and welfare losses of the whole federal system. The reactions of states and communities, which hazard the consequences of increasing public debt or even shifting public debt from state to local level weakens their international competitiveness as locations. Their irrational way into public debt reminds to the behaviour of suppressed people who gnarl and mumble but undertake then actions which vulnerate instead of disburdening themselves. High equalisation transfer payments maintaining their amount despite the reform of the fiscal equalisation scales in the end can satisfy neither the recipients nor the donators because they conserve the dependencies and prevent autonomous strategies of financial reconstruction. The example of Berlin, which achieved a 'passive' budgetary rehabilitation from its budget emergency as a result of its proper cut backs on the one hand and the increasing debt of the other

Länder on the other hand shows that autonomous resolute budgetary strategies against the stream of the other sub national 'suppressed' jurisdictions are successful and help to regain scopes of political action.

The collective negotiations of the federalism reform commission II deal with centralisation as well as with decentralisation measures. Many of the proposals in discussion bring centralisation – e.g. the central regulation of a balanced budget or the federal tax administration –, others provide decentralisation like the subjects of state tax autonomy. Many of them seem to be good solutions if they are regarded isolated. As elements of an integrated reform with the aim to reconstruct the revenue side of the fiscal constitution, they will not lead to the desired results because they abrogate each other. The problem of the commission seems to be that there is no theoretical base how federal competition could 'work' in the German executive federalism, which will be still highly interlinked after whatever reform will be decided. Some very important subjects like the local revenue reform are even excluded from the agenda. Thereby a long-term financial reconstruction of the state budgets depends on the financial equipment of the communities.

Finally, one cannot overlook that most of the Minister Presidents and Ministers of Finance do not want more financial responsibility. Too deep in mind is the opinion that that could be a source of political harm when they never can tell the voters that the Federal minister of Finance was responsible for their inability to sponsor more jobs for teachers. Moreover, important interest groups want to maintain their influence on tax policies, which they can more easily organise under central tax legislation than under decentralised taxation powers and where they can concentrate on new tax expenditures, which are much less costly for the federation than direct subsidies. It is a particular brassiness to castigate the high equalisation grants resulting from these central tax policies as indicators of an unfeasible economic policy of the poor states. In the end, therefore is the danger that the reform could provide an increase of the patronizing and dominating behaviour of the Federation enlarging the contrast between the requirement of balanced budgets for all jurisdictions and the full centralisation of tax legislation in favour of the Bund. This would be the worst case for Germany's international competitiveness. However, there is also possible that the worldwide financial crisis will be used to leave (almost) everything unchanged because the budgetary deficits actually have started to increase again.

## Appendix

€ per capita	1991	1995	2000	2002	2004	2005	2006	2007
Federation								
	4,348.4	8,046.2	9,416.2	9,439.7	10,426.1	10,768.5	11,128.5	11,398.3
States								
BW	2,062.4	2,343.2	2,812.0	3,139.7	3,504.2	3,683.0	3,824.1	3,881.3
By	1,298.0	1,195.9	1,473.9	1,552.2	1,706.9	1,850.7	1,849.0	1,820.9
He	2,494.4	3,044.5	3,561.5	4,078.6	4,692.9	4,962.7	4,831.8	4,937.7
Nds	2,865.6	3,695.5	4,307.4	5,020.1	5,841.1	5,986.4	6,099.1	6,191.4
NW	2,966.5	3,457.8	4,259.5	4,897.9	5,670.5	6,032.7	6,258.4	6,334.7
RPL	2,970.9	3,513.2	4,552.3	5,052.0	5,723.2	6,070.0	6,228.8	6,346.4
Saar	5,827.8	6,400.6	5,728.9	6,138.2	6,980.1	7,716.2	8,344.8	8,799.6
SH	3,850.6	4,753.1	5,567.8	6,132.1	6,926.1	6,916.3	7,685.9	7,771.8
HB	11,450.5	12,676.3	12,892.1	14,521.2	17,003.6	18,518.2	20,148.8	21,534.1
HH	5,914.5	7,824.2	9,722.9	10,528.6	11,734.3	12,134.2	12,367.1	12,282.3
Be	2,354.0	6,207.8	9,885.6	13,170.2	16,329.7	16,901.3	17,354.0	16,628.1
Bb	152.7	3,247.2	4,922.6	5,667.4	6,385.1	6,644.4	6,741.9	6,870.5
MV	123.5	2,184.5	4,202.7	4,957.8	5,978.5	6,312.8	6,312.2	5,977.2
Sn	10.8	1,630.0	2,266.8	2,445.9	2,752.3	2,827.8	2,719.9	2,613.4
SAT	167.8	2,665.6	5,156.2	6,111.5	7,219.7	7,789.9	7,856.9	8,267.1
Th	266.4	2,392.1	4,463.3	5,068.9	5,970.3	6,446.3	6,803.1	6,832.2
spatial states	2,052.7	2,820.6	3,592.6	4,067.2	4,659.1	4,908.1	5,036.3	5,092.6
city states	4,451.0	7,429.7	10,182.6	12,534.8	15,028.8	15,653.0	16,174.2	15,874.8
average	2,226.1	3,151.3	4,054.1	4,660.2	5,386.3	5,664.3	5,821.9	5,857.1
local governments								
BW	742.5	832.4	673.7	623.6	618.9	610.9	625.3	564.9
By	720.1	914.5	1,015.7	1,079.5	1,186.2	1,179.4	1,166.9	1,117.1
He	1,406.4	1,558.8	1,299.2	1,272.8	1,296.3	1,316.5	1,271.3	1,269.3
Nds	1,133.8	1,184.6	1,030.4	988.1	987.4	959.6	942.2	923.5
NW	1,289.2	1,451.3	1,394.4	1,346.0	1,331.8	1,344.1	1,319.0	1,271.6
RPL	938.8	1,036.0	1,047.5	1,094.3	1,145.8	1,157.9	1,183.0	1,191.4
Saar	1,196.7	1,153.2	987.2	871.4	843.8	846.7	916.1	918.2
SH	618.0	725.6	814.0	805.3	808.8	856.0	861.3	825.5
Bb	264.0	664.1	705.0	692.6	705.2	654.2	643.2	646.9
MV	226.4	921.1	1,154.2	1,212.9	1,199.4	1,165.8	1,068.2	1,014.1
Sn	371.6	1,034.5	1,247.0	1,223.8	1,206.0	1,173.1	973.0	929.2
SAT	206.9	945.1	1,225.3	1,288.1	1,345.6	1,332.0	1,295.2	1,248.6
Th	173.9	1,098.3	1,212.6	1,226.1	1,230.1	1,199.6	1,164.8	1,127.7
Average	876.8	1,117.5	1,095.5	1,082.5	1,100.3	1,096.2	1,071.3	1,034.4
state + local governments								
BW	2,804.8	3,175.6	3,537.9	3,763.3	4,123.1	4,294.0	4,449.4	4,446.2
By	2,018.1	2,110.5	2,489.7	2,631.7	2,893.1	3,030.2	3,015.8	2,938.0
He	3,900.9	4,603.2	4,860.7	5,351.4	5,989.2	6,279.2	6,103.0	6,207.1
Nds	3,999.3	4,880.1	5,337.8	6,008.2	6,828.5	6,946.0	7,041.3	7,114.9
NW	4,255.7	4,909.1	5,653.8	6,243.9	7,002.3	7,376.8	7,577.3	7,606.2
RPL	3,909.6	4,549.2	5,599.7	6,146.3	6,869.0	7,227.9	7,411.8	7,537.7
Saar	7,024.4	7,553.8	6,716.1	7,009.6	7,823.9	8,562.9	9,260.8	9,717.8
SH	4,468.6	5,478.7	6,381.8	6,937.5	7,734.9	7,772.3	8,547.2	8,597.3
HB	11,450.5	12,676.3	12,892.1	14,521.2	17,003.6	18,518.2	20,148.8	21,534.1
HH	5,914.5	7,824.2	9,722.9	10,528.6	11,734.3	12,134.2	12,367.1	12,282.3
Be	2,354.0	6,207.8	9,885.6	13,170.2	16,329.7	16,901.3	17,354.0	16,628.1
Bb	416.7	3,911.3	5,627.6	6,360.0	7,090.3	7,298.6	7,385.1	7,517.4
MV	350.0	3,105.5	5,357.0	6,170.7	7,177.9	7,478.6	7,380.4	6,991.3
Sn	382.4	2,664.5	3,513.8	3,669.7	3,958.3	4,000.9	3,693.0	3,542.7
SAT	374.7	3,610.7	6,381.5	7,399.6	8,565.4	9,121.9	9,152.2	9,515.7
Th	440.3	3,490.5	5,676.0	6,295.0	7,200.4	7,645.8	7,967.9	7,959.9
spatial states	2,929.5	3,938.1	4,688.1	5,149.7	5,759.4	6,004.3	6,107.6	6,127.0
city states	4,451.0	7,429.7	10,182.6	12,534.8	15,028.8	15,653.0	16,174.2	15,874.8
average	3,039.5	4,188.6	5,072.8	5,666.9	6,409.4	6,683.4	6,817.7	6,818.1
<b>total public sector</b>								
	<b>7,387.9</b>	<b>12,234.8</b>	<b>13,489.0</b>	<b>15,106.6</b>	<b>16,835.5</b>	<b>17,451.9</b>	<b>17,946.2</b>	<b>18,216.4</b>

Table A1: Public debt per capita of state and local governments 1991–2007

Source: Federal Statistical Office; proper calculations

	1991	1995	2000	2002	2004	2005	2006	2007
Federation								
	22.7%	35.5%	37.5%	36.3%	38.9%	39.6%	39.5%	38.7%
States								
BW	9.0%	9.8%	10.2%	10.7%	11.9%	12.4%	12.7%	12.3%
By	5.9%	4.8%	5.0%	5.1%	5.4%	5.8%	5.6%	5.2%
He	10.4%	11.4%	11.8%	13.0%	14.4%	14.9%	14.0%	13.9%
Nds	15.4%	18.2%	18.9%	22.0%	25.0%	24.8%	24.5%	24.0%
NW	14.3%	15.1%	16.9%	18.9%	21.2%	22.3%	22.3%	21.5%
RPL	15.7%	17.2%	20.2%	22.5%	24.0%	25.4%	25.3%	24.6%
Saar	30.7%	30.5%	24.8%	25.9%	27.7%	29.1%	30.5%	30.6%
SH	20.5%	22.6%	23.9%	26.3%	29.0%	28.9%	31.1%	30.5%
HB	43.8%	43.7%	38.5%	41.2%	46.3%	49.8%	52.7%	54.3%
HH	17.9%	21.0%	22.9%	23.4%	25.7%	26.0%	25.4%	24.3%
Be	13.2%	27.8%	42.7%	56.7%	71.3%	72.6%	73.2%	67.9%
Bb	2.0%	22.5%	28.5%	31.5%	34.0%	34.7%	34.3%	33.0%
MV	1.7%	15.3%	24.9%	28.1%	32.3%	33.8%	32.9%	29.4%
Sn	0.1%	11.1%	13.3%	13.1%	13.8%	14.1%	13.1%	11.9%
SA	2.4%	19.7%	31.4%	34.2%	38.3%	40.6%	39.6%	39.4%
Th	4.1%	17.7%	26.8%	28.7%	31.5%	33.6%	34.2%	32.7%
spatial states	10.9%	12.7%	14.5%	15.9%	17.6%	18.3%	18.1%	17.5%
city states	18.7%	26.4%	33.9%	40.3%	48.0%	49.0%	49.2%	46.5%
total	11.6%	13.9%	16.2%	17.9%	20.1%	20.8%	20.7%	19.9%
local governments								
BW	3.2%	3.4%	2.4%	2.1%	2.1%	2.0%	2.0%	1.7%
By	3.2%	3.7%	3.4%	3.5%	3.8%	3.7%	3.5%	3.2%
He	5.8%	5.8%	4.3%	4.1%	4.0%	4.0%	3.7%	3.6%
Nds	6.1%	5.8%	4.5%	4.3%	4.2%	4.0%	3.8%	3.6%
NW	6.2%	6.3%	5.5%	5.2%	5.0%	5.0%	4.7%	4.3%
RPL	5.0%	5.1%	4.6%	4.9%	4.8%	4.8%	4.8%	4.6%
Saar	6.3%	5.5%	4.3%	3.7%	3.3%	3.2%	3.4%	3.2%
SH	3.3%	3.4%	3.5%	3.5%	3.4%	3.6%	3.5%	3.2%
Bb	3.5%	4.6%	4.1%	3.8%	3.8%	3.4%	3.3%	3.1%
MV	3.1%	6.5%	6.8%	6.9%	6.5%	6.2%	5.6%	5.0%
Sn	5.0%	7.1%	7.3%	6.6%	6.1%	5.9%	4.7%	4.2%
SA	3.0%	7.0%	7.5%	7.2%	7.1%	6.9%	6.5%	5.9%
Th	2.7%	8.1%	7.3%	6.9%	6.5%	6.2%	5.9%	5.4%
spatial states	4.7%	5.0%	4.4%	4.2%	4.2%	4.1%	3.8%	3.6%
total	4.2%	4.6%	4.1%	3.9%	3.8%	3.7%	3.5%	3.3%
state + local governments								
BW	12.2%	13.2%	12.5%	12.8%	14.0%	14.4%	14.7%	14.1%
By	9.1%	8.5%	8.4%	8.6%	9.2%	9.4%	9.1%	8.5%
He	16.2%	17.2%	16.1%	17.0%	18.4%	18.9%	17.7%	17.4%
Nds	21.5%	24.0%	23.4%	26.4%	29.2%	28.8%	28.3%	27.5%
NW	20.5%	21.4%	22.4%	24.1%	26.2%	27.2%	27.0%	25.9%
RPL	20.7%	22.3%	24.8%	27.4%	28.8%	30.2%	30.1%	29.2%
Saar	37.1%	36.0%	29.1%	29.6%	31.0%	32.3%	33.9%	33.8%
SH	23.8%	26.0%	27.4%	29.7%	32.4%	32.4%	34.6%	33.8%
HB	43.8%	43.7%	38.5%	41.2%	46.3%	49.8%	52.7%	54.3%
HH	17.9%	21.0%	22.9%	23.4%	25.7%	26.0%	25.4%	24.3%
Be	13.2%	27.8%	42.7%	56.7%	71.3%	72.6%	73.2%	67.9%
Bb	5.6%	27.1%	32.5%	35.3%	37.7%	38.1%	37.5%	36.1%
MV	4.8%	21.8%	31.8%	35.0%	38.8%	40.1%	38.4%	34.4%
Sn	5.2%	18.2%	20.6%	19.7%	19.9%	20.0%	17.8%	16.2%
SA	5.4%	26.7%	38.8%	41.5%	45.4%	47.6%	46.2%	45.3%
Th	6.8%	25.8%	34.1%	35.6%	38.0%	39.8%	40.1%	38.1%
spatial states	15.6%	17.7%	19.0%	20.1%	21.8%	22.3%	21.9%	21.0%
city states	18.7%	26.4%	33.9%	40.3%	48.0%	49.0%	49.2%	46.5%
total	15.8%	18.5%	20.2%	21.8%	23.9%	24.5%	24.2%	23.1%
total public sector								
	38.5%	54.1%	57.7%	58.1%	62.8%	64.1%	63.7%	61.8%

Table A2: Public debt in relation to GDP 1991-2007

Source: Federal Statistical Office; proper calculations

	1991	1995	2000	2002	2004	2005	2006	2007
BW	8.34%	8.61%	6.90%	7.50%	7.63%	7.90%	8.12%	6.25%
By	6.50%	5.96%	4.99%	5.06%	5.26%	5.14%	4.71%	4.00%
He	10.90%	12.21%	10.02%	10.81%	10.66%	10.56%	9.54%	8.99%
Nds	12.09%	13.55%	12.45%	14.31%	14.21%	14.07%	12.56%	11.75%
NW	13.07%	12.97%	11.57%	12.90%	12.51%	12.01%	11.49%	10.89%
RPL	12.42%	12.83%	12.36%	13.61%	13.48%	13.35%	12.01%	11.75%
Saar	22.98%	24.23%	16.85%	17.78%	16.82%	16.83%	16.55%	15.48%
SH	13.62%	15.10%	14.31%	14.90%	14.84%	14.21%	13.48%	12.34%
HB	23.61%	27.56%	21.48%	22.26%	22.42%	21.72%	20.49%	21.35%
HH	12.39%	15.64%	13.98%	16.00%	14.86%	14.20%	11.10%	12.19%
Be	10.97%	10.89%	16.20%	20.18%	20.46%	20.90%	19.09%	18.35%
Bb	1.24%	9.05%	11.84%	14.60%	15.21%	14.24%	13.20%	11.77%
MV	1.16%	7.22%	12.27%	14.51%	14.30%	14.10%	12.57%	11.94%
Sn	1.27%	6.19%	7.74%	8.74%	7.96%	8.00%	6.85%	5.76%
SAT	1.35%	9.77%	13.33%	16.55%	16.91%	17.41%	16.61%	14.06%
Th	1.71%	8.20%	11.98%	14.92%	14.90%	15.26%	13.49%	12.55%
spatial States	10.24%	10.58%	9.89%	11.00%	10.87%	10.71%	10.00%	9.07%
city States	13.78%	14.34%	16.07%	19.00%	18.82%	18.71%	16.44%	16.72%
average	10.52%	10.93%	10.46%	11.74%	11.60%	11.45%	10.61%	9.76%
old Länder	11.09%	11.56%	10.00%	10.95%	10.77%	10.58%	9.87%	9.09%
new Länder incl. Be	4.64%	8.63%	12.24%	14.92%	14.95%	15.05%	13.67%	12.50%

Table A3: Interest-tax-ratios of aggregated state and local governments (after fiscal equalisation, without FSG for the division of Germany and budget emergencies of Saarland and Bremen)

Source: Federal Statistical Office; proper calculations

	1991	1995	2000	2002	2004	2005	2006	2007
expenditures without interest payments								
BW	3,383.9	3,613.7	3,827.9	3,976.0	3,895.3	3,999.7	4,072.1	4,033.2
By	3,216.2	3,742.5	3,896.7	4,033.7	3,977.1	4,001.0	4,071.7	4,182.0
He	3,478.6	3,884.4	4,203.7	4,259.7	4,319.8	4,313.5	4,499.0	4,743.7
Nds	3,108.8	3,435.1	3,432.4	3,620.7	3,556.6	3,594.7	3,613.6	3,709.9
NW	3,091.6	3,653.0	3,729.9	3,866.9	3,910.5	4,142.5	4,015.3	4,053.9
RPL	2,976.1	3,300.8	3,463.5	3,596.2	3,592.6	3,572.5	3,715.2	3,771.4
Saar	3,001.6	3,358.3	3,579.0	3,638.5	3,735.0	3,773.0	4,045.7	3,883.2
SH	3,196.5	3,574.9	3,460.5	3,598.9	3,666.0	3,845.8	3,833.6	3,817.1
HB	4,476.6	4,938.5	5,462.5	5,627.4	5,621.6	5,491.6	5,283.8	5,215.0
HH	4,241.2	4,736.7	5,110.5	4,467.9	5,480.0	5,188.3	5,268.5	5,356.5
Be	5,142.8	6,029.0	5,601.1	5,567.0	5,381.5	5,660.4	5,307.5	5,361.6
Bb	3,606.8	4,498.1	4,286.6	4,436.2	4,269.5	4,327.0	4,520.3	4,418.6
MV	3,742.3	4,678.0	4,478.6	4,669.5	4,534.3	4,626.7	4,640.6	4,472.2
Sn	3,367.3	4,380.1	4,231.9	4,190.8	4,264.6	4,266.7	4,462.6	4,306.3
SAT	3,576.8	4,443.4	4,382.8	4,419.5	4,509.9	4,562.9	4,518.3	4,339.3
Th	3,627.6	4,345.1	4,310.4	4,184.4	4,175.7	4,162.7	4,239.1	4,267.8
spatial states	3,267.8	3,780.9	3,857.3	3,971.6	3,960.3	4,047.9	4,085.3	4,115.6
city states	4,805.2	5,525.8	5,439.4	5,245.3	5,438.5	5,499.4	5,293.1	5,343.4
average	3,379.0	3,906.1	3,968.1	4,060.8	4,063.9	4,149.9	4,170.5	4,202.5
old Länder	3,241.8	3,671.2	3,808.5	3,924.3	3,941.3	4,028.9	4,051.5	4,113.1
new Länder incl. Be	3,849.1	4,756.6	4,567.7	4,584.1	4,541.4	4,623.7	4,638.7	4,556.4
balance of the single year budget								
BW	-86.57	-154.31	70.26	-201.02	-81.64	-139.82	85.58	450.71
By	10.91	-182.55	123.92	-223.66	-60.99	7.95	212.04	449.56
He	-42.43	-143.39	259.95	-277.07	-258.61	-218.89	84.88	285.48
Nds	90.94	-132.81	134.37	-241.28	-9.50	-116.63	217.42	194.81
NW	84.16	-23.55	134.81	-124.01	-228.08	-192.72	51.55	260.08
RPL	18.35	-90.70	86.40	-245.06	-200.30	-106.67	-48.84	163.75
Saar	35.67	-259.71	-178.21	-456.34	-475.97	-387.46	-349.64	42.32
SH	34.14	-63.42	127.91	-165.48	-167.73	-317.30	-8.47	196.85
HB	1.50	-801.32	-1,042.82	-1,350.15	-1,300.54	-945.42	-471.17	-217.23
HH	26.78	-378.30	115.71	71.22	-400.47	29.32	474.69	391.98
Be	-319.35	-1,354.16	-386.19	-892.63	-381.11	-295.12	108.24	496.58
Bb	-3,606.76	-504.45	27.14	-433.87	20.64	126.05	158.26	575.92
MV	-3,742.32	-644.71	-121.01	-408.68	-130.40	49.04	245.27	555.39
Sn	-3,367.27	-343.77	64.10	-66.42	100.28	174.61	284.17	708.08
SAT	-3,576.83	-946.54	-57.28	-260.82	-160.97	-95.07	208.49	566.60
Th	-3,627.60	-475.05	-49.24	-209.41	-176.37	-9.38	179.09	524.67
spatial states	-99.49	-181.83	108.97	-202.35	-122.79	-104.23	119.13	362.21
city states	-182.04	-830.65	-155.74	-537.32	-418.56	-272.15	152.25	383.80
average	-105.46	-228.38	90.44	-225.81	-143.54	-116.03	121.47	363.74
old Länder	22.74	-95.66	136.68	-188.00	-152.20	-144.08	101.67	308.37
new Länder incl. Be	-544.70	-708.85	-83.22	-370.79	-109.83	-6.20	199.36	582.80

Table A4: Expenditures without interest payments and balances of the single year budgets of aggregated state and local governments 1991-2007

Source: Federal Statistical Office; proper calculations

*western States ("old" Länder)*

BW	Baden-Württemberg
By	Bavaria
He	Hesse
Nds	Lower Saxony
NW	North Rhine-Westphalia
RPL	Rhineland-Palatinate
Saar	Saarland
SH	Schleswig-Holstein
HB	Bremen
HH	Hamburg

*eastern states ("new" Länder)*

Be	Berlin
Bb	Brandenburg
MV	Mecklenburg-Vorpommern
Sn	Saxony
SA(T)	Saxony-Anhalt
Th	Thuringia

Table A5: Abbreviations key



## **The Distribution of Competences and the Tendency towards Centralization in the Argentine Federation**

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### **I. INTRODUCTION**

#### **a. Brief commentaries on geography and history of Argentina**

Geographically, Argentina is a very large country, with a continental land surface of 2.8 million square kilometres. There is substantial asymmetry in the geographical size of the provinces into which the state is divided, ranging from the Province of Buenos Aires with an area of more than 307,000 square kilometres, to the much smaller provinces of Tucuman and Tierra del Fuego, with surface areas of approximately 22,000 and 21,000 square kilometres respectively. The autonomous city of Buenos Aires is smaller still, with a land-surface of only 200 square kilometres. There are substantial differences also in the distribution of population between the constituent parts of the Argentinian federation. Of a total population estimated at 37.5 million people, approximately 14 million live in the Province of Buenos Aires, and only 100.000 in Tierra del Fuego.

Argentina had its first national government in 1810, and declared its independence from Spain in 1816, but only in 1853 was it able to pass its Federal Constitution. The adoption of federalism and a decentralized system which included the municipal regime, was the result of Argentine civil wars fought between “unitarios” and “federales” from 1820 to 1853, which created this form of government as the only manner to solve the political, economic and social conflicts of a country with a large territorial extension.

The original 14 provinces that existed before the Federal State were created between 1815 and 1834. These provinces through inter-provincial pacts established the foundations of Argentine federalism, which was adopted in the Federal Constitution in 1853, with an important amendment in 1860, after the inclusion of the province of Buenos Aires.

## **b) Form of government**

Argentina has a republican and presidential form of government, with a separation of powers between the executive, legislative and judicial branches, including the direct election of the federal President, the provincial Governors and the Head of Government (Jefe de Gobierno) of the Autonomous City of Buenos Aires. Since 1994, a measure of direct democracy has been available as well, through the initiative and referendum. The bicameral legislature called the Congress, comprising a Chamber of Deputies and a Senate.

As in any presidential system, the Argentine Congress is elected independently of the executive branch, for fixed terms of four years in the case of Deputies and six years in the case of Senators. The President may, in “exceptional cases”, exercise legislative power by decree.

In fact, although the importance of Congress, the center of gravity of public power lies with the executive branch. The explanation lies in a range of interconnected factors: a) interruptions in the constitutional order that have sometimes resulted in the closing down of Congress, like in the coups de Etat of 1930, 1943, 1955, 1966 and 1976; b) the leadership role that the executive branch typically assumes in the emergencies and in the political process; c) the citizen distrust on politicians produced the crisis of political representation that affects the prestige of Congress.

Critically, however, they also include the succession of political, economic, and social emergencies that have diminished the role of Congress, including the constitutional procedures that have facilitated this process, with the delegation of legislative powers and the rule by executive decrees. The weakness of a democratic and constitutional culture, to which these problems may be attributed, explains the failure of Argentina to maintain an effective and truly republican system.

## **c) The 4 stages of our “normative” federalism:**

### **1 Original Constitution of 1853**

The first stage covers the making of the 1853 Constitution itself. The defeat of General Rosas, the governor of the Province of Buenos Aires in whose hands political power had been concentrated for a period of 20 years, led to the meeting of a Constituent Assembly, in which 13 Provinces were represented by 2 representatives each one, but without, significantly, representation from the Province of Buenos Aires.

The 1853 Constitutional Convention met in the city of Santa Fe, where 13 provinces were represented by 2 representative each one, -but without the presence of the province of Buenos Aires-, had as a precedent the text of the 1787 Philadelphia Constitution. But due the influence of Juan Bautista Alberdi, father of Argentine public law, the original 1853 constitutional text adopted a more centralized federation than the American one, since, for example, the substantive legislation (civil, commercial, criminal,

etc.) was attributed as a legislative power to the Congress, as well as the review of the Provincial Constitutions and the impeachment of the provincial governors

In other matters, it established the same organization as that of the American federation: a Federal State that allows for the co-existence of various state and governmental orders. The provinces have their own autonomy in institutional (constituent powers), political, financial and administrative matters .

The Senate was established as a federal organ par excellence, with an equal representation for each province (state) and the same representation for the Federal Capital .

## **2. Constitutional reform of 1860**

The pact between the Federation and the province of Buenos Aires in 1859 meant the integration of this province, with the amendment to 1853 Federal Constitution.

This reform caused important changes in the Federation, since it modified certain articles of the 1853 text, with the purpose of establishing a greater decentralization of power. To that effect, it is evident that such was the purpose of the abrogation of the rules that established the review by the Congress of the Provincial Constitutions, as well as the carrying out of impeachments of provincial governors before such organ.

## **3. Coordinated federalism from 1950**

The third stage is the transition from “dual” or “competitive” federalism, to one that is more “co-operative” in nature. The celebration of interprovincial treaties included such matters as the construction of bridges and inter-provincial tunnels, the common management of inter-provincial river basins, the creation of hydro-electric committees, and the establishment of a National Investment Council and Federal Tax Commission, as well as a range of other Federal Councils to deal with matters of common concern in Education, Health, Security, etc.

## **4. Constitutional Reform of 1994**

One of the principal goals of the Convention was to strengthen decentralisation, as a counter to the concentration of power in the country. To that end, the Constitution was changed to recognise the autonomy of municipal government and the autonomous status of the city of Buenos Aires and to authorise the provinces to “create regions for economic and social development”. In the wake of these changes, it thus is possible to identify four levels of government of the Argentine federation: Federal, provincial, municipal, and the government of the autonomous city of Buenos Aires, each with its corresponding responsibilities and with considerable autonomy. In synthesis, such constitutional reform covered various aspects of federalism: 1. Institutional and political. 2. Financial. 3. Economic and 4. Social and Cultural.

#### **d) Our current federalism**

Along the history of Argentina we have suffered a profound centralization process, that had produced a notorious disarrangement between the formal constitution and reality. This situation forces to reconsider federalism in its realistic or sociological aspect, that points towards observing the real validity of its normative aspect.

In this sense, we can see a notorious breach of the federal project of the Constitution produced by a multiplicity of reasons, that we see after in the point of the trend to centralization.

#### **e) Characteristics of our federalism:**

Integrative (because the provinces created the federal government by the Federal Constitution), Asymmetric (in 2 ways: political and economy aspects -as we mentioned before- and in institutional aspects, due to the differences between the provinces and the Autonomous City of Buenos Aires, as members of the federation), Coordinated (as we said previously and in particular, after the constitutional reform of 1994), Centralized (for the process of centralization) and Presidentialist (as we said and we will talk after).

## **II. THE DISTRIBUTION OF COMPETENCES <sup>1</sup>**

On the fundamental topic of the distribution of competences in the federal state, the constitutional reform of 1994 did not modify the highest rule on this subject, the old art. 104 (current 121), originating in the Constitution of 1853. As a consequence, the concepts of Alberdi and Gorostiaga<sup>2</sup> that the provinces have unrestricted residuary powers, and the federal government exercises those expressly or implicitly delegated, and therefore has limited powers, have full force, accepted by the doctrine and case-law of the Supreme Court.

It is true that this rule has undergone modifications, as the centralization process evolved in the country, and even the case-law of the Supreme Court itself has admitted the advances of the central government, as authors such as Vanossi, Frías, Bidart

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<sup>1</sup> For this topic we follow the ideas in our book "Federalismo, autonomía municipal y ciudad de Buenos Aires en la reforma constitucional de 1994", Depalma, Buenos Aires, 1997 and in "Federalismo y autonomía", Enric Argullol Murgadas, Director, Ariel, Barcelona, 2004, in which we took part in the comparative study on the ordering of institutions and powers in compound states, presenting the Argentine case. In relation to the Argentine federation, see "International Encyclopaedia of Laws", General Editor Prof. Dr. R. Blanpain, Kluwer Law International, "Argentina. Subnational Constitutional Law", Antonio María Hernández, Constitutional Law, Suppl. 66, september 2005 and "A Global Dialogue on Federalism", Volume 3, "Legislative, Executive and Judicial Governance in federal countries", Edited by Katy Le Roy and Cheryl Saunders, "Republic of Argentina", Antonio M. Hernández, McGill-Queen's University Press, Montreal & Kingston-London-Ithaca, 2006.

<sup>2</sup> Founding fathers of our Constitution.

Campos, Romero, etc. have noted, but we trust that the changes that have to take place in the future, in accordance with the constitutional mandate emerging from the reform, will deepen federalism.

- The classifications made by the doctrine about the relations of our federal structure are, therefore, still in force. These relations, we remember, are of subordination (arts. 5 and 31, establishing the supremacy of the national Constitution), participation (of the provinces and of the city of Buenos Aires in the federal government, specifically in the Senate) and coordination (which is the delimitation of competences of the federal and provincial governments and that of the city of Buenos Aires), as mentioned by Germán Bidart Campos.<sup>3</sup>

- Likewise, different classifications of competences between the federal government and the provinces are also in force, which we can summarize as follows: conserved by the provinces (art. 121); delegated to the federal government (fundamentally the express competences of the various federal government bodies, e.g., arts. 75, 85, 86, 99, 100, 114, 115 and 116, and those implicit of the Congress, art. 75, sec. 32); concurrent between government orders (arts. 41, 75, secs. 2, 17, 18, 19, first paragraph, and art. 125); shared (requiring the will of the levels of government, such as the law-agreement of tax-sharing and the federal tax body, and the transfers of competences, services and functions, art. 75, sec. 2) and exceptional (for the federal government in direct taxes, art. 75, sec. 2, and for the provincial governments in dictating the underlying codes until these are dictated by the Congress, and for arming warships or raising armies in cases of foreign invasion or of a danger so imminent that it admits no delay, art. 126).

- There are also competences forbidden to the provinces (because they were delegated to the federal government); forbidden to the federal government (because they were maintained by the provinces) and forbidden to every order of government (such as the concession of extraordinary faculties, of the sum of public power or submissions or supremacies to government or to any person, art. 29, or the violation of the declarations, rights and guarantees of the dogmatic part of the supreme law).

We have said that since the reform, the federal relationship is binding on the federal government, the 23 provinces and the autonomous city of Buenos Aires, and in consequence the above-mentioned classifications are, in general, applicable. However, as the city of Buenos Aires has a special nature, that of city-state, distinguishing it from the provinces and municipalities, some special considerations must be made. <sup>4</sup>

- The constitutional reform of 1994 added the following competences to the federal government:<sup>5</sup>

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<sup>3</sup> “Manual de Derecho Constitucional argentino”, Ediar, Bs.As., 1972, Ch. VII. Pp. 120/121.

<sup>4</sup> For this we refer to chapter IV of our book “Federalismo, autonomía municipal y ciudad de Buenos Aires en la reforma constitucional de 1994”.

<sup>5</sup> Following the careful listing made by Castorina de Tarquini (“Derecho constitucional de la reforma de 1994”, Pérez Guilhou y otros, Depalma, Bs.As., 1995, Cap. XXVI, El régimen federal y la reforma constitucional, pp. 351/2).

"1) to establish and modify specific allocations of shareable tax resources, for specific periods and by special law (art. 75, sec. 3);

"2) to provide for the harmonious growth of the Nation and for populating its territory; to promote differentiated policies tending to balance the unequal relative development of provinces and regions (art. 75, sec. 19);

"3) to sanction laws organizing and giving a basis to education, consolidating national unity, respecting provincial and local particularities, within compliance with particular requirements (art. 75, sec. 19);

"4) to approve or reject the new international treaties incorporated by the reform, i.e. human rights treaties with future constitutional hierarchy, integration treaties, standards set by supranational bodies and take account of international treaties signed by the provinces (art. 75, secs. 22 and 24, and art. 124);

"5) to legislate positive measures guaranteeing true equality of opportunities and treatment, and the full benefit and exercise of the rights recognized by this Constitution and by the international treaties on human rights in force on human rights (art. 75, sec. 23);

"6) to dictate a special, comprehensive social security regime protecting children in situations of neglect and of the mother during pregnancy and the nursing period (art. 75, sec. 23);

"7) to arrange or decree federal intervention (art. 75, sec. 31, and art. 99, sec. 20);

"8) to exercise the government function the headship of which is recognized in the person of the president of the Nation (art. 99, sec. 1);

"9) to exercise the general administration of the country, through the head of cabinet, politically responsible to the president of the Nation, and under the control of the General Accounting Office of the Nation (arts. 85, sec. 1, and 100, sec. 1);

"10) to dictate under particular conditions, decrees of necessity and urgency, excluding from such faculty penal, tax, electoral and political party matters (art. 99, sec. 3);

"11) to organize the collection of the National revenue and to execute the national Budget Law, as a faculty of the head of Cabinet, who will exercise this under the supervision of the president of the Nation (arts. 99, sec. 10, and 100, sec. 7);

"12) the organization and administration of justice. The selection of magistrates is now made by a special body, the Magistrates Council, which does not include provincial representation. The appointment is always made by the president with the agreement of the Senate (arts. 99, sec. 4, and 114)".

- The constitutional reform also increased the exclusive competences of the provinces:<sup>6</sup>

"1) to dictate the provincial constitutions in accordance with art. 5, ensuring municipal autonomy and regulating their scope and content in the institutional, political, administrative, economic and financial orders (art. 123). This provision shows the third level of political decentralization, and thus brings in the increasingly firm trend of provincial public law towards recognising municipal autonomy.

"2) to create regions for economic and social development and to establish bodies for carrying out these purposes (art. 124);

"3) to sign international agreements under certain conditions (art. 124);

"4) to exercise all those powers that are implied in the concept of original provincial ownership of the resources existing in their territories (art. 124);

"5) to exercise powers of policing and imposition on facilities of national use in the territory of the Republic (art. 75, sec. 30)".

- In terms of concurrent faculties, the reform incorporated: indirect internal taxes (art. 75, sec. 2); attributions linked with the indigenous Argentine peoples (art. 75, sec. 17) and the provisions in the new clause of progress or of human development (arts. 75, sec. 19, first paragraph, and 125). Even though there is no exact correlation in the text of these two norms, we agree with Castorina de Tarquini<sup>7</sup> in interpreting that all the matters mentioned in art. 75, sec. 19, first paragraph, require the concurrent action of the provinces, and we also consider that the generic statement of art. 125 comprises what is most specific in that norm. Art. 41 likewise recognises the faculty of the Nation to dictate "the norms that contain the minimal measures" on the environment, and in art. 75, sec. 19, the "laws of organization and basis" of education, but in our opinion the previous constitutional doctrine on the complex topic of the concurrency of faculties has not been modified, just as we held in the Constitutional Convention itself.<sup>8</sup> Art. 125 also prescribes that "the provinces and the city of Buenos Aires can maintain social security bodies for public employees and professionals", which should be interpreted as a ratification of the concepts already determined by art. 14 bis, in a special defense of the faculties of the provinces and of the city of Buenos Aires against the attacks of the central government, which aimed at transferring the pension funds by means of fiscal pacts and other pressure.

Finally, as regards art. 42, which provides for "the necessary participation of consumers' and users' associations and of the interested provinces in the control bodies", and in the "prevention and solution of conflicts" and the "regulatory frameworks of the public services within national competence", we also share the opinion of Castorina de

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<sup>6</sup> As noted by the respected researcher mentioned above, Castorina de Tarquini María Celia, *op. cit.*, p. 353.

<sup>7</sup> *Op. Cit.*, p. 355.

<sup>8</sup> See "Reforma constitucional de 1994. Labor del Constituyente Antonio María Hernández (h.)", Imprenta del Congreso de la Nación, Buenos Aires, 1995, p. 60.

Tarquini<sup>9</sup> that a faculty that is in principle national may become concurrent by the will of the provinces interested in participating. We add that the fact that the provinces can participate, as in this case, in national agencies, should be stressed as another feature of the deepening of federalism,

- In relation to the new shared competences embodied in the reform, the same author<sup>10</sup> indicates: "1) the establishment of the contributions-sharing regime, which will be made by means of a law-agreement, on the basis of accords between the Nation and the provinces. [...] 2) In the same constitutional provision [referring to art. 75, sec. 2] another shared faculty is established when it is provided that there will be no transfers of competences, services or functions without the respective reallocation of resources, approved by law of Congress as appropriate, and by the interested province or the city of Buenos Aires. Such a transfer will thus operate as long as there is a willingness shared between the different orders of political power. [...] 3) Finally, the control and monitoring of the tax-sharing and of any transfer of services will be the responsibility of a federal fiscal agency, with representation of all the provinces and of the city of Buenos Aires, so that this function will also be exercised in a shared manner (art. 75, sec. ); 2)".

- To sum up, the most important federal competences correspond to the three powers of the State: Legislative, Executive and Judicial, summarized in the management of common defence, of foreign relations and of the general interests of the country; and the most important subnational competences are those which have to do with the interests of each of the Provinces, through the conserved faculties and in general, with the competences that enable local autonomy in its constitutional, political, financial and local administrative aspects.

It is our opinion that there has been an extensive interpretation of the federal competences, which has permitted a sharp process of centralization in the country.

- Another important aspect to consider is that of the intergovernmental relations in our federation. Art. 107, sanctioned with the original Constitution of 1853-1860 and maintained in the constitutional reform of 1994 in the current art. 125, provides for "domestic" treaties between the provinces. This norm, as from the 1950s, made possible the transit from a dual or competitive federalism to one that is cooperative or of compromise.

Likewise progress was made towards greater inter-jurisdictional relations through Federal Councils which meant the joint participation of representatives of the federal and provincial governments.<sup>11</sup>

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<sup>9</sup> Op. Cit., p. 358.

<sup>10</sup> Castorina de Tarquini María Celia, op. cit. Pp. 359/360.

<sup>11</sup> Such as the Federal Investments Council, the Federal Taxes Council and the Federal Councils on Education, Health, the Environment, Public Works, Domestic Security, etc...



This, naturally, was an indication of a road of flexibilization in the use of the competences and institutional practices. But, we must repeat, this is a matter of a process under way, which must be reaffirmed.

At present, for the political and institutional circumstances we are going through, we are far from making concrete the important modifications that have to be made in our public law, to deepen the decentralization of power and integration, as the appropriate responses of our Constitution to the sharp challenges of the globalized world we live in.

- As for the possibility of **international integration**, the constitutional reform of 1994 in its art. 75 sec. 24 has provided in this matter, as a faculty of the national Congress: "To approve treaties of integration that delegate competences and jurisdiction to supra-state organizations in conditions of reciprocity and equality, which respect democratic order and human rights. The norms dictated in consequence of this have hierarchy over the laws. The approval of these treaties with States of Latin America will require the absolute majority of all the members of each Chamber. In the case of treaties with other States, the national Congress, with the absolute majority of the members present in each Chamber, will declare the suitability of approving the treaty, and it can be approved only with the vote of the absolute majority of all the members of each Chamber, one hundred twenty days after the act of declaration. Rejection of the treaties mentioned in this sub-section will require the prior approval of the absolute majority of the totality of the members of each Chamber". As a consequence, this possibility of supranational integration has been constitutionalized, in accordance with the times we live in.

Argentina is part of a regional system, that of the **Organization of American States**, with a system of protection of human rights, based essentially on the **American Declaration of the Rights and Duties of Man and on the American Convention on Human Rights** (Pact of San José de Costa Rica, 1969), which set up an **Inter-American Commission on Human Rights and an Inter-American Court of Human Rights**. This Convention was previously approved by Law 23.054 of 1984 of the national Congress, but as from the constitutional reform of 1994, has constitutional hierarchy, under the provisions of art. 75 sec. 22.

The American Convention, in art. 28 dealing with the **Federal Clause**, declares:

"1. Where a State Party is constituted as a federal state, the national government of such State Party shall implement all the provisions of the Convention over whose subject matter it exercises legislative and judicial jurisdiction.

2. With respect to the provisions over whose subject matter the constituent units of the federal state have jurisdiction, the national government shall immediately take suitable measures, in accordance with its constitution and its laws, to the end that the competent authorities of the constituent units may adopt appropriate provisions for the fulfillment of this Convention.

3. Whenever two or more States Parties agree to form a federation or other type of association, they shall take care that the resulting federal or other compact contains the

provisions necessary for continuing and rendering effective the standards of this Convention in the new state that is organized."

In consequence, the Argentine provincial states must adapt their legislation and judicial case-law to the American Convention, in the same way as the federal government must scrupulously respect the federal principles of the Constitution in this supra-national integration process, taking care not to affect the provincial and municipal competences and autonomies. Likewise, as we have said before, there must also be participation of the provinces and municipalities both in the ascendant and in the descendant phase of international integration treaties.<sup>12</sup>

The fact is that this is a process under way, in which we are very far from the integration processes such as that of the European Union.

As we saw earlier, according to the constitutional reform of 1994 in art. 124, the Provinces also have faculties to sign "international agreements", with the limitations expressed there. This has also meant a fundamental modification for us that indicates the road to follow in the globalized world of which we are part.

### III. THE TREND TO CENTRALIZATION

Throughout the history of Argentina, we have undergone a profound centralization process, which has produced notable discordance between the normative Constitution and the current reality. This forces us to consider federalism in its sociological or realist face, aiming to observe the genuine currency of the constitutional norms.

#### a) Causes

A multiplicity of reasons have led to **the failure to comply with the federal project of the Constitution**, which Frías has summarized as:

- 1) the **advance of the federal government without sufficient resistance from the provinces** (as in tax matters, in federal interventions and in centralizing policies),
  - 2) the development of **centralizing virtualities of the Constitution itself** (such as from the legislative faculties of the Congress or the commercial clause), and
  - 3) the **infrastructure of socio-economic concentration in the metropolitan area of Buenos Aires** to the detriment of the interior and of the equilibrium of the country.<sup>13</sup>
- We add 4) **the hyperpresidentialism and the federalism.**

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<sup>12</sup> See our study "Integración y Globalización: rol de las regiones, provincias y municipios", Depalma, Buenos Aires, 2000.

<sup>13</sup> "Derecho Público Provincial", Frías y otros, Depalma, Bs.As., 1985, p. 389.

Despite these formal features of the system of government, throughout its history Argentina in fact has experienced a high degree of concentration of power in the national executive, based in the capital of Buenos Aires, which also is the focus of economic and financial power. This phenomenon in turn has had implications both for the operation of democratic institutions and for the operation of federalism. Most political decisions are taken by the President, with the support of provincial governors, which depend economically from the federal government by fiscal co-participation.

The Governors in turn can effectively decide on the list of candidates and control the voting behaviour of their members in the Congress. This abuse of presidential power, which has been termed “hyper-presidentialism”, has tended to subordinate both Congress and the Provinces, weakening not only republicanism but also federalism itself.

On the violations of the Constitution, we repeat the following ideas contained in an article that we titled “**The failure of the centralist project**”:<sup>14</sup> “The recent reports at the end of 2002 on human development from the United Nations and from the Instituto de Investigaciones of the Córdoba Stock Exchange, have coincided on their diagnosis of the grave problems of inequality, injustice, inequity and disintegration, caused among other things by the extreme centralization of the country. It is sufficient for this to look at the human development indices contained in the first of these Reports, where in the case of Formosa as the lowest point they reach 0.156 and in the case of the city of Buenos Aires as the highest point, they reach 0.867, that is, almost 6 times more, as a demonstration of the territorial differences.

The dangers and evils that have been pointed out since the 19<sup>th</sup> century by, among others, Alberdi in his “Bases” opposing the capitalization of Buenos Aires, Sarmiento in “Argirópolis” and Alem in his famous prophecy of 1880 in the debate on the federalization of the city of Buenos Aires. And in the 20<sup>th</sup> century, Martínez Estrada spoke to us of the “head of Goliath” and more recently Félix Luna in his book “Buenos Aires y el país” held that this is an unresolved structural problem that runs through all our history.

This notable phenomenon of concentration, which encompasses all the orders of Argentine social life in relation to its capital and is repeated in nearly all the provinces, has been similar to that occurring in other Latin American countries, which have unfortunately not been able to escape from this characteristic of underdeveloped societies, presenting poor territorial order, with marked asymmetries.

The centralization process of the country around its metropolitan area of Buenos Aires, where in less than 1% of the territory live nearly 35% of the population, is complemented by the circumstance that nearly 80% of Argentine production originates in a radius that is hardly more than 500 km from that area.

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<sup>14</sup> Published in “La Nación” newspaper of Buenos Aires, on January 8, 2003.

It is clear to us that the federalism as a form of State embodied in the National Constitution of 1853 and 1860 was the correct decision for solving the grave political, economic and social problems of such an extensive country, which required an effective decentralization of power.

But the problematic currency of the Constitution could also be particularly seen in this aspect, since in reality a unitarizing project steadily imposed itself, centralizing power in the so-called Federal Government, based in the port of Buenos Aires, which encroached on the constitutional designs and on provincial autonomies, without respecting municipal autonomies either.

This negative process could not be hindered even by the constitutional reform of 1994, one of the main ideas of which was the deepening of the decentralization of power... We can see that the centralist project has deepened in recent times, affecting federal principles, as in the following areas:

## **b) Argentina today**

### **1. Special problems on fiscal federalism**

#### ***1.1. The economic and fiscal dependence of the Provinces and Municipalities***

The centralist advance of the "federal" government over the tax resources of the provinces and municipalities has been exacerbated, strengthening the economic, political and social dependence of these levels of government.

In effect, to the deductions made to primary distribution between federal government and Provinces in the coparticipation system through the use of specific allocations, have been added the check tax and, especially, the retentions on the export of soybeans, corn and wheat. Thus the guarantee fixed for the provinces by art. 7 of Law 23.548 of fiscal coparticipation, of receiving 34% as a minimum of the national tax income, including both shareable and other taxes, has also been violated, at huge damage to the other orders of government.

We believe it essential to establish a National Forum or Conference of Governors, as is found in other federations such as the Mexican or US, in order to consolidate inter-jurisdictional relationships and achieve a more balanced communication of the Provinces in the face of the hegemonic power of the central government.

#### ***1.2. The increase of retentions on exports***

The country has been disturbed recently by the increase in the retentions on exports of soybeans, corn and wheat decided by the government, which has caused a strong reaction from the farmers and agricultural organizations.

We consider the measure was unconstitutional for the following reasons:

1. It was put into effect by means of a **simple Resolution of the National Ministry of Economy, instead of by a Law passed in Congress, as required by the Constitution.**

An essential principle in constitutional democracies has been violated, which is that there is no taxation without a law, rooted in England's 1215 Carta Magna.

2. This Resolution shows up a **lack of knowledge of the republican system**, provided for in art. 1 and related provisions of the National Constitution. The separation and balance of powers as a fundamental principle of the republican system, was put forward by thinkers of the stature of Locke, Montesquieu and Madison and then adopted in the Constitutions of the constitutional democracies.

3. A **deep wound has also been produced in our federal form of State**, embodied in arts. 1, 5, 6, 121, 122, 123, 124 and related provisions of the National Constitution.

In effect, since this is a matter of customs dues that only correspond to the Federal Government, these are not included in the shareable amount from which the Provinces, the Autonomous City of Buenos Aires and the local governments could later participate. In the case of the Province of Córdoba, this increase means a contribution to the national treasury of some 2,540 million pesos, (approximately 700 million dollars) none of which corresponds to the provincial income. Fortunately, the Congress rejected the bill sent by the President for the approval of the resolution.

### **1.3. *The destination of public federal spending***

We consider that sec. 8 of art. 75 of the Constitution is not being complied with, which establishes that the general expenditure budget of the Nation must be set annually "in accordance with the guidelines established for the law agreement on tax sharing, i.e. in terms of objectivity, equity and solidarity. In consequence, the current situation of suffocating centralization that prevents the harmonious development of the country is not modified. Now, the public federal spending is destined mainly to the metropolitan area of Buenos Aires without reasonable criteria.

### **1.4. *Law agreement on tax-sharing***

It should be noted that the modification of the system of Law 23.548, sanctioned in 1988 during the presidency of Alfonsín, was started during the government of Presidente Menem and his minister Cavallo, frequently through the use of decrees of necessity and urgency, and with the Fiscal Pacts, with the aim of reducing the percentage that had been recognized for the Provinces, and this was continued by the succeeding national governments.

In consequence, the centralist advance of the "federal" government over the tax resources of the provinces and municipalities has been exacerbated, strengthening the economic, political and social dependence of these levels of government.

In effect, to the deductions made to primary distribution through the use of specific allocations, which began in the government of Dr. Menem,<sup>15</sup> have been added the check tax and, especially, the retentions on the export of soybeans, corn and wheat. Thus the guarantee fixed for the provinces by art. 7 of Law 23.548, of receiving 34% as a minimum of the national tax income, including both shareable and other taxes, has also been violated, at huge damage to the other orders of government.

We believe it essential to establish a National Forum or Conference of Governors, as is found in other federations such as the Mexican or US, in order to consolidate inter-jurisdictional relationships and achieve a more balanced communication of the Provinces in the face of the hegemonic power of the central government.

As can be seen, there must be no delay in sanctioning the tax-sharing law agreement, to put an end to the violation of the Constitution, which set a deadline which expired long ago, and because it is essential to change the depressing reality of our federalism.

The constitutional reform of 1994 set up new procedures for fiscal co-participation in the distribution of direct and indirect internal taxes, pursuant to a legislative agreement "based on principles of equity and solidarity giving priority to the achievement of a similar degree of development". This legislation must originate in the Senate, and requires approval by an absolute majority of members in each chamber and after, the approval of each Provincial Legislature. This law agreement, which has not yet been enacted, despite the time-frame of the end of 1996 prescribed in transition regulation 6. As you imagine, this is a very grave violation of the Constitution.

To escape from the present labyrinth of tax-sharing we must follow our Ariadne's thread, which is nothing more than respecting the mandates of the Constitution. A shareable amount must be set that is not reduced by the huge number of specific allocations current today, most or all of which must be derogated. Then primary and secondary distribution must be set on the basis of constitutional criteria. For this it is decisive to emphasize the modifications of the competences, services and functions between the Nation, the provinces and the city of Buenos Aires.

A greater recognition of the participation of the provinces and the city of Buenos Aires, which necessarily will then have repercussions in the tax-sharing with the municipalities, will make later discussion on secondary distribution, where disputes arise between the larger, developed provinces and the smaller, more backward ones, relatively simpler. It is here that what I have called the triumph of the centralist project has resulted in a country with enormous differences and imbalances, according to the indices of human

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<sup>15</sup> And which we have described in our book "Federalismo, autonomía municipal..." mentioned above, in Ch. II, analyzing the topic of tax-sharing, with an estimate of the huge amounts taken from the provinces and hence from the municipalities.

development, gross product or income per capita, which it is time to modify. The solidarity criteria demanded by the Constitution must be respected, as other federations do, such as Canada, Australia or Germany, which are noted examples to be considered. This complex and decisive debate must start now, following the established constitutional bases.<sup>16</sup> For this a truly overarching policy must be exercised that overcomes party antagonisms, strengthens inter-jurisdictional relationships and enables a balanced development of the country in accordance with the federal project of the Constitution.

## **2. The lack of progress in the regional integration process**

We consider that, even though the map of regions is almost formalized with the already constituted regions of North Argentina, Patagonia, New Cuyo and Center, -with only the integration of the Province of Buenos Aires and the Autonomous City lacking-, no advance can be seen in this process. The institutional, economic and social situations undergone, added to the absence of an overarching policy have surely influenced this. Some noteworthy activity has recently been seen only in the Central Region. The modification of territorial organization is urgent, with strategic projects like the bi-oceanic corridors, which involve carrying out significant infrastructure works such as the termination of the Córdoba-Rosario highway and the consolidation of the passes over the Andean Cordillera, in accordance with the agreement signed by the Mercosur with Chile.

## **3. The lack of compliance with other norms related to economic aspects of federalism**

Here we include the lack of creation of the Federal Bank, the maintenance of centralizing legislation that is not adapted to the principle of the provinces' ownership of natural resources and the insufficient exercise of the new competences in international agreements that enable supra-national integration, with the participation of provinces and municipalities.

## **4. The lack of full autonomy for the Autonomous City of Buenos Aires**

This brief analysis of the problems of our federalism cannot omit what occurred with art. 129 of the National Constitution, which recognized full autonomy for the City of Buenos Aires, in one of the most significant advances of the constitutional reform of 1994. It is well known that the National Congress sanctioned Laws 24.588 and 24.620, which violated the letter and the spirit of this constitution, restricting the autonomy of the City,

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<sup>16</sup> To contribute to this long-delayed and fundamental debate, the Instituto de Federalismo of the Academia Nacional de Derecho y Ciencias Sociales de Córdoba which I direct, has published the book "Aspectos fiscales y económicos del federalismo argentino", Córdoba, 2008, with contributions from economists, jurists and specialists of other disciplines.

by preventing it having a police force and complete administration of justice. This situation particularly affects our form of state and the Argentine provinces, since they continue contributing to the national treasury that carries responsibility for the police and national justice service (civil, penal, commercial and labor) of the richest city in the country.

#### **IV. CONCLUSION**

##### **a) Good constitutional design on distribution of competences in our federation.**

We think so, according to comparative federal approach, because the autonomy of provinces, city of Buenos Aires and municipalities is granted by wide and extenses competences.

##### **b) The current tension between federal government and the interior of the country over the centralization.**

It was a problem troughout our history and now continues as we mentioned. In particular, the recent conflict among Federal government and farmers and agricultural organizations, arose people-s conciousness on the importance of federalism.

##### **c) Lack of compliance with the federal project of the Constitution.**

It is clear to us that the Constitution is not being complied with, in terms of our federal form of state, just as is seen in relation to our republican form of government, particularly through the phenomenon of hyperpresidentialism. The decay in our rule of law implies the violation of the principles of the federal republic and an advance of the national government over the competences of the Provinces.

##### **d) The need to change the process of centralization.**

The constitutional reform of 1994 encouraged decentralization of power as we mentioned in the fourth stage of the history of our federalism.

However, the institutional changes were insufficient to modify the process of centralization in many aspects, and specially, regarding to the asymmetries of our regional and provincial development. In conclusion, we need to change the process of centralization, by the execution of the federal and republican project of the Constitution.



## **Centralised Power and Decentralised Politics in the Devolved UK**

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### **Summary of the paper**

Formally, the system of devolution in the UK appears highly centralised. In practice, the devolved governments have quite extensive autonomy. The nationalist governments elected in 2007 are pushing for more decentralisation.

### **Centralising factors**

- Westminster parliament retains full constitutional supremacy. Westminster can rewrite any of the devolution settlements.
- Westminster can suspend devolution – and has in Northern Ireland
- Devolution extends to only 15% of the UK: England remains highly centralised
- All the funding for the devolved governments comes from central government: they raise no revenue of their own
- There is a unified civil service, in Scotland and Wales and the UK
- Whitehall has retained a centralised mindset. Central government lawyers check all devolved legislation for competence
- Whitehall conducts intergovernmental relations on a bilateral basis, reducing the possibility of coordinated action by the devolved governments.

### **Decentralising factors**

- There is a long tradition in British territorial politics that the centre is not strongly interested in the periphery
- The absence of a written constitution means there are no clear boundaries to the powers and functions which might be devolved
- Nor are there clear limits to where the process of devolution might end. Since 1973 the UK government has formally recognised the right of Northern Ireland to leave the UK if a majority ever vote for that. By implication the same right applies in Scotland
- Westminster has adopted a convention that it will not legislate on devolved matters save with the consent of the devolved parliaments

- In practice Westminster cannot repeal or significantly amend the devolution settlements without similar consent. The initial referendums in 1997 have proved a political means of entrenchment
- Funding for the devolved governments comes as a single block grant, with no ring fencing, tied grants or conditional grants
- The asymmetry of devolution makes it easier for devolved governments to seek extra powers.

### **Current developments**

- Nationalist parties are now in power in Scotland (SNP minority government), Wales (in coalition with Labour), N Ireland (coalition with unionists)
- In all three devolved territories the trend is towards further decentralisation.
- The SNP has launched a 'national conversation' in Scotland about future constitutional options, hoping to hold a referendum on independence in 2010. Unionist parties have responded by establishing commission on additional powers for the Scottish Parliament. The commission will focus mainly on greater fiscal autonomy, not more legislative powers.
- In Wales the Labour/Plaid Cymru government has also established a commission on funding devolution, and a commission to prepare for a referendum on the grant of full legislative powers. The referendum is due to be held by 2011.
- Northern Ireland is set to acquire powers on policing and criminal justice (long sought by the nationalist parties, resisted by unionists)

### **Future developments**

#### *Fragmentation of UK?*

- The SNP could win a majority of seats in Scotland at the next Westminster elections in 2010; but they are unlikely to win a majority in the Scottish Parliament in 2011. The SNP cannot hold a referendum on Scottish independence unless it is authorised by the Scottish parliament or the UK parliament.
- Northern Ireland is unlikely to vote any time soon for reunification with the Republic of Ireland, because there is insufficient support

#### *Further federalism*

- If Wales gains full legislative powers, there will be greater symmetry between the three devolution settlements, which might in time be consolidated and entrenched
- Full federalism cannot be achieved without granting devolution to England.

## Introduction

The theme of this conference is to assess forces for centralisation and decentralisation in federal and devolved countries. Understanding the UK's territorial political system requires close attention to be paid to the distinction between *de jure* and *de facto* powers of the different institutions. Given the absence of a codified and entrenched constitution, this distinction may be even more significant in the British context. A high degree of formal centralised power co-exists with extensive practical sub-national autonomy. Conversely, there may be areas where powers devolved by law are weakened through informal or unintentional restraints on their exercise.

## The Traditional British Constitution

The United Kingdom has historically been regarded as “among the most centralised of the major industrial countries in the world” (Kilbrandon 1973, cited in Lijphart 1999, p.17) with political power concentrated in the national Parliament and Government based in London, known in shorthand as Westminster and Whitehall respectively. Up until the late 1990s, Britain was described as having an archetypal “power hoarding” rather than “power sharing” constitution (King 2001, p.24), making the country a “centralised union state” though not a pure unitary system (see Rokkan & Urwin 1983; Mitchell 1996). In the language of Tsebelis, the UK's political system included just a single “veto player” in the shape of the ruling party at Westminster (Tsebelis 2002, pp. 78-79).

The principal characteristics of the UK's “power-hoarding” unwritten constitution, also known as the “Westminster model” were:

- A single Parliament and Government ruling the entire country from London.
- The doctrine of “parliamentary sovereignty”, meaning that legislation passed by Parliament could not be overruled by the courts.
- Weak local government subject to control and interference from the centre, and with limited control over its own budget.
- A majoritarian “winner-takes-all” electoral system leading to politics being dominated by two large Britain-wide parties.
- Some variation in public policy and institutional structures between the different parts of the UK (such as Scotland's separate legal and education systems), but with these being managed by territorial departments of the unified British government (the Scottish, Welsh and Northern Ireland Offices), limiting their real autonomy.

## Devolution: beyond the Westminster model?

Between 1997 and 1999, directly-elected legislatures and separate executives were created for three of the four parts of the United Kingdom – Scotland, Wales and Northern Ireland. Steps were also taken towards the establishment of elected regional assemblies for the nine regions of England, though in the event this only occurred for London in a weak form (and we consequently ignore subnational government within England in this paper). This set of changes (termed “devolution” in British political

discourse) marked a significant break with the UK's centralist traditions and was described as "the most radical constitutional change this country has seen since the Great Reform Act of 1832" (Bogdanor 1999, p.1).

Yet devolution was from the start a unionist project, designed as a response to the threat of nationalism (particularly in Scotland) on the basis that creating governments at the subnational level would "not only safeguard but also enhance the Union" (Scottish Office 1997, para. 3.1). Significant bulwarks against excessive decentralisation were built into the design of the new territorial constitution from the start. In particular, important aspects of the pre-devolution constitution – including parliamentary sovereignty, the centre's control of taxation, and a unified civil service – were retained.

However, for two reasons these factors may not always in practice function as a significant centralising force. First, the national government may *choose* not to utilise the tools at its disposal to limit subnational autonomy: indeed, it is a central tenet of British 'territorial politics' as an academic discipline that the centre frequently seeks to liberate itself from extensive entanglement with peripheral affairs (see Bulpitt 1983; Bradbury 2007). The second limiting factor is that the new subnational institutions enjoy a high degree of political legitimacy and *de facto* entrenchment (being founded subsequent to popular referendums) that mitigates against significant constraint from the centre. This gives sub-national governments agenda-setting capacity to challenge the centre in ways the UK Government may not have predicted.

The British constitution thus rests upon a dynamic balance between centralised formal power that predates devolution and dynamic decentralising political trends unleashed by devolution. The unresolved tensions between these two facets of British territorial politics have come to the fore since 2007 when the Labour Party's dominance across the country came to an end. Nationalist parties – committed to the break-up of the United Kingdom – are now in power in Edinburgh, Cardiff and Belfast and all have launched initiatives to reshape the balance of power between centre and periphery. Meanwhile the UK government under Gordon Brown has unveiled its own 'Britishness' agenda to counteract these centrifugal tendencies, as well as indicating a willingness to rethink certain aspects of devolution while seeking to downplay expectations of radical change across the board.

We now go on to examine key aspects of the British territorial constitution, in broad terms making the case that while the centre retains important power in formal terms, the practical impact on subnational autonomy is less significant.

### **The Division of Competences: A centralising or decentralising force?**

The laws passed in 1998 establishing the new subnational institutions in Scotland, Wales and Northern Ireland set out the division of legislative and executive responsibilities between the national and subnational tiers of government. Although there were significant differences between the three devolution settlements, in each the relevant legislation set out a range of policy areas where subnational bodies would have

no role. These “reserved powers” include foreign relations and defence; macroeconomic affairs; regulation of businesses, consumer protection and the labour market; social security; asylum and immigration policy; energy strategy; broadcasting; and the constitution. In addition, the UK government retains control of the criminal and civil justice systems, other than in Scotland.

Such provision for “exclusive competences” of the national government is not uncommon in federal or other decentralised political systems. However, some of the powers reserved in the British case are worth noting. The UK centre’s near-monopoly of the social security system and taxation – designed to maintain the country’s status as a “single economic and social space” – is uncommon elsewhere, and is indeed the source of controversy in the UK.

Inevitably, the effect of reserved powers is to restrict policy autonomy at the devolved level. However, a more noteworthy aspect of British devolution (particularly in the context of the country’s centralist traditions) might be the relative importance of the policy areas that are devolved. These include: health, education, local government, culture, the environment, many transport responsibilities, and (in Scotland) police and justice. Moreover, devolved areas tend to be unconditionally transferred from the centre. Arguably, the logic of British devolution is for a clear demarcation of powers between centre and periphery – a “layer cake” model – with the British government and parliament involving itself in “domestic” matters (or “low politics” in Bulpitt’s terms) only for England, and preferring not to expend resources trying to impose similar policies across the UK. Evidence of this is the lack of provision – at least for Scotland and Northern Ireland – for “shared competences” of centre and periphery, or “framework powers” set at the centre to limit the extent of policy differentiation. The devolved bodies have therefore been able to develop policy that significantly differs from that in England, and often in the face of British government disapproval: the introduction of proportional representation for local government in Scotland and the abolition of pharmaceutical charges in Wales are two well-known examples.

In the case of Northern Ireland, there is a third category of policy areas (notably including policing and criminal justice), which are controlled by the British government until there is consensus for their transfer. This is a temporary situation, with the British government actively seeking to broker a deal between the rival communities in the Northern Ireland Assembly enabling responsibility to be handed over.

The position for Wales also differs in that the devolved legislature has only secondary legislative powers, and consequently relies upon the passage of framework laws at Westminster that set the scope of its policy autonomy. The British government is committed to drafting such provisions “permissively” (Wales Office 2005, p.22) so as to leave maximum discretion to the Welsh institutions. Since 2007 a new process of transferring primary legislative powers on a case-by-case basis to Wales has been in operation. This is designed to lead to a full transfer of legislative autonomy over 20 broad policy domains, which would further entrench the “dual federalist” nature of British devolution, with clear delineation of national and devolved political spheres.

This picture is inevitably a simplification. The UK is not federal in formal constitutional terms, and the centre retains a range of powers by which it could restrict subnational autonomy or even effect recentralisation when its interests are threatened. Some of these are examined below.

### **Parliamentary Sovereignty and the Unwritten Constitution**

The devolution statutes of 1998 did not affect the existing power of the UK Parliament to legislate across the UK in all areas of policy (e.g. see section 28(7) of the Scotland Act 1998). Nor could they, since unless and until a codified constitution for the UK is agreed upon, the doctrine of parliamentary sovereignty remains intact by default. This means that Westminster is able to legislate on all matters, including the devolved matters mentioned above. Such legislation cannot be challenged in the courts, while legislation passed by the three devolved legislatures can be struck down if it is found to overstep their powers.

In practice, though, there is a strong convention established that no legislation will be passed by Westminster that intrudes into a devolved sphere without the explicit authorisation of the devolved government and parliament. Under this 'legislative consent convention' the Scottish Parliament has voted no fewer than 86 times (up until summer 2008) to give its consent to bills proposed by the British government. This process has caused some controversy, and critics have attacked it as a backdoor method by which power is recentralised to London. Indeed, some controversial matters have been dealt with through this mechanism, such as legislation creating the Serious Organised Crime Agency, and laws that recognised same sex partnerships and lowered the age of consent for homosexuals.

However, while there is some evidence that the Scottish government uses this mechanism as a way to duck tricky political issues, the fact remains that the Scottish Parliament has the power to vote down legislative consent motions. Proof that the power to withhold consent is no sham was provided in spring 2008, when the British government was drafting a bill regulating the disposal of nuclear waste. After the Scottish Government confirmed its opposition to nuclear power (and its intention to use devolved planning powers to block the construction of new nuclear power plants), the British government excluded Scotland from the relevant sections of the bill (see Paun 2008a, section 4.1). The alternative, to legislate in spite of Scottish opposition, was constitutionally available but politically unthinkable.

A similar process operates in regard to Northern Ireland when devolution is in operation. The picture in respect of Wales is somewhat more complicated due to the Assembly's "legislative dependence" (see Richard Commission 2004, chapter 8) on Westminster. Though the autonomy of the Welsh institutions is undoubtedly less than those in Scotland and Northern Ireland, here too the UK government has adhered to the principle of consent, desisting from imposing unwanted policies on Wales, usually introducing Welsh bills following formal requests from the Assembly in Cardiff.

In the absence of a written constitution, parliamentary sovereignty also guarantees to the centre the power to amend the constitution by simple majority vote. This marks the UK out from federal systems, since in formal constitutional terms the powers of subnational bodies in the UK have merely been 'delegated' by the national parliament, and may be taken back unilaterally should circumstances change. And indeed this power has been used. For instance, devolution to Northern Ireland was suspended in 2002, with all legislative power returned to London where it remained for four and a half years.

The centre's control of the constitution also extends to institutional and procedural matters that might be considered natural for subnational institutions to regulate themselves. For instance, the electoral systems are strictly controlled from the centre. The date of the Scottish Parliament election and the design of its ballot paper are determined in London. Similarly in Wales, the British parliament in 2006 passed legislation amending the Welsh electoral system that was criticised by opposition parties as driven by partisan interest (see e.g. Bowers 2006, pp.7-9).

Here too, however, there is a general presumption that the centre wields its power to rewrite the rules of the game only by consent. The legislative consent convention mentioned above is used to amend (generally to add to) the powers of the Scottish Parliament and Executive. In the case of Northern Ireland, moreover, it has been written into law since 1973 that if a majority of voters support reunification with the Republic of Ireland then the British government would allow this part of the UK to secede. There is a similar, though unwritten, recognition of Scotland's right to independence if majority support were forthcoming.

To sum up, the structure of the devolved constitution grants the centre extensive power to intervene in devolved affairs and change the rules of the game. In comparison to federal countries with codified constitutions this appears a highly centralised situation. However, in practical terms the British government almost never seeks to legislate in a devolved area or amend the territorial constitution without the consent of the relevant subnational bodies.

### **Territorial Finance: the Centre's Trump Card?**

An additional significant mechanism by which decentralisation is limited is the control that the centre wields over almost all of the financial aspects of devolution. All taxes are set and collected by the British government, aside from Council tax (for local government), and in Scotland the power to vary income tax by 3% (so far unused). The devolved bodies are therefore unable to use fiscal policy to influence economic performance or to deliver other distributive or redistributive goals. For instance, the current administrations in Scotland and Northern Ireland have both called for the ability to reduce the rate of corporation tax imposed in their territory in order to attract more inward investment. Both have been rebuffed.

The subnational governments' lack of fiscal powers means they have no direct ability to influence the size of their own budgets. The UK government allocates to each of the three devolved territories a "block grant" out of its general tax revenues, which the devolved bodies then use to fund the public services for which they are responsible. The size of these grants is calculated principally via the Barnett Formula, which was created in the 1970s when devolution was first under consideration. The formula is based on the respective population shares of the four parts of the UK, with Scotland, Wales and Northern Ireland receiving increments to their budgets in line with changes in spending in England in equivalent policy areas.

The traditional defence of the formula has been its administrative simplicity and automaticity, avoiding the need for complex negotiations and inter-territorial conflict. However, the British government has the power to provide additional funds that bypass the formula when this suits its interests. For instance, additional funds have often been found for Northern Ireland to encourage the rival parties to share power. In 2000, there was also a major row about whether EU structural funds awarded to Wales should be passed on to the Welsh Assembly or retained by the Treasury. As guardian of the formula, the Treasury also has significant interpretative leeway. For instance, spending on the Channel Tunnel and the 2012 London Olympics have both been classified as UK rather than English spending, meaning that the devolved bodies do not receive additional monies as a result. Finally, the national government also reserves the right to keep for itself money which it saves as a direct result of policy innovations at the devolved level. So the British government has vowed to hold on to money saved from Council Tax Benefit payments in Scotland if the SNP government implements its plan to abolish this form of local taxation.

The advantage for the subnational governments is that they have complete autonomy over how to spend the grant. In contrast to the system in other federal or quasi-federal countries (e.g. see Kincaid 2008 on the USA), the devolved institutions are not constrained by ring-fencing, conditional grants or earmarks. Unlike local authorities in England, the devolved governments are not required to meet specified performance targets in return for funding. From the point of view of the national government, the advantage of the system is that it allows central control over the size and distribution of the tax burden.

The financial arrangements strike a mutually-acceptable balance between central budgetary oversight and subnational autonomy over policy. However, this separation of taxing from spending powers is far from ideal in terms of accountability. The devolved governments have no fiscal accountability to their own electorates. Another centralist aspect is that the devolved governments' budgets are determined on the basis of decisions taken about the appropriate level of public spending in *England*. Thus, if a decision were taken to decrease public spending in England, there would be a knock-on reduction in the budgets of the devolved administrations even if in those territories there was a political consensus to increase public spending.



### **Soft institutional constraints on decentralisation**

Recentralisation may also occur as a result of indirect or “soft” institutional constraints. One such factor – illustrated above – stems from the curious hybrid status of the centre as both “federal” government for the UK as a whole, and the government of England. Combined with England’s sheer size (at 84% of the UK population) and a consequent ignorance in Whitehall about devolution matters, this can generate “spillover effects”, where decisions taken on policy for England may have the unintended consequence of impinging upon the autonomy of the devolved bodies (Jeffery 2007). An example is the difficulties faced by Scottish universities as a result of increases in tuition fees in English higher education institutions. The Scottish Government has also struggled with the problem of a declining population while the British government tightens immigration policy in response to pressure from the more crowded South of England.

The subnational bodies can also suffer from the the centre’s control of access to international institutions. The EU policy-making process is of particular importance, because of Scotland’s large agricultural and fisheries sectors, and Wales’ and Northern Ireland’s reliance on EU structural funds. But the subnational governments are entitled to access to negotiations – both within the British state and at the EU level – solely at the discretion of the UK government: there is no legal guarantee of participation as in countries such as Germany. In practice the devolved governments have enjoyed a high level of access (Jeffery 2005); but some participants have found that even Scotland (the strongest of the three devolved administrations) frequently finds its voice ignored (see e.g. Fraser 2007).

Finally, it may be the case that the structure of the civil service and intergovernmental machinery also have a diffuse “soft power” centralising effect. For instance, there is still – as before devolution – a unified Home Civil Service for the whole of Great Britain (though not Northern Ireland). Officials working in the Scottish or Welsh administrations are formally part of the same organisation as their counterparts working for the UK government; although recent commentators have found that in practice fragmentation along territorial lines is well under way (Greer 2008).

The British government has also tended to avoid high-profile intergovernmental fora which could give a platform to subnational governments to challenge the centre (Trench 2005). It has preferred to conduct intergovernmental relations on a bilateral, informal and confidential basis. This bilateralism heads off the threat of coordinated action by the devolved bodies in pursuit of greater resources or autonomy, and raises the chances that the centre will get its way. And the informality and confidentiality keep disputes and negotiations out of the public domain, depriving the devolved bodies of one of their strongest weapons – their high legitimacy in the eyes of voters. On the other hand, if the structure of intergovernmental relations strengthens the position of the centre, it might do so only so long as the devolved governments are willing to play the game by the centre’s rules. Since 2007 this may have changed, with potentially dramatic consequences for constitutional stability.

## Developments since 2007: Devolution transformed

The first eight years of devolution, from 1999 to 2007 were relatively smooth, with few high-profile disputes. One major reason for this was that Labour was dominant throughout this period at the UK level and in Scotland and Wales. In addition, this was a period of high public spending growth, dampening latent tensions about the distribution of resources. This has all changed.

In May 2007, in the third set of elections to the Scottish Parliament, Labour was defeated by the pro-independence Scottish National Party, which went on to form a minority administration (with the support of just 49 of 129 seats). Although its margin of victory over Labour was narrow – at 1-2% of the vote which translated into a one-seat lead – the SNP dramatically seized the political initiative, with Labour traumatised by its first defeat in a serious election in Scotland since the 1950s.<sup>1</sup> In Wales, meanwhile, Labour also fell back, losing its majority. Initially it appeared that a ‘rainbow coalition’ of the other three parties (Plaid Cymru, Conservatives and Liberal Democrats) would consign Labour to the opposition benches for the first time. In the end, however, negotiations collapsed and Labour was able to remain in office, but now in coalition with the nationalist Plaid Cymru. But the price of this deal was to agree to key nationalist policies, towards which Labour in Wales was reasonably sympathetic, but Labour at Westminster was not. In Northern Ireland, finally, after a five year suspension, extreme nationalist and unionist parties finally agreed to form a power-sharing coalition.

The cumulative impact of these developments has been great. For the first time, the UK Labour government – which is weakened in any case by economic and other problems – is confronted by governments with different views of how the territorial constitution should operate. Particularly in Scotland and Wales, the new governments have demonstrated the extensive agenda-setting power that institutions with high popular legitimacy enjoy. Tensions will also rise from the slowdown in public spending announced in the 2007 Comprehensive Spending Review: the budgets of the devolved governments will rise by 2% per annum over the next three years, under half the figure in previous rounds (see Paun 2008b, section 3.2).

In Scotland, events have moved fastest. The SNP Government published a White Paper and launched a ‘national conversation’ on Scotland’s constitutional future within three months of taking power (Scottish Government 2008). Cleverly, while emphasising their ultimate commitment to an independent Scotland, the nationalists also raised the possibility of a middle way ‘devolution-plus’ option, in which significant new powers would be transferred to Edinburgh. Polls show that support for independence remains flat at 25-35% (Curtice 2008), but there is more support for strengthening the power of the Scottish Parliament. The SNP have capitalised on this by choosing to highlight disputes with the British Government where public opinion is likely to be supportive. Examples include: control of broadcasting policy, Scotland’s role in EU fisheries negotiations, energy policy and nuclear power, control of Scottish Parliament elections (see Carman & Mitchell 2007). In addition, there have been a number of finance-related

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<sup>1</sup> Labour had also lost to the Conservatives in the European Parliament election of 1979.

disagreements, including over the size of the Scottish budget, North Sea oil revenues, corporation tax, London Olympic spending and the right of Scotland to reform local taxation without losing out on related benefit payments (discussed in Trench 2008, section 8.3).

In most of these cases, the centre retains the constitutional powers to overrule Scotland, but driven by high poll ratings the SNP has continued to dominate the field. The greatest evidence of this came in autumn 2007 when the three unionist parties in Scotland – Labour, the Conservatives and the Liberal Democrats – united to establish a ‘Commission on Scottish Devolution’ (Calman Commission) to examine the case for further decentralisation, including over fiscal powers (see Calman Commission 2008). The UK Government was initially sceptical, suggesting that further constitutional reform was a red herring, and that Scotland had yet to make the most of its existing powers. But Labour in London eventually recognised the way the wind was blowing and committed funding and officials to assist the process. This may give the centre some ability to influence the recommendations of the Commission, but it has also raised expectations that enhanced autonomy for the Scottish Parliament will be delivered.

In Wales, there have been similar developments. First, as agreed under the terms of the Labour-Plaid coalition deal (Labour & Plaid Cymru 2007), the new administration has established an All-Wales Convention, which will seek to pave the way towards the devolution of full primary legislative powers. Legal provision for this next step in Wales’ constitutional development was made in the 2006 Government of Wales Act, but it will only take place if and when there is agreement from the Welsh Assembly (on a two-thirds majority basis), from the British Government and Parliament, and from the Welsh people in a referendum. The Labour Party at Westminster (and in particular certain anti-devolution Welsh Labour MPs) remain unconvinced that the time is right for such a step, but the centre lacks the effective political power to prevent the devolved government from pushing for additional autonomy through the work of the convention.

A greater challenge still for the power of the centre comes from the Welsh Government’s decision to set up a Commission on Finance to examine the funding basis of the Welsh Assembly. Combined with the work of the ‘national conversation’ and devolution commission in Scotland, this body is likely to pose a significant threat to the centre’s control of taxation and budget-setting, which represent perhaps the most effective centralising force in the territorial constitution.

The Northern Ireland political system remains very fragile, with little agreement between the four parties that jointly govern on a policy agenda. Therefore, it is unable to operate as a force for decentralisation in the same way as the Scottish and Welsh bodies. In fact, it is the British Government that is seeking to advance the process of decentralisation by transferring responsibility for police and criminal justice, and the subnational actors unable to agree on this move (due to inter-communal distrust about control of these powers). A taste of the pressures to come if full political “normalisation” is ever achieved came in spring 2007, when all parties in Belfast united to campaign for the equalisation of corporation tax levels with the Republic of Ireland (Wilford & Wilson 2007, section 9.1).

The UK Government ruled out this move, and has also sought to dampen down speculation that the Barnett Formula will be replaced, or reviewed. This instinct is likely to be reinforced as the next general election approaches and attention shifts to the crucial electoral battlegrounds in England, where talk of a new funding settlement risks stirring up resentment at higher public spending in the devolved territories. However, while the centre has the formal power to veto any reconsideration of the devolution finance system, or of the legislative powers of the devolved bodies, it cannot prevent the establishment of subnational initiatives which have the power to set the terms of debate. Ultimately the centre is likely to be dragged into these processes against its will. Signs of this occurring include the British Government's delayed commitment to the Calman Commission, and its promise to publish a "factual paper" on the Barnett Formula.

In following rather than setting the agenda in territorial constitutional reform, the UK Government may in the end be confronted with an uncomfortable choice. It can either veto recommendations that have already built up momentum and legitimacy at the subnational level, or it can accept significant further decentralisation that may threaten the delivery of core government objectives. Resisting further devolution is particularly difficult for a party such as Labour, which has historically relied upon Scotland and Wales for electoral support. But giving way – particularly over control of finance – goes against the deeply-rooted instincts of Whitehall. Faced with this dilemma, and beset by far greater political threats, the government is most likely to sit on the fence, and seek to delay any decisions as long as possible.

The alternative route that the government might take is to develop a coherent narrative for the UK as a whole, to challenge the centrifugal tendencies described above. To some extent, this is what Prime Minister Gordon Brown attempted to do in the early part of his premiership, in which he emphasised "Britishness" as a central theme of his government. In particular he has focussed on values that supposedly tie Britons together, such as: liberty, responsibility, fairness, creativity, enterprise, public service, the welfare state, diversity, and equal opportunity. In terms of concrete initiatives, the government has committed to creating a British Statement of Values to help cement the Union. But aside from the fact that the values identified could easily be associated with many other western countries, a central critique of this approach is that "trying to build a society or a nation simply upon the basis of shared values is like trying to construct a one-legged stool" (Hazell 2008, p.3).

What the government misses out is any analysis of the institutions and interests, as well as the values, which provide a counterweight to the pressures stemming from devolution. This might include a clear rationale for how powers and resources are distributed across the country. In its weakened state, the current government is unlikely to attempt any such project, meaning that it might be a future Conservative government which inherits this task. The Conservatives' problem, however, is the low legitimacy and electoral support they receive in Scotland and Wales. The numerical dominance of England (referred to earlier) is such that the Conservatives could conceivably win a majority in the UK in 2010 entirely on the basis of seats in England. Although for centuries a unionist party, the Conservatives also have an English nationalist wing that could

inflame tensions with the other parts of the country, particularly over finance. Consequently, territorial politics is likely to remain dynamic for some years to come. In conclusion, we ask where this dynamism is likely to lead the UK.

### **Conclusions: What future(s) for the UK**

Territorial politics have been transformed by the emergence of governments with competing political agendas. The subnational governments have used their autonomy to set the agenda on constitutional reform, seeking additional powers and laying down a challenge to the centre. Despite the centre's strong formal powers it has been unable to contain these developments, with the result that further decentralisation appears likely. The key question is whether this decentralisation can be managed so as not to threaten the unity of the UK as a whole. Loosely speaking, we might argue that the UK faces two possible futures: fragmentation, or further federalism.

Fragmentation, in the sense of the actual dissolution of the UK, appears highly unlikely. In no part of the UK is there majority support for secession. In Northern Ireland and in Scotland polls suggest around a third back this option. In Wales the figure is lower still. But assertive attempts by the centre to restrain decentralisation – for instance to block cross-party proposals for further devolution – might boost support for nationalism. Conversely, if decentralisation continues apace, independence might eventually seem the logical next step, rather than an unthinkable leap into the unknown. Independence is talked up by the media, especially in Scotland; but the UK still seems very far from the position of a country like Belgium.

Alternatively, there remains the possibility that a more deeply-entrenched and stable constitutional settlement might be created for the UK as a whole, moving the country towards a federal solution. Finance could act as a catalyst in this respect, as the centre will have to arbitrate between the competing claims of each part of the country. A new system of greater fiscal decentralisation combined with needs-based equalisation procedures might just provide the basis for a system of fiscal federalism. At the same time, if Wales gains full primary legislative powers and Northern Ireland takes over its own security arrangements, there would be a trend towards greater symmetry in the three devolution settlements. This could facilitate a move towards a more settled territorial constitution, with firmly entrenched powers for each tier of government, a firmer financial settlement, and institutionalised processes for resolving territorial disputes.

This solution would further constrain parliamentary sovereignty and the centre's dominance of finance. It would not represent a move to full federalism, which could only be achieved by including England in the devolution settlement. Nor would it represent a move to a fully codified constitution. Gordon Brown has indicated his support for such a move in the longer term; but in practice the classic British piecemeal and incrementalist approach to constitutional reform is likely to continue.

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## **The Impacts of the New Cooperative and Tripartite Federalism on the Traditional Distribution of Competences in Austria**

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### **Introduction**

The basic thesis of my paper is that important *practical changes* in the federal fiscal system and in the financial situation of states and union as well as the structure of the *real political process* and the real distribution of political power have dramatically changed the traditional constitutional system of Austrian Federalism. Some of these changes were influenced by the development of national financial and political systems. However, the greatest part of the new distribution of weights within Austrian Federalism results from the cooperative accession process to the EU and the subsequent development of EU law and politics. The dynamics of two completely different national and supranational federal systems created a highly intermingled suprasystem of legal and political hierarchy and cooperation which is far from classical two-level federalism.

### **1. The Traditional Constitutional System of Legal and Fiscal Federalism**

In order to give you an impression of the really decisive changes of the Austrian system, I will try to explain very shortly the basic features of legal and fiscal federalism according to the Federal Constitution and their interpretation by jurisprudence and the Constitutional Court.

From the very beginning, Austria's federalism was a "*historical compromise*" between two antagonistic theoretical models and political concepts of clearly distinct centralistic and federalistic views and this antagonism was also decisive for all further developments of the system until today. As a result of this inconsistent theoretical and political background, the Austrian constitutional system has, on the one hand, all formal elements of *classical federal systems* like the USA and Switzerland, especially

- constitutional distribution of competences,
- participation of the states in federal legislation and administration,
- constitutional autonomy of the states,
- financial autonomy of the states based on a tax sharing system,



- strict legal equality of federal and state legislation, governments and administration,
- highly developed procedures and institutions of cooperative federalism,
- constitutional jurisdiction interpreting and updating the federal system by deciding conflicts between federal and state authorities and individual claims.

On the other hand, the real situation of the states' competences, legal powers and constitutional autonomy is very different from the standard characteristic of regular federal institutions and seems to correspond rather to the type of a (poorly) decentralised *unitarian state* than to a classical federal state. Let me give you some examples of this substantive centralisation within the formally federal institutions in Austria's constitutional system:

The most important type of competences is the "*exclusive federal competence in both legislation and administration*" (especially Article 10 of the Federal Constitutional Law, but also in numerous other special provisions). More than a hundred important and extensive public functions belong to this centralistic type of competences and thus give federal legislation and government – especially in combination with exclusive EU competences – overwhelming power and practical supremacy with regard to states' autonomy. The *residual* or *general competence* of the states (Article 15 of the Federal Constitutional Law) therefore has no real substantive meaning because only few matters are left to this type of competences.

This legal supremacy of federal powers is increased by the weakness of states' rights to participate in federal legislation and administration. Although the federal parliament is divided in two houses – the *National Council* and the *Federal Council*, elected by the states' parliaments –, the second chamber has no important political powers or legal competences compared to the National Council. The Federal Council is solely endowed with the right of a *suspensive veto* in the federal legislative process which can be overruled, however, by a persisting vote of the National Council with the same quorum as the first resolution of the National Council needed to pass.

States perform most part of federal administration as a type of *delegated* ("*indirect*") *federal administration* under the federal government's control and instructions. State Governors are responsible for the indirect federal administration to the Constitutional Court. Furthermore, there also exists a highly developed *direct federal administration* through special federal authorities in the states and on the level of federal ministries. Also this high portion of direct federal administration – especially with regard to police and social agencies – is very unusual in traditional federal states.

Moreover, Austria's *fiscal federalism* is really shaped after the model of a decentralised unitarian state: States and local governments are treated as "lower territorial units" that are, strictly speaking, only forms of local governments at different levels and with different competences. The power to assign and distribute taxes is not reserved to constitutional law, but left to ordinary federal legislation. It does not come as a surprise that the most important types of taxes are either "*exclusive federal taxes*" or "*joint federal*

*taxes*”, divided among federation, states and local governments with the respective shares being fixed by federal law. In contrast, states have no important taxes of their own. Their main revenues come from joint federal taxes or special transfers, fixed by special legislation or cost sharing treaties between governments. The effect of this legal regime would normally be that the Austrian states would be completely dependent on the Federal Government and federal law as far as their financial autonomy is concerned.

In reality, however, the situation is altogether different: Federation, federal states and local governments are linked together in a very tight and closely interwoven net of financial relations, regulated by treaty regimes and tripartite institutions which do not allow any of the participating governments to act against the financial interests of the other partners of the system. But this is the point to leave formal constitutional regulations and to return to and elaborate on my initial thesis regarding practical changes in the reality of federalism in Austria.

## **2. The transformation of the system into a “living federalism”**

The “catalyst” of the transformation process of Austrian federalism was a very highly developed cooperative and bargaining system. This “*consociational*” type of democracy and politics has a long tradition in Austria and was systematically developed by states and local governments in order to overcome the legal weakness of their position. Cooperation has become the paramount instrument to unite the political powers of the states and co-ordinate state administration in order to prevent centralisation and to create a countervailing political power against the Federal Government’s overwhelming legal powers. “*State Conferences*” already took place before the enactment of the Federal Constitutional Law in 1920 and were important instruments of participation for the states during the creation of Austrian federalism. Fiscal federalism used to be one of the oldest fields of cooperation: Although the federal government could enact the “*Tax Sharing Law*” – which operates for a limited period, currently from 2005 to 2008 – formally without consent of states and local governments, in political practice it was always negotiated with the “*partners of financial redistribution*” and eventually enshrined in a unanimously adopted “*pactum*” before the Tax Sharing Law was formally passed in parliament. Meanwhile, the Constitutional Court has held in many decisions that this pactum is an essential proof of the factual correctness and constitutional validity of tax sharing legislation.

Cooperative federalism underwent very important developments and progresses in the course of the more than forty years of negotiations with the federal government about formal “*reform demands*” (“*Forderungsprogramme*”) of the states. Since 1956, they tried to realize a great “*Structural Reform*” of Austrian federalism in a cooperative bargaining process and they could indeed achieve a series of constitutional reforms to their favour (1974, 1983, 1984, 1987, 1988, 1990), but were also confronted with antagonistic tendencies of centralisation and stagnation during the same period.

By passing this reform process the states developed instruments and procedures of information and coordination on a high technical standard, partly formally legalised,

partly informal, in political and administrative agreements and institutions. There are more than 500 conferences a year – periodically or for special purposes – enabling the heads of governments and senior officials of the states to meet. Special (in-formal) institutions and agencies, such as the states' "*liaison office*" in Vienna, pre-prepare these inter-state conferences and provide the necessary information. The most powerful political institution of states' cooperation is the "*Conference of State Governors*", meeting four times a year and for special purposes. There are also two institutions of local governmental cooperation: the "*Association of Austrian Cities and Towns (Austrian Municipal Federation)*" and the "*Austrian Association of Municipalities (Austrian Communal Federation)*" which are both mentioned in the Federal Constitutional Law (Article 115).

The most important *legal forms* of cooperation are the formal *public law treaties* between Federal and State Governments or among the states themselves (Article 15a Federal Constitutional Law) and all sorts of private law agreements between the three levels of government. By virtue of these legal instruments or political agreements a great number of combined programmes in different policy fields have been launched like health programmes, social security, spatial planning, environment protection, energy production and supplying, education systems and others.

Cooperative federalism has become of such great political and technical importance in Austria that all major programmes or changes in the legal, political or financial situation of the states or local governments are negotiated and cannot be carried out without their consent.

Furthermore, the accession process to and later on the membership in the *European Union* brought a far-reaching progress of cooperative federalism. Quite surprisingly, the states had clearly approved of joining the EU and presented themselves to the Federal government as important partners and opinion leaders during the difficult national and international political process of accession. From the beginning, the states demanded effective measures of compensation for the threatening losses of autonomy and participation caused by the peculiar organisation and decision-making process of the EU and they made clear that against their will public opinion would not be in favour of an accession.

Against the background of this political situation, the Federal Government decided to involve the states in the national process of preparing and realising the accession. Cooperative federalism reached a new and sophisticated level of action to which the states were not accustomed at all. Cooperative teams were installed at the federal ministries. Later on, even a new "*Council for European Integration Policy*" was established. Thus, the demands of the states were generally accepted. They were enshrined in the Federal Constitutional Law (Articles 23a to 23f) and in state treaties with the federation and among the states themselves. By virtue of this complex legal system, the *participation of states* in the European process of preparing and making decisions is ensured in four different ways:

- Federal agencies and representatives to the EU have to *inform* states and local governments *immediately* and *comprehensively* about all European projects that in some way or another refer to the competences or the interests of the states. They may on their part inform the respective federal agencies and representatives about their views and interests regarding the European project in question.
- If the project falls within the states' legislative competences, they can agree on a "uniform (common) statement" which is principally binding upon federal representatives unless there are "*compelling reasons of foreign or integration policy*".
- Apart from these ways of indirect influence on the European decision-making-process, the states may be *directly* represented in the Council of the European Union if topics falling within their competences are dealt with and the states' representative is authorised by the competent Federal Minister who then participates in the Council together with him.
- Furthermore, the states and local governments are represented in the (advisory) *Committee of the Regions* and have their own representations in Brussels to represent their interests and attend the preparatory procedures in EU committees, commissions and administrative bodies.

The stimulus to shape new types of cooperative federalism was even greater in the *descending phase* of European law-making process, i.e. *the implementation* of EC regulations, directives and planning acts by the member states and the complex controlling procedures of this implementation by the EU. As it is true that the EU is a union of national states, only the *Republic of Austria*, represented by Federal Government, is legally responsible for the correct implementation of EU measures. But since the internal structure of the Austrian legal order is *federal*, the constitution has adopted a very strict regime of divided competences governing the implementation process of European law into the national legal order. States are obliged by the constitution to implement EU law that falls within their competences. But only if a "*court within the framework of the EU*" decides that a state did not implement EU law properly, the federal government is endowed with a provisional competence to set the necessary acts of implementation until the respective state implements the EU law properly.

This complicated regime of implementation within the federal system requires a lot of new procedures and instructions of cooperative federalism. The federal government coordinates and supervises the implementation of EU law by the states, but without having formal competences in the respective matters. Therefore federal agencies usually have to respect the states' view on their particular way of implementation and also have to defend this view with regard to the EU institutions, even if the case comes before court.

As the internal system of distribution of competences differs very much from that regarding European competences, nearly every case of implementation causes conflicts or at least doubts regarding the national competence for acts of implementation. Very

often the result will be that one single legal act or political planning measure of the EU is implemented by legislative or administrative acts of the nine states and the federation because the respective European act “touches” state and federal competences. It is obvious that in such a case cooperative federalism is required to coordinate state and federal measures in the interest of the citizen and economic efficiency. With regard to the implementation of the EU directives on *public tenders* even the national constitution had to be changed (see Article 14b of the Federal Constitutional Law) to disentangle the legal chaos of ten legislations and administrations dealing with one inseparable EU implementation case.

Up to now every attempt to adjust the Austrian system of competence division to the system of EU competences was deemed to fail because these two systems are incompatible since they are founded on very different political and historical processes. Also the very last project of a commission sponsored by the Federal Government to make competences “*highly flexible*” attended by a stronger participation of states’ representatives seems to have no chance to be accepted by the states.

Thus the prevailing system of the sophisticated procedures of cooperative federalism appears to be the only realistic way of running the Austrian federal system within the EU. The main problem arising from this situation is the strong *financial pressure* to reduce the enormous complexity of institutions, agencies and procedures this dual national and supranational cooperative federal system produces for every highly regionalised or federal state within the European Union.

### 3. The New Tripartite Federal System

Regarding this connection between fiscal considerations and cooperative federalism, we reach, as I think, the climax of the EU induced transformation of the national federal system in Austria – that is: the consequences of the common *budgetary stabilization* policy according to Articles 99 and 104 EC Treaty and the complex national implementation acts resulting from it. In Austria, EU stabilisation policy was implemented by a treaty between the Federation, states and local governments (at this time “*Stabilitätspakt 2005*”, BGBl I 2006/19) and a special (fiscal) “*Consulting Mechanism*” (BGBl I 1999/35) which prevents unilateral shifting of public charges from one (budget) authority to another, e.g. by legal orders or creation of new public functions or responsibilities. If the cooperative consulting process fails, the authority which causes the new public charge – either by shifting or creating new responsibilities – has to bear the costs for it and the fiscal adjustment between the public authorities has to be changed according to the new fiscal burdens.

Two completely new aspects of national federalism appear on the basis of these instruments and procedures: First, *Local Governments* become a third equal partner in a *tripartite federal system* which had to be authorised by a special constitutional act (BGBl I 1998/61) because the Federal Constitutional Law provides for a classical two level federalism between federation and states. The second new aspect is the *subordination of parliaments* and their budgetary and legislative competences under a tripartite

cooperative fiscal consultation and stabilisation policy which is completely inconsistent with the autonomy of either federation and states in classical federalism and can only be explained by the fact that stabilisation policy is now entrusted to the community of national sovereignties of member states within the EU.

## Conclusion

The original processes of transformation of constitutional federalism, caused by the politically strong position of state governors and the organisation of the political parties with their power basis on the states' level, have been dramatically reinforced by the EU induced changes of the Austrian federal system. The governments and administrations of states – not their parliaments – have been substantially strengthened in a very sophisticated cooperative system. However, the autonomy of all national levels has not at all been increased and all suffer from constantly rising fiscal burdens. Fiscal considerations thus seem to overlap more and more the basically good performance of competences and public responsibilities within the fragile net-work of a highly developed cooperative federalism in the special context of the dynamic supranational integration within the EU.

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## **1948-2008: The Ups and Downs of a 60-Years Long-Decentralization (?) Process in Italy**

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### **ABSTRACT**

The paper analyzes first the circumstances and historical frameworks in which the various steps of Italy's decentralization process took place, from the early post-war partial solution of the "Special Regions" envisaged by the 1948 Constitution, through the failure of the radical reforming attempts pursued during the nineties, the subsequent "decentralization with unchanged Constitution" phase (so called "administrative federalism") up to the fully fledged reform of Title V of the Constitution (Act 3/2001), followed by an attempt to reform it (to get a true political federalism) by the subsequent centre-right government, which was defeated by the constitutional referendum of 2006. Then it describes the economic and financial background that during the first decades kept the Italian politics united around the concept of unitary state (leaving aside the "Special Regions"), subsequently provoked the birth of 15 "Ordinary Regions" (1970-72), and then caused a more stringent push towards a North-South (or a rich-poor) political conflict by the Northern League. It also mentions the various concepts of "equalization" of public resources which have been behind the various stages of the decentralization and regionalization process (especially at the regional level) and are now at the core of art 119 of the new Constitution. Finally, it gives a brief account of the not so hidden conflict between the Centre and the Regions (especially the Northern Regions) about their respective competencies; and of the attempts now being pursued (especially) by Lombardy Region to gain a special status within a "double speed" system of "devolution". With a final hint on the burden being placed on Italy's public finances by the "federalist" solutions and non-solutions.

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### **0- Foreword: is Italy properly located in a Conference on federalism?**

After thanking the organizers for the honour, I feel a little frustrated in submitting this kind of paper at today's Conference. In fact, with the exception of the British and (perhaps) of the South African speakers, the rest of you are dealing with true "federalist" situations, where the word "Federation" is part of the "identification card" of the country *de qua agitur*. Not so for Italy, where the only constitutional project which contained the



words “federalism” and “devolution” was rejected by popular *referendum* in 2006. Up to now, and despite what I shall be describing from now onwards, Italy is a unitary state (perhaps with the exception of its “special Regions”) where the most that can be conceded is “decentralization”. That is why I used this word (with a question mark, however) to define the Italian way out from entralization.

## Part I – The ante- 2001 story

### 1 – 1948: decentralization (with a bit of unconfessed Germany-oriented federalism!) steps into the Italian Constitution

Different approaches and political visions merged together in the Italian Constitution, which was approved December 27, 1947 and came into existence on January 1<sup>st</sup>, 1948. As far as the local and regional matters were concerned, the Christian Democrat Party was particularly in favour of the local liberties, which were considered a bulwark against the oppressive centralisation of the fascist dictatorship; while the Communist culture (massively present in the Parliament) was less sensitive towards the autonomous drive and strongly anchored to the sense of State unity and particularly suspicious of the regional level of government. So, in the 1948 Constitution, the principle of local and regional autonomy (not of federalism!) lies in the words of art.5 “ *the Republic... recognizes and promotes the local autonomies and implements the widest possible administrative decentralization in the services that depend on the State*”. In addition, art. 117 grants legislative powers in many important sectors to the Regions (from agriculture to tourism, from health to territorial development).

The implementation of the principle was very asymmetric, however: only the local communities were granted a truly autonomous organization, while the regional level was (to a large extent) severely mistreated and discriminated through a differentiation of “special” and “ordinary” Regions. This last division has been badly digested by “ordinary” Regions and – right in these days - is exploding into a hard political conflict. In fact, the 5 “Special Statute Regions” – Trentino Alto Adige, Friuli Venezia Giulia, Valle d’Aosta, Sicilia and Sardinia – were allowed to be born immediately for “linguistic” or “insularity” reasons (!), while other say that there were international obligations imposed by the peace treaty between Italy and the Allied Powers after World War II and fears about a possible secession of these peripheral areas.

What is to be stressed is that the 5 Special Statute Regions of Italy represent - in my modest opinion – *the very first example of political and fiscal federalism in the Mediterranean area*, setting aside the very peculiar case of Yugoslavia. In fact, each of the five regions has a special statute, which is essentially a basic law that has full constitutional authority. The special statute has ever since included special provisions in terms of autonomy from the financial point of view. The problem here is that the “special financial autonomy” has been granted “for superior reasons” without too much attention to the unbalances it created to the rest of the building, so that there is now a creeping

jealousy between the two sides of the wall, separating the special and the ordinary Regions.

This situation is proving less and less sustainable, and is creeping through official documents, like the *Documento di programmazione economico finanziaria 2001-2004*, where there is an open complaint about the inadequacy of the participation to the general funding of the (national) equalization schemes by the “Special Regions”. It is not only a question of “too much devolution of taxing powers”, but also of the destination *also* to the SR of the same benefits targeted to the Ordinary Regions, whether ring-fenced or not.

What is intriguing here is the particularly sophisticated mechanism of armour-plating of the special concessions granted to the SRs. They cannot almost be changed! In fact, although there is not need of a constitutional amendment, but only of a common law, for whatever change, the degree of agreement needed between State and SRs is such, that it is virtually impossible to lower the degree of financial privilege of the SRs . No wonder that such a process has only been applied once, i.e. at the time of the introduction of the mechanism! So any reform is virtually impossible to achieve, less of a constitutional law.

The outcome of those decisions are sufficiently described through the figures and the graphs of the Annex to this paper.

## **2 – Twenty-two years later: the Ordinary Regions**

The two-track regional design of the Constitution was not fully developed until the 1970s: that is, not until 1970 were the “15 ordinary Regions” granted the right to come into existence, and until 1972 to receive devolved legislative powers. “The creation of the 15 ordinary regions led to a national system of regional governments that supplemented the existing 5 special regions and provided a response to both problems by bringing the administration of public policies closer to the people and allowing the Communist Party to manage power at the regional level” (see Lanzillotta, p.5).

The whole system underwent a qualitative leap forward in 1976/77, and a quantitative one in 1978/80, when the whole gigantic National Health System was allocated to the Region’s budgets.

Thanks to art. 117 (see above), in the following 20 years the ordinary Regions were engaged in creating different policies and differentiated administrative structures. Given the varied economic, social and political characteristics of the Regions, they were allowed to adopt different policies and administrative response to local needs. The Regions also displayed different administrative capacities and levels of efficiency. “Thus the historic north/south divide resurfaced in regional administrative practices” (Lanzillotta).

Contrary to the case of Special Regions, the funding of Ordinary Regions was initially the least “federalistic” that can be: there was almost no tax autonomy and some 80% of

the expenditure was centrally financed. The radical tax reform of early 70s swept away the already rooted tax autonomy of municipalities and Provinces, and certainly did not give any tax accountability to the Regions. As a result, the latter (and local governments) were financed by state transfers based on an ex post accounting of their expenditures. This stimulated a continuing and uncontrolled expansion of budgetary expenditures, which was one of the factors that produced an increase in public spending and public debt.

### **3 – The nineties and the “administrative federalism” *escamotage*, under the Northern League’s pressure**

The first change of the nineties was in the financial scenario: i.e. the need to reduce the public debt and overall public expenditure. On the political side, this caused the breaking of the silent pact by which Italy’s Northern communities were expected to finance the redistribution in favour of the Southern ones, provided the lira could be devalued continuously. Accordingly, this was the moment – around 1992 – when the issue of fiscal federalism came to the surface and the Northern League took up a central role in the national political debate. “The parallel collapse of the old political order (former Premier Craxi and his Socialist Party had suddenly disappeared from the political scene) helped to increase the pace of these changes and the ongoing fiscal crisis made the introduction of a number of vital structural reforms even more urgent” (Lanzillotta, p 6) Also, the need to reduce public debt and public spending turned into an imperative of more efficient governance at all levels of government, bringing together power and fiscal responsibility for all regional and local administrations, while at the same time recalling a reduction in the presence of the State in the national economy.

The second change was the introduction of electoral rules that favoured the role of the national, regional and local levels of government. This was the beginning of the process that later brought to the bi-polar asset of the Italian political scenario.

The third and final change is the one that impinges most on my theme, because it deals with the *decentralization of powers from the national to local levels*. From 1993 to 1998 these changes took the name of an Italian Professor of Administrative Law, Bassanini, who gave his name to a set of reforms which maximized decentralization through ordinary legislation without changing the Constitution. He concentrated on the simplification of administrative procedures, and this is why that phase of Italian path towards decentralization was called *administrative federalism*.

The search for a substitute of a “true, but impossible” federalism via the *escamotage* of the “administrative federalism” in a country where the administration has always been Rome-centric has met serious difficulties with the “unbundling” of the respective competencies of the various layers of government. There have been a serious resistance, in Rome and in other territories where the employees of the central administration are overwhelming, to the dismantling of the “State”, a quite comfortable companion . So what really has happened in many cases is the silent refusal to redeployment of the functions and the personnel, the overlapping of the central and the

regional apparatus, etc, with a final outcome: the increase of the cost of the functions involved in the “administrative federalism”.

The final step of the impressive process of Italy’s decentralization of the nineties – before the constitutional reform of 2001 - I would consider Act 56/2000, which dealt with a new, interregionally solidaristic, scheme for the financing of the gigantic National Health Service (100 bn euro its current cost). In this scheme the “national interest” (to an equal service level provided to everybody living in the Peninsula) and the various regional approaches to the health care of the citizenry are combined, and the financial arrangement are devised in a corresponding way, with a minimum of resources centrally provided and regional tax apportionments well defined.

## **Part II – The post-2001 agonizing story**

### **4 - The reform of Title V of the Constitution through the Act 3/2001, the (so far unique and never implemented) “milestone” in the process**

Eventually, *in 2001*, the agonizing discussions of the nineties about decentralization came to a sudden solution *with the abrupt approval*, by the only votes of the ( then left wing) governmental parties, *of a major reform of Title V of the Constitution*, which deals with the distribution of powers across levels of governments and the related fiscal federalism solutions. The law was passed just few days before the national elections which brought the centre-right coalition to government (and this explains perhaps 80%, not 100%, of the delay in implementation suffered by the law so far).

The 2001 constitutional reform changed the administrative architecture of the Republic by placing State, Regions, Provinces, Metropolitan Cities and Communes at the same level (“*pari dignità*” in Italian). *As for the distribution of (legislative ) powers between State and Regions (the only two levels empowered to producing laws) the basic rule adopted was the following: all the functions not explicitly attributed to the State are responsibility of the Regions.* This is, to me, the real “federalist” revolution of Act 3/2001!

Areas of exclusive central government and concurrent central and regional government competencies were specified in various spending and legislative areas; all areas not so specified were assigned to the exclusive competency of the Regions by default. Clearly this reallocated much power to the Regions, as not all potential areas could be enumerated. Regions were also for the first time granted legislative powers in areas of their exclusive competency on both the spending and the tax side. However, power sharing in the areas of overlapping competencies was not clear and became the genesis of numerous subsequent conflicts among centre and periphery.

While the reform (Articles 117 and 118 ) displayed a precise breakdown of spending responsibilities, *it also allowed (art. 116) for a potential “double-speed federalism”, i.e. temporarily differing degrees of autonomy in different regions*, along the lines of the

Spanish model of the nineties, terminated in 2002, which saw Catalonia leading the “special competencies” group of Comunidades Autonomas. This issue will be resumed in the last paragraph of this paper, dealing with the “Lombardy proposal” of implementation of the “double speed federalism”.

In an attempt of adding a personal imprinting to the just approved reform, the new Berlusconi government made a number of follow up constitutional reform proposals. In the meanwhile, the Regions started to “exploit” the new provisions for their own powers, so that they raised various cases of conflict against the Constitutional Court. The ruling of the Court, however, were mostly in favour of the State rather than the Regions, coming to the conclusion that, as far as the area of overlapping competencies was concerned, the responsibilities should be split as to reflect the respective inherent duties (laying down fundamental principles – the State – and applying those principles also through spending and financing laws – the Regions). However, Regions’ new legislative powers in the financing and taxing field were never implemented because the national Parliament failed to define the required framework law.

### **5 – Years 2002-2007. Other steps towards (and back from!) decentralization, through ordinary and constitutional legislation**

The new Title V reform also envisaged a new financing model under Article 119, which implied fully fledged revenue autonomy for lower levels of government to finance their normal activities. The latter, however, are suffering from the well known Italian disease, which is given by the enormous differences in revenues and wealth among territories, and therefore there is a wide need for centrally driven equalization funds. Also, art. 119 only allows borrowing by local governments to finance their investment expenditure

But unlike the spending side, the revenue side of the local budgets has not received precise and detailed separation criteria among the revenue sources. In the first phase of the period examined here, under centre-right government, there was even a clawing back of regional taxing powers in practice, as the previous centre-right experience of the nineties had already experienced. This time the victim of the “de-taxation” policy was the “Ferrari of local taxes”, i.e. the IRAP, which (as we saw *supra*) is being collected at the regional level and hits the business community. While it could not be abolished for fear of a crackdown of Regions’ budgets (it is earmarked to health expenditure), it suffered selected deductions from the tax base. The Constitutional Court ruled that IRAP was a national, not a regional tax, thus paving the way to the central government freezing of the regional tax autonomy (2002), in line with the electoral promises of lowering the tax burden. However, such autonomy was restored in 2006, after the European Court had ruled in favour of the IRAP legal status side to side to VAT, against the very counselling of Italy’s party!

In order to “unbundle” the problems of fiscal federalism, in 2003 a High Commission on Fiscal Federalism was formed to draw up a set of proposals which should have turned into a draft law, possibly a new constitutional law capable of competing with the 3/2001 law. Such a true “federalist” law (the so called “devolution law”) – reallocating health,

education and administrative police as areas of exclusive, rather than shared, regional competencies, and the creation of a Chamber of Regions - was actually passed just prior to the April 2006 national elections, but *it was not confirmed by national referendum* the following June. It was easy for the new left wing (led by Professor Prodi) coalition to totally ignore the High Commission's Report and, in 2007, to abolish the Commission!

As you may know, the left wing coalition ceased to operate in spring 2008: before its fall, two more draft laws had been put before Parliament by the government dealing with decentralized governance: i) the so called "local autonomy code" (on spending assignments or competencies) and ii) the law on liberalization of local public utilities. It also *vowed to implement article 119 as a future reform priority*, and a draft law specifying the financing framework for all such sub-national levels of government was presented to Parliament in the Summer of 2007.

## **6 – Year 2008 – Third Berlusconi's victory and , as for the fiscal federalism... back to square one?**

While I am speaking to you, a new step towards a settlement of the fiscal federalism issue is taking place in Rome, this time from a centre-right position, in the aftermath of the April 2008 political elections. Berlusconi's government (and, above all, the Italian Parliament) has to choose between three draft laws on implementation of art. 119:

- 1) one presented in September 2007 by previous centre-left government of Mr. Prodi;
- 2) one submitted, two months earlier, by Region Lombardia and re-submitted after the elections in May 2008, by the centre right government;
- 3) one, a sort of combination of the two, drafted by Northern League's Minister Mr. Calderoli, due to be submitted to the Parliament in these days (mid-September 2008)

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Three are the main features of the *first proposal*: i) the coordination of public finance as a whole; ii) the internal coordination of the national tax system; iii) the financing of the Ordinary Regions and the equalization scheme.

As for issue i), the target is a rather technical one, i.e. disentangling the yearly budgets of lower levels of government from the central ones, in order to ensure to Regions and local authorities safe and secure streamlines of resources through the years, with the side-effect of a joint global control of the public deficit, while at the same time leaving to the regional level of government – on a voluntary basis - the task of sharing the fiscal discipline with "their" local authorities.

As for issue ii), it can be summarised by saying that Regions can establish regional and local taxes on tax bases not already used by the central level.

Really fundamental appears issue iii). The underlying idea is that the functions delivered by the Regions have different “merit”, to which a corresponding difference in financing should be tied. So, there would be 4 different sectors of the Regions’ expenditure: i) essential levels of services (to day health and welfare, tomorrow perhaps education); ii) transfers to local authorities assigned to basic services (equally meritorious as those directly made by Regions); iii) expenditure on less stringent services (to industry, tourism, environment, etc.); iv) specific expenditure envisaged by comma 5, art. 119, targeted to development and cohesion of territories. To each segment of the expenditure a different, decreasing from top to bottom, level of national equalization should be applied.

Issue iii) also raises the special problem of the financing of local authorities, for which the law draft proposes the concept of a financing based on measures of “standard expenditure”, which is a very revolutionary notion for the haphazard Italian customs as far the efficiency in the provision of public services is concerned.

Prodi’s proposal also mentions the issue of the Special Regions, in so far as it timidly envisages modifications to their present financial setting (increases of their expenditure duties and compulsory participation – on the donors’ side - to the national equalization schemes valid for the Ordinary Regions), but the reactions from them have been – of course – promptly negative!

All in all, the fate of this draft proposal has not been very promising already during its preparation, as it raised mistrust both from some of the Regions (the Southern ones, fearing future shrinking of the equalization fund) and from the Communes, which do not like (in their majority) the idea of having their finances regulated (especially on the equalization side) by the regional level of government.

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I come *now to the second (Lombardy) proposal*. Here again we can distinguish three main features: i) strong tax decentralization; ii) lighter equalization than in other projects; iii) more transparency in the interregional financial flows.

Tax decentralization – According to the “federalist” philosophy, the Lombardy proposal considers the tax revenue belonging to the “territory” and not to the State. So the idea behind the draft is that a share as much as possible large of income tax (rate 15%, to be dragged out of the national rate) and of value added tax (yield 80% of the total from each Region) should go to the Regions. The outcome would be some 150 billion euro, much more than the 70 billion needed to fully implement the devolution of competencies according to Act 3/2001, but certainly necessary for the horizontal equalization scheme envisaged (see *infra*).

Equalization and related conditions - The draft contains equalization proposals which appear, altogether, less generous than the Prodi’s platform. It certainly accepts the references to art. 117, but it speaks of “minimum welfare standards”, not of “equal welfare standards”. This goes hand in hand with the more relaxed target of reducing by

at most 50% (much less than it has been so far in Italy) the differences in fiscal capacity among territories, leaving the residual financing of the non basic needs to the regional administrations.

The Lombardy proposal on interregional horizontal equalization contains two unusual, but very understandable, conditions: i) the first refers to the external evaluation of the efficiency of the receiving Regions in spending the money received; ii) the second concerns the correction of the (traditional) “actual” fiscal capacity into a “potential fiscal capacity”, whereby also the *tax evasion and the cost of living* of the receiving Region would be considered. Clearly, this proposal suffers from its “unilateral viewpoint”, i.e. the viewpoint of the major stakeholder of the equalization fund. (Something like: Who is going to pay wants to pay as little as possible and be sure it is not cheated by those who benefit from its “hardly earned” money!)

Financial relationships between Regions and Communes - Another very relevant feature of the Lombardy proposal is what I would call “the German model of Region/Local governments financing” and which stems from the “Inter-istitutional agreement among all levels of government” signed in February 2003 in Milan jointly by Region, Communes, Provinces and Intercommunal Unions of the Lombard territory. Not differently from what happens in Germany (with the *Laender* and *Gemeinden* involved in joined management of the territorial finances and deficits) the Regions would take care of the overall regional - local finances (including the deficit issue) and administer the equalizing funds now devolved by the State directly to Communes and Provinces; and so on. However, the atmosphere in Italy is not surely so cooperation-oriented as is in Germany, except perhaps in some northern regions – like Lombardy. Communes have not shown interest in this proposal.

The way forward, i.e. the “differential federalism” request by Lombardy - Also absolutely innovative is the current parallel proposal for a “differentiated” or “double speed” federalism coming from Lombardy. This possibility is envisaged by art. 116 c.3, which deals “further forms of devolution beyond the standard ones”. The Region Lombardy feels ready to take up some 12 new functions included in the consociative legislation area State-Regions. The request appears a little “provocative” (Zanardi, p.128) insofar as it reminds the whole country that Lombardy, especially in case its “lighter” equalization scheme were approved, can afford the financing of whatever non strictly State function, beyond being the main payer of the standard functions of all other poor Regions.

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*As for the third proposal, the so called “Calderoli draft”* (bozza Calderoli, the name of the Minister who is in charge of the reform), the first informations about its architecture have only been available from the end of July. It is a paradox that the proposal has gained an almost immediate role of an acceptable “intermediate solution” between the Prodi proposal and the Lombardy one, despite the fact that the Minister belongs to the Northern League, which is the proponent of the most radical and extremist ideas about the building of federalism in Italy.



Not differently from the Centre-left proposal, it considers “basic services”, to be provided and funded in equal terms throughout Italy, health, education, social welfare, with an additional special attention to the funding of local transport services.

What has gained the approval from both the potential losers (the Southern Regions) and the potential winners (the efficient Northern Regions) is the fact that the proposal is still a “general framework” law, a sort of grey area which shall have to be translated into a number of applied, practical, solutions. So, for the moment we have shaky convergence on some principles, but no real certainty on the final outcome. For example: for the moment North and South agree on the “equalization” principle as mentioned in the general “Calderoli” proposal, but will the agreement survive when the general rule shall have to be translated into workable decisions, likely to hit the budgets of Southern Regions? Or, again: the Ministers draft mentions a transitory period of some months for the full implementation of the technical rules, while the Southern Regions ask for at least five years of adaptation... Again: what do the words “adequate equalization” mean in the case of the local and regional expenditure for transports? And so on...

### **7 – Final comments and considerations. Is there a cost of “not having federalism” in Italy?**

Before leaving the scene to comments of the audience, let me look at today’s Italian constitutional panorama of regional and central powers, a panorama.

**BOX – The essentials of the three proposals**

EQUALIZATION FUND		
<p><b>Lombardy Centre-right (approved by opposition)</b></p> <p>Horizontal fund, made up of portions of regional taxes and of transfers from the richer Regions.</p>	<p><b>Prodi Centre-left, old Government</b></p> <p>Funds are allocated in Central Government budget and are available only to poorer Regions.</p>	<p><b>Third, intermediate (Calderoli = Northern League)</b></p> <p>Less pervading role of the State. Only for health, welfare and education. Only partial for transports. Strict control of the efficiency levels of the receiving Regions.</p>
TAXATION		
<p><b>Lombardy Centre-right (approved by opposition)</b></p> <p>Regions will get a share of 80% of VAT and 15% of Income tax, plus excises on oil, tobacco and games.</p>	<p><b>Prodi Centre-left, old Government</b></p> <p>Each year overall tax pressure will be fixed by the General Planning Document for each level of government and the yield will be split according to the functions.</p>	<p><b>Third, intermediate (Calderoli = Northern League)</b></p> <p>Regional necessary, standardized, expenditure is financed by IRAP's revenue, other regional taxes etc., + shares of equalization fund.</p>
BASIC SERVICES		
<p><b>Centre-right (approved by opposition)</b></p> <p>“Basic” are the services concerning social and civil rights.</p>	<p><b>Prodi Centre-left, old Government</b></p> <p>The same as Lombardy + regional transports + basic expenditures of smaller municipalities.</p>	<p><b>Third, intermediate (Calderoli = Northern League)</b></p> <p>“Basic” are health, education, social welfare, while regional transport would receive only partial funding.</p>

largely defined by Act 3/2001 and now, 7 years later, still waiting for a financial setting from Italian Parliament.

*The State has exclusive competency* over: i) public order and security; ii) defense; iii) foreign policy; iv) monetary policy and savings; v) justice; vi) electoral rules and citizenship; vii) immigration and relations with religious institutions; viii) general rules on education; ix) social security; x) protection of the environment and cultural resources. The State determines the essential level of civil and social services, guarantees citizens' rights and the principle of solidarity between areas with different levels of development.

Then we have a *vast area where there is a sharing of responsibilities* between the State and the Regions. In the field of education the State only establishes the "general rules", while in the fields of cultural heritage and the environment it has exclusive jurisdiction, although Regions have a say in the economic side of the matters (costs and value adding, in the case of culture). As for health services, the Regions have increased decision making power, while it is up to the State to establish the essential standard levels. Other concurrent areas are work safety, scientific research and technology, large infrastructure networks, energy etc.

*The Regions have legislative exclusive responsibility* for significant areas such as: i) local development; ii) social services; iii) agriculture; iv) urban planning; v) professional education, etc.

Both in the sharing and in the totally exclusive case the Regions are supposed to rely on the cooperation of the lower tier of government, especially of the Communes, which are expected to be "adequate", i.e. large and strong enough to undergo new devolved tasks.

Rightly it has been said that "at the moment, Italy can best be described as a devolutionary asymmetric federal system in the making": powers have actually been transferred (devolution), asymmetric because there are two types of Regions and "federal in the making" because even after the 2001 reform the term "federal" or "federalism" do not appear in the Constitution (Palermo, Woelk).

Depending on the interpretation of the above notions on the budgetary side, there will be different possible fiscal federalism scenarios in tomorrow's Italy. The degree of solidarity will be decisive. Fiscal federalism will be the very essence of the game. But as also the current German discussions show, fiscal federalism is a politically most sensitive issue, because it calls for a new system based on autonomy and efficiency of each territory, as well as on very different economic and administrative systems, while maintaining social cohesion and equality of rights. All of this within a framework of public finance which is characterized by a high level of public debt.

Implementing fiscal federalism will have undoubtedly a cost. But not implementing it – says a recent well documented report by another northern Region, Veneto, which is on the forefront of the claim for federalization of Italy – has had and will have even higher costs, especially those associated to the inefficiencies of the public system in the subsidized areas, not only in the South (see Regione Veneto).

The table is thus ready for dinner, and the guests are just waiting for the food and the drinks be served. The Italian Parliament is at work to cook and, hopefully, serve a decent meal, 60 years after the 1948 breakfast!

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**ANNEX****SOME READY-MADE INFORMATION ABOUT ITALY'S FACTUAL DECENTRALIZATION****1 - The current (2006) situation: number and types of local government**

A unitary State (see international statistics, e.g. IMF)

20 Regions, *of which*

5 "special" ( 3 on Northern border\* + Sicily and Sardinia )

- 15 "ordinary"\*\*\*

108 Provinces (but many more on the way to be created!)

8100 Municipalities (Communes)

\*Of these one is split into two "special Provinces"

\*\* Could be compared with the "regimen foral" and the "regimen comun"

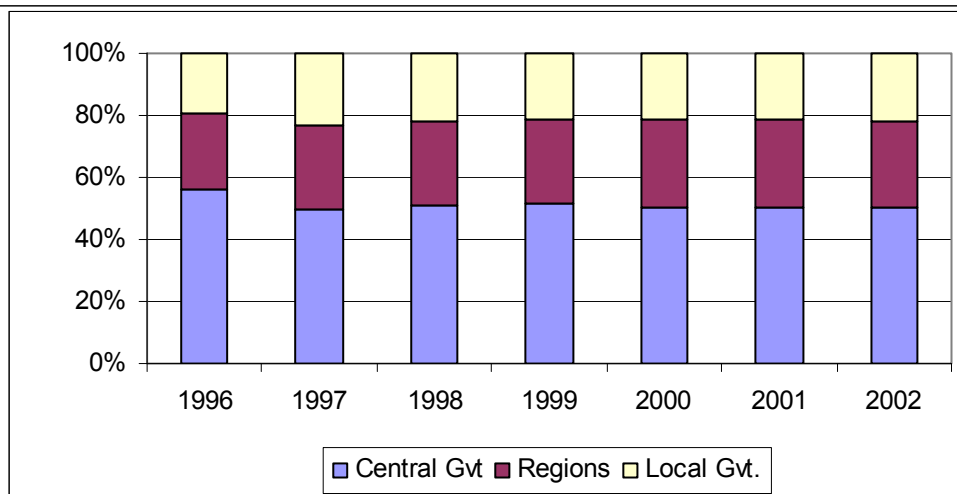
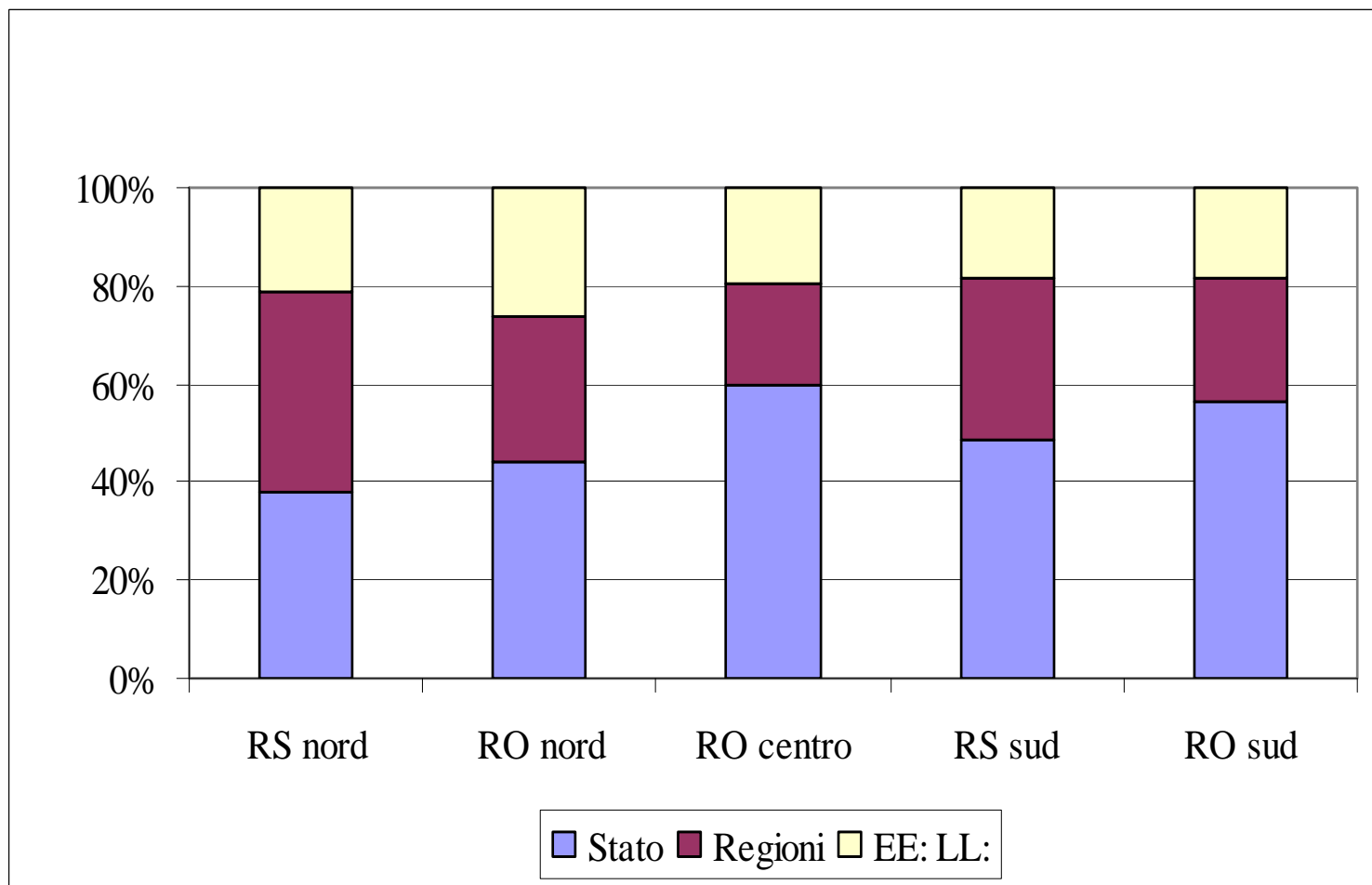
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**2 - The relative weight of local government in the total public expenditure of the country.**

	Year 2004 (bn euros)			+ 2004/1999 in %		Weight local/total in %	
	Total gov.	gen. Of which cent.gov. loc.gov.		Centr. government	Local	2004	1999
Current exp.	599,3	332,6	171,8	14,3	39,2 (!)	28,7	25,1
<i>of which inter- ests on debt</i>	68,4	65,5	3,3	-10,7	+ 3,2	6,3	5,6
Capital exp.	55,6	31,2	38,2	12,4	35,0	68,7	64,2
<i>of which real investment</i>	34,9	7,2	28,6	3,7	47,4	81,8	72,4
Total expend.	<u>654,8</u>	<u>363,8</u>	<u>210,2</u>	<u>14,2</u>	<u>38,4</u>	<u>32,1</u>	<u>28,3</u>
<i>In % of GNP</i>	48,0	26,8	15,4	(*) Source: Banca d'Italia			

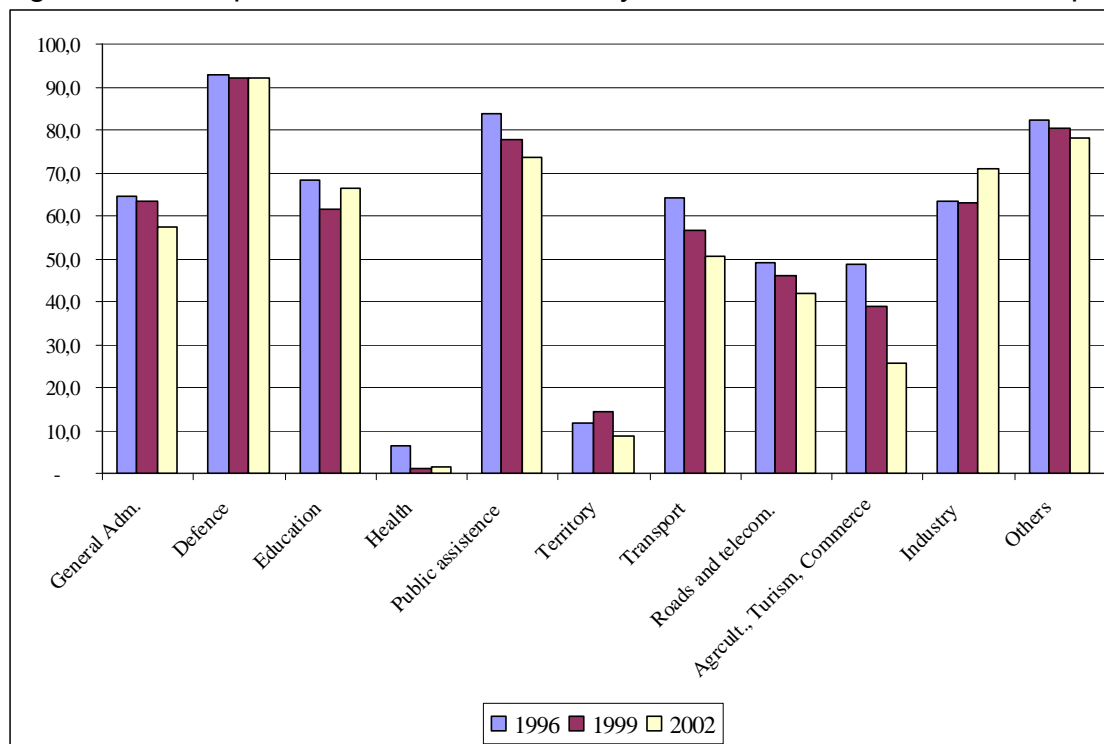
3 – Some graphical illustrations:

Fig. 1 - Degree of decentralization of total public expenditure in the Italian regions



(for the Central Government, expenditure net of payments for interest on public debt and for social security)

Fig. 3 – Final Exp. of Central Government by Function - % of total Public Expenditure



## Main comments to Fig. 3:

- The State maintains over 90% of defense expenditure (obviously)
- Over 80% of welfare (less obvious) and “other”
- Over 60% of education and industry exp.
- Over 50% of transport exp.
- Over 40% of roads and telecommunications exp...

... but has come to almost zero in health expenditure and between 10 and 25% of expenditure for “territory” and for non industrial sectors (agriculture, tourism, etc.).

Increasing expenditure for “Industry” in the 1996-2002 period is an exception among all other items, all decreasing.

So, decentralization of ex-central competencies and expenditures is a slow but unavoidable process, which will be accelerated after the confirmation of the 2001 constitutional law.

In year 2004

The Regions showed the following composition of expenditures (in %):

- general administration 5,4
- education and training 4,8
- social welfare 2,3
- health 51,3
- economic sectors 6,9
- transports 6,6

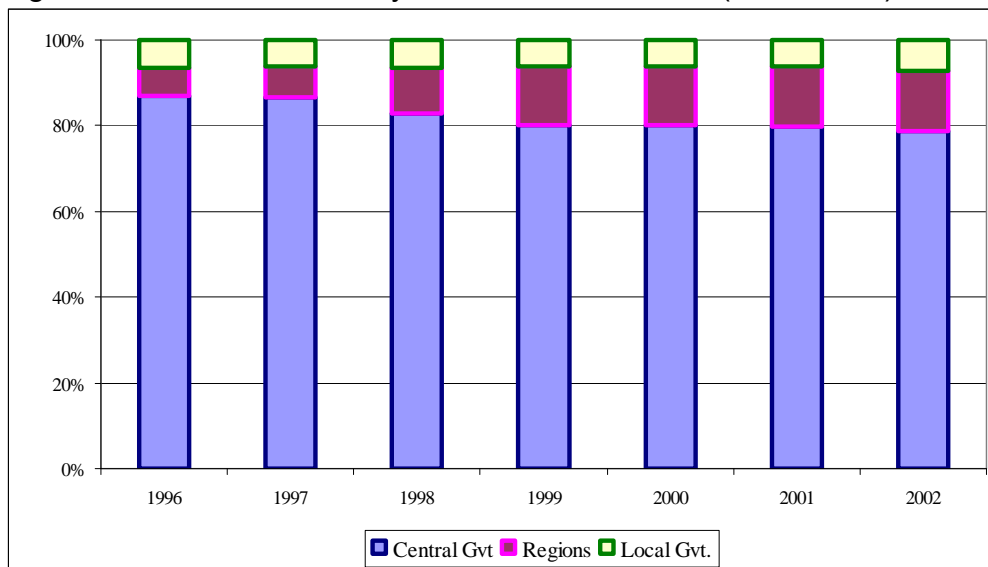


- territory 5,2
- social housing 2,
- not allocated 15,0

TOTAL: 100

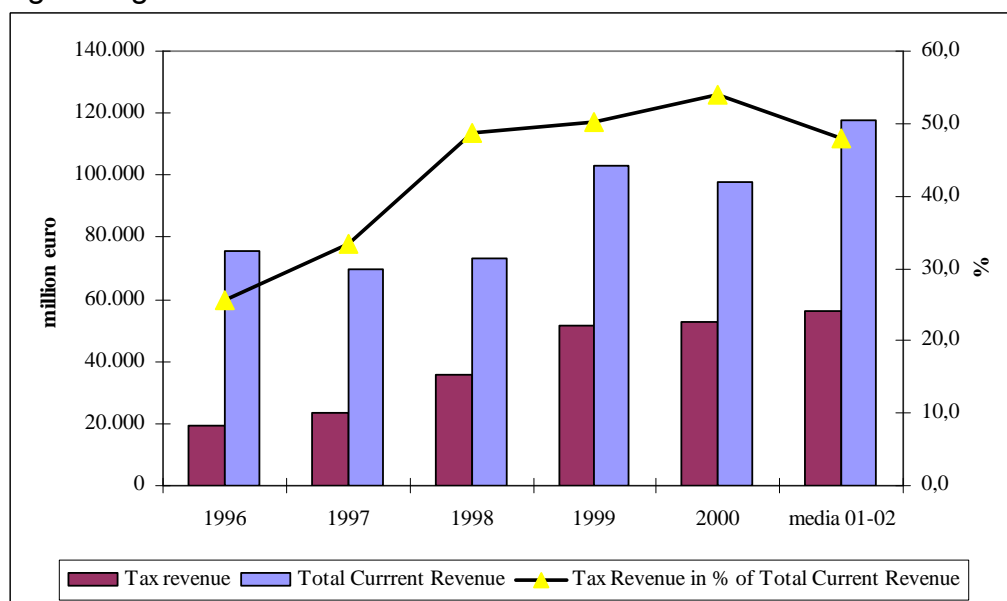
Which shows that *health* is still the dominating target of Regions' mission, although no longer all-absorbing as it was in 1978, but that *economic development* (including infrastructure design) has come to get some 20% of budget allocations).

Fig. 4 – Total tax revenue by level of Government. (1997-2002)



(for the Central Government, net of compulsory contributions for social security)

Fig. 5 Regions - Tax Revenue and Total current revenue.



Source: Figures from 2 to 5 are taken, by kind permission of the Authors, from mimeo "Main Issues of Italian Fiscal Federalism", by E. Buglione and M. Marè. Fig. 1 is an elaboration of E. Buglione.

## PRESENT CENTRALIZATION IN RUSSIAN FEDERALISM: ECONOMIC EFFECTS AND INTERACTIONS

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The Russian Federation is one of the quickly developed federations in the world. For rather short period of time, we have witnessed several models of the Russian federalism existed in practice. Adopted 15 years ago, the Russian Constitution proclaimed principles of an almost *Ideal model* of federal relations (Articles 4, 5, 6, 11). However, this model, originally based on the "best practices" of other countries, was becoming in practice a purely "Russian" model that had its roots in the real circumstances of the mid-1990s. By the end of this period, the Russian federal model combined typical features of federal states with peculiarities such as status asymmetry, emphatic national "colouring," ambiguous status of the very territories of a number of the subjects of the Russian Federation, inadequate resources to exercise status powers of bodies of state authority in many subjects of the Russian Federation, and excessive personification of intergovernmental relations.

Dr. Seliverstov, in his presentations delivered by at the passed IACFS conferences, characterized the peculiarities of the Russian federalism of the 1990-s as follows:<sup>1</sup>

- separatist tendencies taking place in a number of republics in the Northern Caucasus and threatening the RF integrity;
- the risk that the Russian federalism could transform into "bargain federalism" based on separate agreements between the federal center and the subjects of the Russian Federation;

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1. V.I. Klistorin and V.E.Seliverstov, "Transformation of Federalism and Regional Policy in Russia at the Turn of the Century" (in Russian), *Region: Economics and Sociology*, 2002, Vol. 3; and V.E. Seliverstov, "Federalism and Regional Policy in Russia: Strengthening Power Vertical" (in Russian), *Region: Economics and Sociology*, 2004, Vol. 1.

- growing influence of both oligarchic structures and large business on political processes in the center and regions that resulted in the direct interpenetration of authorities and business;

- absence of a common legal framework in the Russian federalism, and significant inconsistency of the federal and regional laws;

- increasing interregional disparity failed to be smoothed over by fiscal federalism.

As a result, by the end of the last century, Russia was an example of an asymmetric federation both in social and economic aspects. This happened because of a disastrous economic crisis of that time as well as the fact that the Administration failed to provide its effective governance.

The ex-president V. Putin who came to the President's post after Mr. B. Eltsin in 2000 proclaimed a goal of strengthening federal status - the liquidation of the above mentioned risks and threats in particular - as a goal of high priority. Today we can say that all the tasks (except the last one – the interregional disparity) have been realized. However, the decisions, which had been made at that time and had split up the world's opinion, were:

- significant strengthening of presidential power, and its expansion to a regional level through a new institution of Plenipotentiary Representatives of the President of the Russian Federation established in eight federal districts;

- repression of rebellious groups in Chechnya with the following de-facto restitution of this republic within Russian economic and legal space (extremely strong measures of the President Eltsin in 1999-2000, which were concluded by the storm of the capital of the Republic, preceded);

- great efforts were made to establish a strong party in power - "United Russia" - in order to eliminate the influence of the Communist Party and other oppositional right-wing parties. Additionally a 5% barrier of party-representation in the Lower Chamber of the Parliament (State Duma) was introduced, and this resulted in the fact that a number of out-parties were not represented in the Duma;

- direct election of governors was annihilated. Today governors are elected by local parliaments, and candidates are those as advised by the RF President;

- certain measures were taken against several oligarchs who were too aggressive in their claims to power or control over decision-making at the federal and regional levels.

These political and economic innovations were obviously in the midway of stronger centralization of the Russian federalism.

All in all, we may state that in the period of Mr. V. Putin's presidency, Russia has experienced dynamic changes in federal relations. These changes include state regulation of territorial development, the development of a legal framework and new institutio-

nal structures for regional policy, and a streamlining of relations between the centre and the regions.<sup>2</sup>

First, federal relations have been dominated by three reforms: administrative, municipal, and budgetary. Harmonization of regional and federal laws was successfully pursued, and the division of powers between federal and regional executive bodies was actually carried out. Administrative reforms have also been launched, and it is hoped that a prioritization and streamlining of the provision of government services will improve the quality of public administration. Administrative and municipal reforms are linked to the restructuring of the budgetary process. The key theme of all these changes has been results-oriented budgeting that will become the basis for budgetary processes at the regional and municipal levels. In the course of these reforms, attempts are being made to fine-tune regulations and standards for the provision of government services at the federal and regional levels, including the development of registries of spending commitments.

Second, a significant strengthening of the federal budget, primarily due to a favorable world energy market, created new opportunities for federal policy in the regions. Besides the traditional, federally targeted programs, the regions now implement national projects designed to solve urgent social problems, such as housing, education, and health care. The Federally Targeted Investment Program has been launched, which provides funds on a competitive basis for investment in individual projects implemented in regions. Contests for the creation of special economic zones in regions have become yet another long-awaited innovation.

Third, work has finally commenced on developing institutional structures for regional policy. The most important step in this regard has been the restructuring of the Ministry of Regional Development of the Russian Federation. Equally important are the regional policy institutes now being established locally—in regions, large municipalities, and at the level of the federal district. Regional development agencies or corporations (occasionally called investment development agencies) have been advocated for some time. These institutions are positioned at the intersection of interests between authorities and businesses.

Fourth, during the past few years we have witnessed the implementation of measures to improve the territorial-administrative division of Russia, which have led to mergers of a number of regions and autonomous districts – when one RF subject was included into another. Besides producing political benefits, such merges can play a significant role in reducing interregional disparities. One such example was the merger of Krasnoïarsk Region, Taimyr Autonomous District, and Evenk Autonomous District; another was the merger of Irkutsk Region and Ust-Ordynsk Autonomous District. According to V.

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<sup>2</sup> Viacheslav Seliverstov, "Federalism and Russia's New Regional Policy: Choosing a Development Model". In: *Federalism, Power and the North: Governmental Reforms in Russia and Canada*. Edited by John F. Young. Center for European, Russian, and Eurasian Studies. University of Toronto, 2007.

Klistorin, “the enlargement of regions was considered as a tool of solving two problems: to reduce regional legal asymmetry (by merging the “matreshka”- regions with the following unification of a legal status of a new region), and to lower the dispersity of an economic space through inclusion of the underdeveloped regions into the developed and financially self-supporting regions”.<sup>3</sup>

Fifth, the process of establishing the large state corporations has commenced due to the goal of providing higher governmental participation in strategic industries of the economy such as infrastructure, aircraft industry, nanotechnologies and etc.

Sixth, the mechanisms of public-private partnership have started to work well, including those applied to the large infrastructural projects being implemented in the subjects of the Russian Federation.

Finally, there has been a noticeable intensification of work at the level of federal districts and regions to develop strategic programs concerning regional development. This is an indication of the desire of regional governments to tackle major long-term tasks in economic and social development, both independently and jointly.<sup>4</sup>

Table 1

Socio-economic crisis of 1990-1998(99) in Russia  
and its overcoming (% to those of the pre-crisis year 1989)

Indicators	Low point of the crisis	2007
GDP	56	100
Industry	46	85
Agriculture	54	80
Investments	21	50
Real incomes per capita	53	125
Unemployment (% to occupied population)	13	6,5
Depopulation (thousand people per year)	950	500

<sup>3</sup> V. I. Klistorin, “New Stage of Debates about Federalism in Russia” (in Russian), *Region: Economics and Sociology*, 2008, Vol. 3

<sup>4</sup> See, for example, *Regional Development Strategies and Programs: Comparative Analysis* (Moscow, 2006); V.V. Kuleshov and V.E. Seliverstov, "Strategic Objectives and Development Potential of the Novosibirsk Region" (in Russian), *Region: Economics and Sociology*, 2006, Vol. 3; and V.V. Kuleshov and V.E. Seliverstov, "Siberia's Socio-Economic Development Strategy: Institutional Conditions and Implementing Mechanisms" (in Russian), *Region: Economics and Sociology*, 2005, Vol. 4.

All these are in the tideway of the federal status enforcement and the improvement of quality of public administration. However, a good deal of financial resources is required to do these. Such resources go from the surplus federal budget as well as from the budgets of the subjects of the Federation.

The latter today have good financial resources, and many of them are surplus (for example, the budget in the Novosibirsk Region is 12 times bigger than 9 years ago). It is obviously connected with the better economic situation in the Russian economy, and presently the parameters of the pre-crisis time have been recovered (see Table 1).

Speaking of evaluation of the tendencies in the development of the Russian federalism and its centralization, one should remember that they are closely connected with the Russian spatial development and regional policy. As we said above, the beginning of the political and economic reforms caused the stronger differentiation of the socio-economic development and standards of living in the RF subjects. Presently GDPs per capita in the regions differ in 117 times, and unemployment – in 78 times. This is an example of the spatial socio-economic stratification never yet seen in the world. This results in existence of “poverty zones” in the Russian map, rising social and ethnic tension and a criminogenic situation in a number of depressive regions (the most depressive regions are the Northern Caucasus republics and several autonomous districts in Siberia and the Far East). Equalization of regional budgets, made within the framework of fiscal federalism, has failed to solve this problem because the Regional Financial Support Fund, which makes interregional transfers, is too small. However, the most important reason is that the regional equalization, based on the principle - “the poorer a region is, the more it gains”- can not produce incentives for regions to accumulate their own financial resources through higher activity in the regional “growth points”.

We regret to say that for years the Russian regional policy and fiscal federalism stays in “a backyard” of our economic policy. This can be seen from the lack of financial resources, assigned for regional policies and tasks of fiscal federalism, and from weakness of these institutions as well as our wrong choice of concepts and models for regional policy. Until recently, we have changed our basic model of regional policy from an “equalizing” one to a “polarized development” model which implies the support for “regions-locomotives” only. Many times before, we expressed our negative evaluation of such policy because it leads to greater differentiation of Russian regions.<sup>5</sup> Architects of this idea used to refer to positive foreign practices of such “polarized regional development” and used to prove that the world had rejected the “equalizing” regional policy long ago.

However, from all evidence we can see the contrary. The best example is the EC regional policy - rather effective and based on supporting depressed European regions, and EC does not intend to reject it. Moreover, today EC applies a new principle – so-

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<sup>5</sup> See, for example, V.E. Seliverstov, “Regional Policy in Russia: Choosing a New Model” (in Russian), *Region: Economics and Sociology*, 2006, Vol. 4; V.E. Seliverstov, “Myths and “Reefs” about Russian Regional Development and Regional Policy” (in Russian), *Region: Economics and Sociology*, 2008, Vol. 2.

called “cohesion policy”, due to which the enormous financial resources have been accumulated in the form of special funds for conditional projects aimed at the reduction of regional disparities in Europe. EC intends to direct 347 billion euro for such cohesion policy in 2007-2013. In Canada, a “polarized regional policy” model was applied only in the 1970-s, and later it was substituted for modern tools combining new principles of supporting both depressed regions and regions-leaders.

Any regional policy should support key objectives of federalism, and they both, taken together, should provide the equal rights for the access to goods and services to all citizens of their countries no matter where they live. Should a regional policy provide the realization of sectoral or corporate interests only, it could put obstacles in solving social problems oriented to ensure the rights for adequate standard and quality of life. We must emphasize that today the social orientation of regional policy is of great importance to Russia.

We must also say that vital changes have been observed in this field over the latest months. In the summer 2008, the Draft Concept of Improved Regional Policy of the Russian Federation was published on the WEB-site of the RF Ministry of Regional Development (hereinafter referred to as the Concept).<sup>6</sup> This document cardinally differs from those developed by the Ministry in 2006 such as “Principles of Federal Regional Policy, Its Development and Implementation Schemes. Draft federal law” and “Concept of Socio-economic Development Strategy for RF regions”.<sup>7</sup>

We think that it was for the first time in the Russian history when the Concept had declared such principles as to reduce disparities in the socio-economic development of the RF subjects and to ensure a sound balance between accumulating economic potentials in the RF regions and providing better living space and equal social and economic rights to people no matter where they live. This undoubtedly put new accents on and among the economic, social, regional, investment and innovation policies in Russia.

Recent years have thus witnessed transformations in various areas of federal relations and regional policy. These transformations provide reasons for cautious optimism. Caution is warranted as initiatives are implemented at the lower level, in regions and municipalities, implementation can be inconsistent, unsystematic, poorly coordinated, and excessively bureaucratic. National projects delivered by local institutions and competitions for special economic zones risk becoming examples of bureaucracy merely going through the motions, where the end result resembles too closely the status quo. One could give many specific examples of lost opportunities and inconsistent and bureaucratic actions on the part of central authorities. The implementation of certain

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<sup>6</sup> “Concept of the Improved Regional Policy of the Russian Federation (in Russian) <http://www.minregion.ru/WorkItems/NewsItem.aspx?NewsID=923&PageID=378>

<sup>7</sup> “Concept of the Strategy of Socio-Economic Development of the Regions of the Russian Federation” (in Russian), <http://www.minregion.ru/WorkItems/DocItem.aspx?DocID=136&PageID=148>.

administrative reforms deserves particularly strong criticism. This should not surprise anyone. It is unrealistic to expect much else when institutions engage in self-reform.<sup>8</sup>

Unlike the first stage of administrative reform (2003-2005), which had as one of its main objectives the organizational streamlining of executive power, this second stage (2006-2008) was designed to bring about a fundamental renewal of the relationship between executive power and society (civic and commercial). Practically all tasks set out for the second stage—and there were roughly sixty such tasks—targeted this objective. These tasks were incorporated by the Government of the Russian Federation into the "Action Plan for the Implementation of the Administrative Reform in the Russian Federation in 2006-2008," and include those that could be formally regarded as the traditional tasks of improving the structure or clarifying the functions of state authorities. At the same time, it is important to note that one of the tasks that the architects of the reform's second stage have been particularly eager to promote (and that is quite difficult to achieve) is the standardization and regulation of the provision of government services. This standardization and regulation must therefore become an integral part embraced by all levels of public administration.

The various dimensions of administrative reform can have a dual effect on federal relations. On the one hand, reforms are absolutely necessary to improve the quality of executive power in Russia at all levels. On the other hand, by providing the newest bureaucratic mechanisms, they can further strengthen an overly centralized system. This is most noticeable if one looks at the approaches used to develop the second stage of the administrative reform and its results in the centre and the subjects of the Russian Federation.

The problems which we encountered in implementing the local self-government reform were no less difficult than those in other reforms. This reform launched in 2003 became Russia's only *reform of a reform*. This reform was designed to review the concept and repair the outcomes of earlier municipal reforms implemented between 1993 and 2000. Thus, it is reasonable to explore the results of earlier reforms and the rationale behind any radical re-formation of local self-government in 2003. One should keep in mind that in the 1990s, Russia created both a legal foundation—first and foremost, a constitutional foundation—and the organizational prerequisites to transform local government. This transformation intended to take local government from the lowest level of the Soviet system, subordinate to higher levels of administration, towards local self-government, consistent with other new features of the Russian state, such as federalism, democracy, and the rule of law. Local self-government, however, was intended to come into existence *before* the conditions were created to implement these new features. With its ratification of the European Charter of Local Self-Government in 1998, Russia entered European municipal space, expressing a long term commitment to local self-government and to further integration with Europe.

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<sup>8</sup> Vladimir Leksin, "The Impact of Administrative and Municipal Reforms on Russian Federalism". In: *Federalism, Power and the North: Governmental Reforms in Russia and Canada*. Edited by John F.Young. Center for European, Russian, and Eurasian Studies. University of Toronto, 2007



The main problem in the implementation of the local self-government reform was the fact that the newly established and former local governments failed to execute their powers fully and effectively. According to Russian experts, there are three primary difficulties associated with the new administrative-municipal reform. First, the new law maintains a uniform approach to the organization of municipal power throughout different regions of the country. Second, the financial capacity of local governments remains insufficient to implement their authority. Third, there remains a continued practice of either downloading to local governments previously identified and newly defined federal and regional powers, or uploading local authority to higher levels of government. Such shifts undermine the objectives of clarifying and optimizing intergovernmental relations.

Thus, the latest (second) reform of local self-government became, both in substance and implementation, a reflection of the trend towards strengthening the federal presence. The uniform format approved by the centre provides for the mandatory establishment of new local governments and the modification of those local governments established earlier according to the principles of the first municipal reform. The new reforms, however, maintain the financial dependence of the vast majority of municipalities on federal and regional centres, and act as a centripetal force, redistributing local power to the centre. This is why the new municipal reform is increasingly viewed as an attempt to further strengthen at the local level a model of centralized federalism that has been implemented in Russia consistently since the beginning of the twenty-first century.

Some analysts offer a harsher assessment of the very direction of Russian federalism and regional policy reform, claiming that recent years have marked the beginning of the end of federalism in Russia since too much political and economic power is concentrated in the federal center. Undoubtedly, these tendencies are evident and may be found, for example, in the distribution of tax incomes between the center and RF subjects. While this ratio should be 50% to 50% according to the former Budget Code, it was 56: 44 in 2004, and nearly 67: 33 in 2008. This witnesses a dramatic rise of the state incomes and their consolidation at the federal level with the following return to regions through one or another channel.

Nevertheless, our assessment of dynamics along the centralization-decentralization axis in Russia is more moderate. It is clear that in recent years we have witnessed a noticeable strengthening of central power in its relationship with the regions. This was reflected in the formation and strengthening of the *vertikal*, as well as in a whole set of measures associated with the concentration of political and economic powers in the presidency and the federal government. We focus on two other important questions. To what extent was this centralization justified? And has Russia now lost some of the defining characteristics of a federal state?

The answer to the second question appears quite obvious. Even the significant centralization of power in Russia over the past five years does not damage or change the very structure of federalism embodied in the country's constitution. The primary characteristics of federalism persist. These include a constitutional division of powers

and the existence of representative, executive, and judicial powers accountable to the regions.<sup>9</sup>

Centralization of resources and powers in the federal center occurred in 2003-2005 is justified as an expedient and effective action that has had a positive impact on the socio-political and socio-economic situation in the country. This impact was felt in politics, public administration, and particularly in the socio-economic field, where its most obvious manifestation was a noticeable stabilization of public payments for a number of social benefits. Other manifestations of this positive impact include the launching of a number of new social programs and a significant expansion of the state's investment opportunities.

One should add that the radical redistribution of jurisdiction and powers that took place in the years 2002-2003 to the benefit of the centre is not fixed but under constant adjustment. Over one hundred powers in various areas, such as forest, water, and local resources management, were given back to regional governments as they exerted pressure on Moscow. Still, despite significant criticism levied by scholars, experts, and regional authorities against the new Law on Subsoil—first and foremost, against the decision to abolish the principle of "two keys" in subsoil use regulation—this sacred cow of federal authority has remained untouched. Highly centralized rules and procedures concerning subsoil management are still in force, which, in our opinion, makes regions less interested in their effective use.

These tendencies can not be credited to federal authorities making concessions to regional and municipal authorities. Rather, they are an indication of the poor quality of law-making in Russia and the fact that adopted laws do not take into sufficient account the possible consequences of implementation in different regions and to different populations. Efforts to unify federal legislation only exacerbate these problems. Certainly, ad hoc measures that have been taken to adjust such laws are necessary, but they come at a very high price. Such an approach produces "legal nihilism" and introduces confusion into the law-making process in the regions.

Little is achieved by overreacting to the significant strengthening of centralization and concentration of power in the hands of the federal centre. The centralization of power was dictated by the need to establish order in Russia in the socio-economic, legal, and financial spheres, and to strengthen her position in the international community. The specific forms and manifestations of these processes were certainly determined by the head of state and the approach he adopted to strengthen presidential powers. History will tell whether these actions were correct and reasonable. It should be emphasized, however, that even if these actions approached a dangerous threshold beyond which the features of federalism would have become indistinguishable from a unitary state, these actions did not damage the overall federal structure of the Russian state. Russia is hardly a quasi-federation like the USSR.

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<sup>9</sup> *Federalism: Theory, Institutions, Relations* (In Russian). Moscow: Iurist Publishers, 2001.

There are no simple recipes or rules for federations concerning an optimal ratio between centralization and decentralization. In this regard, there is a marked difference among various federal states, and the notion that "the more decentralization there is, the more democracy there is" does not hold in all cases. The well-known postulate that "federalism is the territorial frame of democracy" is inaccurate because it completely ignores the rich democratic traditions of unitary states.

As for Russian "rollback" from principles of democracy today, there is a counter-question – how strong is the demand for democratic institutions such as election, publicity and etc. in the Russian society at present? We regret to state that it has not been active so far and shaped by a small group of the population who believe in liberal values and support the ideas of right-wing parties. Vast majority of the population are primarily concerned about economic welfare, stability, public safety, social justice and how to avoid the corrupt and bureaucratic practices.

It is common to characterize recent Russian reforms as lacking a systemic approach and to view their implementation as a departure from the liberal course of the 1990s. These are not accurate characterizations. First, it should be noted that in the early twenty-first century, the Russian President and the government have been consistently *radicalizing*, rather than smoothing over, reforms either launched or declared in previous years. Unfortunately, both Russian and foreign researchers tend to almost completely ignore this fact, although it was only recently that the Russian government, with the support of the Federal Assembly, took advantage of the improving economic situation and the rising power of the "centre" and started the implementation of many liberal and market reforms that had existed only as ideas in the 1990s. This process involved the restructuring of critically important sectors such as energy and transportation, and the introduction of a flat income tax. Other measures included changes to the government's list of social obligations, reorganization of the housing and public utilities sector, and the launch of military reforms. At the same time, there was not a single case of revising earlier reform initiatives such as privatization and price liberalization. Changes in Russia's banking and retail trade sectors in 2005-2006 were not a rejection of liberal principles and market values, but simply a market adjustment of the service sector.

Second, reforms introduced in recent years were designed to legitimize, rather than change, a policy developed over seven years ago of a dominant *federal presence*. This policy is currently manifest by direct and indirect actions on the part of federal authorities in the regions (*subekty*) of the Russian Federation parallel with (and sometimes contrary to) actions by regional and local governments. Analysis of these actions and trends indicates that the federal role is not a spontaneous conglomeration of relevant events and processes. Rather, such developments are a unique institutional phenomenon of modern political culture, one that logically follows from the very nature of new Russian federalism and Russian statehood. A constitutionalized federal presence is a necessary attribute of any federal state and is marked by an institutional commitment to the supremacy of the federal constitution and federal laws. This legal foundation defines in every federation the legal authority and competency of federal institutions, and enumerates spheres for joint jurisdiction, where power is shared with the subjects of the

Federation. Thus, a federal presence becomes a distinctive manifestation of the role of central administration in a decentralized state.

In modern Russia, the federal presence shapes everything: the organization and the work of the institutions of legislative, executive, and judicial power; the state's legal space; its social policy; and the practice of generating and managing public funds. In the regions of the Russian Federation, a federal presence is manifested very strongly and in many ways; it permeates all aspects of public life. This prompts claims that can be heard frequently about Russia losing its typical federal characteristics and turning instead into a unitary state. The federal presence openly intrudes upon established processes for making and implementing decisions concerning exclusively regional or municipal matters, proving time and again that in the end, "everything is decided at the top" (*naverkhu*). This is why serious concerns have been voiced that further strengthening of the federal presence in Russia conflicts with the principles of federalism and postpones the development of independent authority in the subjects of the Russian Federation. After all, by definition, federalism requires a system of authority where accountability extends beyond the grasp of the president of the Russian Federation.

Our analysis shows that it would not quite correct to state that modern Russia of "Putin-Medvedev" is less federate and democratic than B. Eltsin's. In fact, these "two Russias" are different counties characterized by different levels of the economic development and quality of public administration at the federal and especially regional levels. We would say that Eltsin's federalism was much more decentralized but more formal, ineffective and "propagandistic". It may seem paradoxical, but modern federalism, commenced in Russia at the beginning of the new century, is more effective and radical than a previous model despite its rigid structures and less freedom for the subjects of the Russian Federation.

It should be noted that the configuration of public authority has noticeably changed since the election of a new President Dmitry Medvedev. As we said before, during Mr. Putin's presidency, the presidential branch of power markedly dominated the system of executive and legislative power. Today it is the executive power, i.e. the Government, federal ministries and regional governments that was strengthened by Mr. Putin after his coming to the post of Prime Minister. This fact should not be treated as "diarchy" as certain experts, who oppose the President to the Prime Minister or the President's Administration to the Government, used to do. Most likely it is a fact of achieving a logical balance of the "power vertical", though in this situation legislative power remains still dependent.

The Russians got tired of being pessimistic. It is obviously that all levels of the public administration have become extremely corrupt and bureaucratized. Modern Russia is not exactly an ideal model of a constitutional state with advanced institutions of civil society. To become such state, it will take rather decades than years. Our judiciary system is not fully independent and this can be easily proved by numerous evidences. Nevertheless, more optimistic and positive outlook on the economic, social and political life as well as on the prospects of our incorporation into world's community prevails in the country at present. The events of the last month, related to the Georgia-Osetya

conflict, undoubtedly have changed these processes in some degree; though, in our opinion, they won't bring the long lasting consequences. However, this depends not only on the political and economic development of Russia as a legal, democratic and market-oriented federate state but also on overcoming the recurrences of Russophobia taken place in political elites of a number of countries.

## **Centralisation and Decentralisation Trends in Spain.**

### **An Assessment of the Present Allocation of Competences between the State and the Autonomous Communities**

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A first approach to legal texts may lead to considerer, initially, that Spain is a highly politically decentralised country from the standpoint of the distribution of powers or competencies between the state<sup>1</sup> and the autonomous communities (ACs). In practice, as tends to occur with all legal systems, things are much more complex and require further glossing.

In this paper, I will first provide a very summary description of the main characteristics of the legal system of distribution of competences which is set forth in the 1978 Spanish constitution (SC) and in the statutes of autonomy of the ACs. I will then briefly take stock of the way this system has taken shape in practice. Thirdly, I will analyse the main mechanisms which have led to the present situation. And finally I will, also briefly, refer to the novelties introduced in this area by the reforms of the statutes of autonomy that either have just been approved or are about to be approved.

#### **1. System of distribution of competences set forth in the constitution and the statutes of autonomy**

In Spain, the allocation of competences between the state and the ACs is regulated both by the constitution and the seventeen statutes of autonomy of the ACs. Specifically, articles 149.1 and 2 of the constitution list the state's competences and leave it to the statutes to perform the highly relevant constitutional function of assigning the respective ACs the competences they must hold, while respecting the constitutional list of competences reserved for the state. The competences not held by the ACs fall upon the state by virtue of the residual clause (article 149.3 SC). The statutes of autonomy, then, play a more prominent role than the majority of the constitutions of the member states of the federations while determining the competences of the ACs and, indirectly, those of

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<sup>1</sup> Following the Spanish terminology, by "state" I will refer all through this paper – and unless another term is particularly specified – to the Spanish central government.

the state – the latter not just because they indirectly delimit the scope of the residual clause but also because, by defining the material and functional scope of the autonomous competences, indirectly yet ineluctably, they also outline the scope of the state competences contained in the list of article 149.1 SC. For this reason, it is worthwhile analysing the novelties introduced by the statutes of autonomy that have just recently been approved. Despite this, while assessing the nature of the statutes of autonomy it should also be borne in mind that, unlike the majority of constitutions of federated states, they are not the outcome of an ordinary power but are state laws, although they arise from pacts or agreements between the state and the respective ACs.<sup>2</sup>

Nevertheless, the allocation of the competences set forth in the constitution and the statutes of autonomy can be made flexible by two mechanisms provided for in the constitution itself: first, if it fulfils certain requirements, the state may pass harmonisation laws on matters in which the ACs hold competences (art. 150.3 SC), and in the other hand, it may delegate or transfer the exercise of state competences to the ACs, also under certain conditions (art. 150.1 and 2 SC).

Finally, not in the realm of the distribution of competences per se but in the area of rules for resolving conflicts among norms and among legal systems, the constitution establishes the principles of the prevalence and supplementarity of state law (art. 149.3 SC).

We can say in advance now that, in practice, none of these clauses has been applied significantly: the residual clause has virtually never been applied so that, except for a handful of occasions, the state has not gained competences by this route.<sup>3</sup> Nor has the clause on prevalence been used on a regular basis as a rule for resolving conflicts among norms.<sup>4</sup> The principle of supplementarity, which in the early years was used by the state as a universal clause for allocating competences, after some rulings of the Constitutional Court in the 1990s led the principle to a simple rule on relations among the state and the autonomic legal systems endowed with a very small practical influence.<sup>5</sup> Likewise, the state has hardly ever made use of the laws on harmonisation,<sup>6</sup>

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<sup>2</sup> However, it should be pointed out that when drafting and approving the first statutes in the 1980s, not all the ACs could participate with the same intensity in these agreements. However, this is an issue that we cannot dwell upon here.

<sup>3</sup> The statutes have tended to occupy the entire field left by the constitution, and the interpreters and enforcers of the constitution and the statutes, including notably the Constitutional Court, have tended to interpret the matters of competence expansively in order not to apply the residual clause. The only realm in which we can consider that the residual clause has indirectly been applied more often is the state's taking on competences that in theory belong to the ACs, wielding the argument that the phenomena covered by these actions have a supra-autonomous territorial scope. Further on I shall refer to this centralisation mechanism.

<sup>4</sup> It should be borne in mind that in the Spanish legal system there are no overlapping competences as there are in the systems in which this clause is commonly applied. In Spain, the conflicts among norms tend to be resolved by applying the principle of competence.

<sup>5</sup> These include, among others, rulings 147/1991 and 61/1997.

and the use of delegating or transferring competences can also be deemed relatively rather insignificant.<sup>7</sup>

If we turn to the **content** of the competences, the first conclusion we can draw is that the constitution and the statutes give the state a clearly pre-eminent position with respect to the ACs. Obviously, this is not a hierarchical relationship, but it is one of clear pre-eminence that is manifested in two different spheres. First, in the state allocation of what we could call a “pool of extraordinary competences” that allows it to act unilaterally and monopolistically over the constitutionally established system of distribution of competences. Thus, unlike what tends to occur in the majority of federal states, in Spain the state is exclusively able to reform the constitution, while the ACs have only a marginal authority to initiate reform- therefore, in Spain the state has unilaterally what is called the competence over competences.<sup>8</sup> Secondly, the constitution (art. 155) also contains a clause on extraordinary or emergency powers in favour of the state, which in cases of need allows it to adopt the opportune measures to ensure the normal functioning of the system – although this clause has never been applied to date. Finally, the clauses on supplementarity and on prevalence, mentioned above, also display this pre-eminence, despite the fact that they are rarely applied in practice.

However, in addition to these extraordinary powers, the pre-eminence of the state is especially manifested in the relevance of the competences that has been reserved for it, which allow it to set major sectorial policies and to regulate the areas with the highest economic, social and political importance. Specifically, in addition to the “traditional” competences found in the majority of federal powers (national defence, international relations, nationality, immigration and alienage, currency – today largely in the hands of the European Union, etc.), the state has also competences over the administration of justice, over the main branches of law (criminal, procedural, business, labour) and over the main economic and social sectors (social security, health, the environment, education, public safety, etc.), as well as two “transversal” competences that allow it to act in a highly diverse range of areas: the guarantee of equality of all Spaniards in the exercise of constitutional rights and duties (art. 149.1.1 SC)<sup>9</sup> and a competence that in practice, significantly, has ended up being called “general ordering of the economy”(art.

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<sup>6</sup> This might have been influenced by a ruling from the constitutional court that strictly curtailed its scope (STC 76/1983).

<sup>7</sup> At the beginning of the 1990, central government delegated a large number of competences to the most of the ACs. These delegated competences were, nevertheless, assumed within the concerned Statutes of Autonomy by means of an ad-hoc reform of those statutes which explicitly referred to central government delegation of powers. Actually, the delegation of powers was a technique applied to make sure that all statutes of autonomy had exactly the same contents.

<sup>8</sup> It is true that legally the ACs have no decision-making authority in the process of reforming the constitution, and it is also true in practice given the current consolidation of the ACs and the importance that the territorial leaders (often called “barons”) that the two main state parties have gained, the possibility of amending certain aspects of the “territorial constitution” without a certain degree of consent by the ACs might be problematic.

<sup>9</sup> This article gives the state the exclusive competence over “regulating the basic conditions that guarantee the quality of all Spaniards when exercising their rights and fulfilling their constitutional responsibilities”.



149.1.13 SC).<sup>10</sup> To complete this panorama, the state also preserves an important “competence” for developing the fundamental rights of Spaniards (art. 81 SC), although it is not on the list of the state’s competences.<sup>11</sup>

However, it is worth highlighting that the state does not have all the functions in all these matters. In some it only serves the function of establishing the basis or the framework that must be developed by the laws of the ACs, while in others it has the competence to legislate but the ACs are in charge of execution. But, what is relevant is that in the Spanish system the basic competences and, to a lesser extent, the legislative competences, stand out for their number and the importance of the matters they encompass.

With regard to the ACs, I have already mentioned that the statutes of autonomy have striven to allocate to the communities in a great deal of detail the competences that the constitution does not reserve exclusively for the state. The result is that the communities have competences in a very wide range of matters. Also worth noting is that in this case as well, from the functional standpoint, these competences are exclusive, shared or executives. The latter type of competences is certainly numerous and relevant but whit the exclusive-and the shared competences the ACs can, in principal, establish their own policies and exercise their political autonomy.

This brief sketch of the system of distribution of competences set forth in the constitution and the statutes of autonomy lead to the conclusion that, as is perfectly logical and as takes place in all the legal schemes in place, this system cannot fully fit within any of the existent theoretical models:

Indeed, firstly, the system for allocating competences follows none of the patterns of the dualist models in which the different territorial entities tend to act as isolated compartments in the matters in which they are granted exclusive competences. The Spanish system, as I mentioned above, simultaneously uses two criteria for allocating competences: the criterion of exclusivity and the criterion of sharing matters, but the latter criterion is more important due to the number of matters to which it is applied, and due to its practical relevance. In other words, there are many more matters in which the framework laws or the legislation are reserved for the state and in which the autonomous communities are in charge of legislative development and execution or just the latter, than matters which are allocated exclusively to either the state or the ACs.

Nor does this system of distribution of competences follow the patterns of cooperative or executive federalism. This is first because despite the fact that, as mentioned above, the ACs have many executive competences, there is no general clause assigning this type of power exclusively to them. We could say that they are the ordinary administration, but not the sole administration. The state continues to retain important executive

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<sup>10</sup> Specifically it says that the exclusive competence over “framework legislation and coordinating general planning of the economic activity” falls upon the state.

<sup>11</sup> In this article, the constitution reserves developing the fundamental rights and the public freedoms for organic laws, which is a type of law that only the state may enact.

competences and maintain its own administration on ACs' soil. Likewise, also as mentioned above, for the time being there are no in the Spanish legal system effective cooperation and participation mechanisms.

Finally, the minuteness and detail with which the constitution and the statutes delimit the competences shows a clear rejection of the models of overlapping or concurrent system of competences (perhaps with the exception, very partially, of competences in culture - art. 149.2 SC). Naturally, this does not mean that this model of precise delimitation of competences entails a rejection of cooperation or collaboration in the exercise of the respective competences: one thing is which body holds the competences, and another is how they are exercised. In fact, counter to what is upheld in certain overly simplified explanations, a precise delimitation of powers can contribute to facilitate the cooperative exercise of these competences.

In short, the main characteristics of the legal system of distribution of competences can be summarised, for our limited purposes here, by saying that the state holds competences on almost all matters, most of them are basic or legislative competences, not exclusives and that these powers, and other constitutional clauses, put the state in a position of pre-eminence with respect to the ACs. The ACs, in turn, also have competences over an extensive range of matters, and their shared and executive competences are broader than their exclusive competences. The autonomy legally granted them is political autonomy, in the sense analysed herein, they also have far-reaching executive competences, but, unlike it happens in the majority of federal systems, the ACs do not participate in state-wide bodies and decision-making processes.

## **2. Assessment of the current functioning of the system of distribution of competences**

Just as in all systems of distribution of competences, the system designed in the Spanish constitution and the statutes allowed for multiple forms of development and implementation. The implementation that was ultimately imposed in Spain after 30 years of what is called the *State of the Autonomies* is characterised, in my opinion, by the following main traits:

First of all, by the omnipresence and pre-eminence of the state, which, as we have seen, was already *in nuce* in the constitution and the statutes of autonomy, but in practice has been exacerbated leading not just to a notable centralisation of the ability to establish the more relevant political options in all matters but also to a correlative *administratisation* of the political autonomy which the ACs legally have. The ACs have lost – in fact they never had – the ability to set their own policies in matters endowed with a minimum of completeness, homogeneity and political, economic or social importance in order to produce or spur major changes in these areas. The ACs have played a major executive role: they provide the key public services -such as healthcare or education- through their powerful administrations; they have more than 50% of the public employees in Spain and manage around 30% of public spending; additionally,

they act in a wide range of matters – as they only remain excluded from the few matters in which the state has exclusive competences. They have, then, **extensive but low quality autonomy**. This fact is confirmed by having a look, for instance, at the content of laws passed by the ACs parliaments: most of laws have organizational, procedural and budget and financing contents. In relative terms, very few laws imply a substantive policy content, and among these laws, a large part reproduce provisions from already passed state framework legislation. Such a legislative technique has been criticized and even banned by the Spanish Constitutional Court; the ACs, nevertheless, keep in using it since it is hard to find a subject-area which has not been extensively covered by strikingly detailed state framework legislation; as a consequence, the margin left to AC legislation is so fragmented that, in order to keep some legislative consistency, the ACs have no choice but to reproduce the contents of framework legislation within their own laws. As an example, after 30 years of political decentralization and in spite of having competences on developing legislation, the ACs have not managed to pass their own laws on education because there is no legislative margin; the few ACs that have tried to do so, have had to largely reproduce the existing state's framework legislation on the subject.

Naturally, this generic diagnosis requires many nuances. For example, the state's actions are not so crucial in all the areas of action. In some matters the ability of the ACs to establish their own policies are larger than in others. Likewise, it is also true that a great deal of political power can also be exerted by organising and managing the public administration and the public services, and more generally by their executive competences. In fact, there is not a radical distinction between political autonomy and simple administrative autonomy, rather in many respects they are part of a veritable *continuum*. However, all these nuances do not belie the above conclusion, which is confirmed when analysing the scope that the exclusive, shared and executive competences of the ACs and the state have finally acquired. To wit:

With regard to exclusive competence of the ACs, we could state that exclusivity has practically vanished. The state does not refuse to enter in any matter in order to regulate what it deems requires unitary treatment or, more simply, that it deems has enough political or economic relevance. There is often the sense that, before performing a specific action, the state never analyses whether it holds the competence or not, but whether it is politically important or not. If it deems that it is, it acts and then seeks the competence that authorises it to do so and always finds it using a wide variety of techniques, especially by giving its transversal competences and basic competences a broad scope. As a result, in practice there is no realm with a certain degree of homogeneity, completeness and practical transcendence from the economic, political or social standpoint that is reserved exclusively for the ACs. The matters in which the ACs may exercise exclusive competences are fractured, residual and interstitial. Precisely for this reason, from these areas the ACs cannot adopt policies that are effectively and practically transcendent.

However, if the scope of the matters within state competence is very extensive, so is its intensity or incisive, as in its exercise of competences the state does not limit itself to setting the overarching political goals, rather it often lays out, in great detail, the

legislative and regulatory options that the ACs must abide by. This phenomenon is extremely incisive in the very important shared competences, in which the state sets the framework legislation and the ACs are empowered of the legislative development and execution. The rule in this case is that the framework legislation is contained not just in formal laws but also in regulations and even in implementation acts, plus these basic provisions go into a great deal of detail. For this reason, here too, the ACs' ability to set up their own policies is highly limited in practice.

It should be reiterated once again that in Spain, unlike in systems of cooperative federalism, this lack of capacity for setting their own policies is not offset by the ACs' participation in state bodies or in the state-wide decision-making processes in which these policies are set.

In contrast, also as mentioned above, the executive competences of the ACs are important, despite the fact that the state continues to retain important powers of execution as well as its own administration in all the ACs. What is more, for some time we have been witnessing the interesting phenomenon of the state's recovery of executive competences via a restrictive application of the criteria of territoriality of competences of the ACs: whether a social phenomenon which is covered by the ACs' competences is extended beyond the territorial limits of a single AC, rather than trying the territorial fragmentation of the public activity over this phenomenon or to coordinating the activity of the ACs affected, the state recovers automatically the competence. As a result, on many matters, two circuits are overlapping or superimposed upon each other: the state circuit, dealing with "supra-autonomous community" phenomena – and, in consequence, the most important ones in practice –, and the intra-autonomous community phenomena, which fall upon the ACs. It is a kind of concurrence which, in principal, is not preview by the Constitution

This statement brings us to another feature of the system of distribution of competences currently in force in Spain. Despite the fact that the ordinary option was not the system of overlap or concurrence, in practice it is increasingly frequent for both the state and the ACs to fulfil the same type of role over the same type of matter with different kinds of competences. This reveals a rising loss in the regulatory capacity or regulatory efficacy of the legal rules governing the allocation of competences. The constitutional guarantee of the system of allocation of powers, the well known characteristic of federal systems, is becoming increasingly weak.

In contrast to this, it is true that certain interpretations of the constitution have been beneficial for the ACs. For example, despite the fact that the constitutional text reserves for the state the exclusive competence over the administration of justice –which is not a decentralised power in Spain- it has been accepted that the ACs can take on competences over the so-called administration of the administration of justice, that is, over the human and material means in the service of the administration of justice (except for the judicial staff, i.e., justices and magistrates).

The initial interpretation of the state's exclusive power over international relations has also evolved favourably for the ACs, allowing the ACs to perform external actions related

to their competences and interests, as long as they do not entail treaty-making power, create any legal obligations for the state or interfere in the state's foreign policy.

Finally, I wanted to point out a last trait of the system for allocating competences on which there is some confusion, especially outside of Spain: the symmetrical model of allocation of competences. It is true that the 1978 constitution allowed not all the ACs to have equal powers – it even allowed not all of them to have the same legal nature –; it is also true that it imposed different speed or paces on the ACs to reach the highest level of competences; however, now, that this period has elapsed and several reforms of the statutes of autonomy are in place, the ACs' competences – with the exception of the ineluctable “differential features”, such as their own specific language or civil law that only some ACs have – the competences are substantially identical in all the ACs. The only relevant asymmetry is the particular financial system of the Basque Country and Navarra which allocates much higher economic resources and greater management autonomy to these two ACs.<sup>12</sup> The statutes of autonomy currently being reformed may complete the symmetry; although some of them maintain some differences, everything points to the fact that, even in these cases, eventually the interpretation will tend towards uniformity, as has always occurred in Spain.

### **3. Mechanisms or techniques through which the processes of centralisation or *administratisation* of the political autonomy of the ACs takes place**

To my mind, there are five main mechanisms through which the state intervenes in all matters, which give rise to the “administratisation of autonomy” of the ACs referred to above. These are clearly phenomena that also occur in other federal or quasi-federal systems, but in Spain they are may be particularly relevant. They could be listed as follows: the allocation of a very broad material and functional extension of the basic competences of the state; the extent given to the so-called horizontal or transversal competences (the ones in articles 149.1.1 and 149.1.13 SC); the conversion of the “territory”, or the territorial scope of the phenomena covered by autonomous competences, to state competences; the vast promotional activity (the spending power) realised through conditioned, co-financed and even centralised management subsidies in matters of the competence of the ACs, which often undermines the constitutionally established system for allocating competences; and finally, the transposition of European directives and regulations in areas where the ACs hold competences, as well as the assumption by the state of the function of “single national authority of coordination” required with more and more frequency in the EU directives and regulations. Let us briefly examine these.

#### **3.1 Material and functional extension of the state's basic competences**

The constitution grants the state basic competences over, for example, social security, health, education, the environment, the legal system of the public administrations, the

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<sup>12</sup> In this system both these ACs collect all the taxes and pay to the State only the cost of the services they receive from it.

energy and mining system, the press, radio, television and the media in general. Neither the constitution nor the statutes define the functional and material scope of the state framework competences. This important aspect of the system for allocating competences is therefore “deconstitutionalised” and the state laws have gradually defined the content of these competences, giving them a much broader scope.

Therefore, with regard to the formal acts through which the basic or framework legislation are set, they are not limited solely to laws but are very often set through regulations and even through simple implementation or executive acts. Likewise, with regard to their content, the basic legislation are not limited to principles or minimum standards, but very often they contain specific rules that go into a great deal of detail.

On numerous occasions, the constitutional court has had to issue rulings on the scope of the framework legislation, stating that it had to be restricted to laws and the basis must be principles that had to allow the ACs to be able to set their own policies, despite the fact that it has added that there might be exceptions to this general rule. However, in practice, the exceptions have become the rule and the constitutional court, with very few exceptions, has always accepted this situation.

The basic or framework legislation has also extended from the material standpoint, in the sense that it has come to include in its scope sub-matters that in theory could have been considered as included in confronting or bordering matters of the competence of the ACs. One of the reasons of this may be that the basic competences permit the Constitutional Court to allow the intervention of the state –for the basis- and the ACs –for the rest of the functions-, and it seems that both, the state and, above all, the Constitutional Court, they find comfortable to apply this “solomonic” criterion. Just to give a single example of this “material extension”, the basic state competence over the “legal system of the public administration” but this competence has not been interpreted as framework laws on the systems of resources and the relations between the administration and the ones being administered – according to the common interpretation of the legal doctrine of the expression “legal system” when the constitution entered into force – rather it included in this phrase any regulation that affects the public administration (all administrative law, to put it plainly).

### **3.2 Horizontal or transversal competences: articles 149.1.1 and 149.1.13 SC**

a) The clause on equality of all Spaniards in the exercise of constitutional rights and duties, contained in article 149.1.1 SC and mentioned in the footnote nine, has become the fallback clause that the state uses erratically and increasingly frequently to intervene in the areas where it holds no other competences. Currently, this is the clause wielded, for example, for entering more incisively and generally in the realm of what is called social protection or social assistance, which is the exclusive competence of the ACs (for instance, regulating a system for providing aid to the dependent people). The political transcendence of this matter has led the state to want to have a stronger and more manifest presence in this field, and its justification for encroaching on this competence is article 149.1.1 SC even if a truly constitutional right is not involved.

As I have analysed elsewhere,<sup>13</sup> this provision has taken a random course: hardly used until the late 1980s, perhaps because of its potentially expansive effects and its ability to subvert the entire system for allocating competences, later the state have tended to apply it in an increasingly profuse and erratic way, in the sense that this application does not seem to respond to any precise and uniform conception of the content of this competence. Indeed, at first the doctrinal debate on article 149.1.1 SC was essentially between those who conceived of the basic conditions as material conditions and those who interpreted them as the regulation of certain fundamental aspects of constitutional rights and duties. There were even debates as to whether there was a true competence or whether it constituted a simple limit on the exercise of the ACs' competences. In a series of rulings handed down since 1997,<sup>14</sup> the Constitutional Court made it clear that it was a state competence, but chose the second of the aforementioned doctrinal alternatives, that is, the one considering that it referred to the regulation of "fundamental legal positions", to the regulation of "some part of rights", not to predetermining the "material conditions" aimed to ensure the efficacy of rights. It also tried to delimit the scope of state competences by stating that, for example, it was a regulatory competence ("the regulation" states article 149.1.1 SC); that these fundamental legal positions had to be regulated by law; that they had to refer to concrete aspects, so it could not contain a complete regulation of rights; that it was extraordinary in nature; that it did not reserve for the state material realms in which the ACs could not enter, rather that simply if the state had set these conditions that the ACs had to abide by them; and it even stated that the state was subjected to a criterion of proportionality.

Despite this, we have to admit that the constitutional jurisprudence has not been uniform, and especially that in many cases the state has simply been unaware of it, resorting to this clause to hand down not only laws but also regulations and even to carry out merely executive activities; based on this competence it has regulated not just parts of the rights but it has also set up the "material conditions" in a broad sense that includes everything from the justification of subsidies to the establishment of procedural mechanisms of coordination between the state and the ACs<sup>15</sup> and it has used it not just in relation to the constitutional rights *per se* but also with simple "guiding principles" and even to establish basic conditions that guarantee the "unity of the market" or the "exercise of economic activity". In short, article 149.1.1 SC has served the state to recover competences and to condition the autonomous communities' exercise of their competences.

It is probably not realistic nowadays to uphold that the scope of this competence should be limited to the doctrine established by the Constitutional Court in rulings 61/1997 and 164/2001. However, it is also clear that in order to avoid unbridled expansion of article 149.1.1 we must clearly outline its content and demand a more contained application of

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<sup>13</sup> La cláusula competencial de l'article 149.1.1 CE in "Autonomia I Justícia a Catalunya". Barcelona, 2003. There are many publications on article 149.1.1 SC, including one especially worth citing, the book by Javier Barnés, "Problemas i perspectives del artículo 149.1.1", Institut d'Estudis Autònoms, Barcelona, 2004.

<sup>14</sup> Especially, SSTC 61/1997 and 164/2001.

<sup>15</sup> Such as on matters of tribunals to defend competences and to set up the procedure to hold tests to earn the degree of graduate of secondary education for people over the age of 18.

it. It is true that in all the legal systems of politically decentralised states, some relatively open clause exists, and quite likely must exist, which allows the central bodies (the federation or the state) to perform concrete actions that in given circumstances are absolutely necessary and that are not contained in any of their specific lists to competences. However, in order for these clauses to not put the system for allocating competences in constant jeopardy, first they must be limited in number and recognised as “emergency clauses” as opposed to regular clauses for everyday use; and secondly they must effectively be used only under exceptional circumstances, as their extraordinary nature requires. The problem with the Spanish legal system is that there are a great many of these “open” clauses, whose application is difficult to control from the jurisdictional point of view (art. 149.1.13, basic competences, 149.1.1, supra-territoriality, etc.), plus they are applied not restrictively but quite commonly.

b) As concludes professor Manuel Carrasco in an excellent monograph on the article 149.1.13 SC, in the Spanish system, the state competence for establishing the basis and the coordination of the economy has take on an expansive nature and a totally indeterminable scope. This has resulted in the fact that “based on (this competence), the state can potentially undertake any type of action aimed at planning the economic activities, included the ones that set the content of the competences held by the autonomous communities that the Statutes of Autonomy formally recognise as their exclusive competence”.<sup>16</sup> As demonstrated in this book, this potentially expansive capacity has repeated been made reality.

Indeed, the state competence on basis and coordination of the general ordering of the economy is used profusely and with an extraordinary scope. Often, counter to what the Constitutional Court demands in numerous rulings, the framework legislation and state coordination exercised on these matters refer to issues that do not have a “direct and significant (influence) on the general economic activity”, nor do they set “the guidelines and overall planning criteria for a specific sector”, rather they refer to extremely specific aspects wholly lacking in major widespread influence on the economy. Many striking examples of this fact could be cited – such as the agreement on the welfare of rabbits and chickens, which is based on this precept<sup>17</sup> – or the rules on the labelling, presenting and advertising of food products, not to mention industrial safety, such as “methods of quantitative analyses of binary mixes of textile fibres”<sup>18</sup> or the amount of meat, ham, and other ham-derived products.<sup>19</sup> It is clear that all these phenomena have economic repercussions, but they do not seem important enough to justify the application of article

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<sup>16</sup> Manuel Carrasco Durán. “El reparto de competencias entre el Estado y las Comunidades Autonomas sobre la actividad económica”. Published by Tirant lo Blanch and the Institut d'Estudis Autònomic. Valencia. 2005. Along the same lines: Enoch Albertí, “Autonomia política i unitat econòmica”. Published by Civitas and the Institut d'Estudis Autònomic, Madrid, 1995.

<sup>17</sup> An agreement signed by the Ministry of Agriculture, Fisheries and Food and the Community of Valencia (Official State Journal 31/01/2008). In fact, everything related to the care, exploitation, transport, experimentation and slaughter of animals was already based on article 149.1.13 SC and Law 32/2007.

<sup>18</sup> Royal Decree 4/2007 dated the 12<sup>th</sup> of January 2007.

<sup>19</sup> Royal Decree 1467/2007.



149.1.13 SC. There is not a single Official State Journal, published daily in Spain, which does not include some state laws, decrees, ministerial orders or simple resolutions that are explicitly based on the article 149.1.13 SC.

The goal is not to call for a literal interpretation of 149.1.13 SC, nor to question the state's need to have an importance competence for coordinating and giving overall direction to the economy and guaranteeing the unity of the market, despite the fact that, in relation to this latter issue, abusive interpretations of this principle should be avoided which, as is understandable, might simply be incompatible with a politically decentralised system such as the one designed by the Spanish constitution.

### **3.3 Spending power. Conditioned, co-financed and centralised management subsidies**

Just like in the majority of states today, especially social rule-of-law states, Spain is very active in economic promotion activities, and, more specifically, it carries out an intensive programme of subsidies: there is often an average of more than seven laws, decrees, ministerial orders or simple resolutions that award subsidies and aid published daily in the Official State Journal, and the monetary amounts they award are economically significant. For our purposes, what we are interested in highlighting is that often this subsidy activity serves the state to recover competences that the constitution and the statutes of autonomy allocate to the ACs.

This primarily takes place by setting the goals or the purposes for which the aid is granted – which cannot dovetail with the political objectives which, in theory, the ACs are responsible for setting in their exclusive and shared competences. And secondarily, takes place by reserving legislative and management functions for the state in areas in which it has no recognised competences.

The Constitutional Court has repeatedly established a consolidated doctrine that aims to avoid these serious distorting effects of the system of allocating competences. However, the state very often does not respect this doctrine by taking advantage of the delay with which the Court hands down its rulings – more than seven years later – and the *pro futuro* effects that it gives its resolutions – in order to not make private individuals return aid that they improperly received.

According to this constitutional doctrine established primarily around ruling 13/1992, albeit with earlier precedents, the state may earmark economic resources for any purpose and in any matter even if it does not hold the competences on the matters in question. However, it has to do so respecting the system of distribution of competences established in the constitution. This means, in essence, that if subsidies or aid are granted to matters in areas where the state does not hold the competences, it has to limit itself to setting the overall objectives or the sectors to which these resources will be earmarked, but it is up to the ACs to set or specified these goals, regulate the conditions and the process of awarding the aid, as well as processing and actually granting or awarding it. If the state subsidies refer to matters in which the state holds the basic competences, it can further specify the objectives for which it wants to earmark the

funds, but it has to leave leeway for the ACs to specify these goals and exercise the remaining functions related to this aid. If the state subsidies are granted in matters in which the state can legislate but the ACs must execute the legislation, the state can set the objectives and regulate the conditions and the award process, but processing and actually granting or awarding the aid falls upon the ACs due to their executive competences.

However, the Constitutional Court accepts exceptions to this doctrine. It accepts that under certain circumstances state subsidies cannot be *territorialised*: that is, the 17 ACs may be charged with neither setting the regulation on the requirements to be eligible for the subsidy nor normally their specific management. The problem is that the criteria used by the court to delimit the exceptions are quite generic,<sup>20</sup> plus the state interprets them even more broadly, as shown by the fact that almost all the state subsidies appealed before the Constitutional Court were declared unconstitutional.<sup>21</sup>

The problem worsens further when allocation of the state subsidies is conditioned upon co-financing by the autonomous communities. In these cases, that happen to be quite frequently, the state not only conditions the policies of the ACs but it also conditions the spending power of the ACs. In fact, in these cases we can claim that the communities own the resources are devoted to the programmes or policies established by the state.

There is no need to stress the loss in the quality of political autonomy in the ACs which results from the state's economic promotion activities and the dangers this entails for the allocation of competences as designed by the constitution. In Spain, the possibility that the state might earmark resources for any matter or purpose is rarely questioned, but we must more clearly define the criteria that make impossible the territorialisation of the estate subsidies in matters of competences of the ACs and, in these cases –that must be exceptional- we must establish the procedure that makes it possible for the ACs to take part efficaciously in these decision and in the managed of these subsidies.<sup>22</sup>

### **3.4 Supraterritoriality as a jurisdiction of the state. The two overlapping circuits of competences**

The principle of territoriality of the autonomous communities' competences, which requires the ACs to exercise their competences over social phenomena that fall geographically within their territory, is often interpreted in a restrictive fashion, prompting

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<sup>20</sup> The criteria are: to ensure the full effectiveness of economic promotion measures, to guarantee all the potential recipients' possibility of winning aid in equal conditions; to prevent the overall amount of the aid from being exceeded.

<sup>21</sup> See Pomed Sánchez, Luis "Jurisprudencia constitucional sobre subvenciones" in *El régimen jurídico de las subvenciones. Derecho español y comunitario*. Published by Consejo General del Poder Judicial, Madrid, 2007.

<sup>22</sup> Nowadays, the participation of the ACs in the subsidies' decision-making process in general and in particular with respect to the criteria of territorialisation, when it actually takes place (which is not in all occasions) is done though the sectoral conferences (intergovernmental conferences of ministers or high political officers). However one has to take into account that, for reasons I cannot go through now, the actual working of these conferences cannot be considered as satisfactory.

a transfer of competences to the state on matters in which in theory it has no authority to act, as all the ACs have exclusive competences. This holds true when the social phenomena addressed by the AC competences spread or affect the territories of several or all of the communities. In this case, when the object does not affect exclusively to the territory of one single AC., the activity is often transferred to the state automatically instead of fractioning the public action so that each AC acts over the part of the phenomenon that falls within its territory, or, subsidiarily, instead of arbitrating cooperation mechanisms among the ACs or even mechanisms of state coordination.

There is no need to overstate the reductive potential of this type of interpretation on the autonomous competences, especially in a globalised world in which few minimally important social phenomena do not extend beyond the borders of a single AC. The transfer of competences to the state takes place when the state laws establish the territorial connection of the autonomous community competences (for example, when they reserve to the ACs the competences over the some subjects -insurance companies, trade unions, etc.- that operates only in the territory of one ACs) or by laws that reserve for the state actions on subjects that affect more than one AC (foundations, trade unions, etc.). The Constitutional Court has handed down a clear doctrine on the need to try to fraction the public activity and seek cooperation mechanisms among the ACs before the state can resort to setting up coordination instruments, and clearly before being able to transfer the competence to the state. However, the Court has been deferential when passing judgement on the state laws that set restrictive points of territorial connection on the scope of the autonomous community competences, that is, when weighing the sufficiency or insufficiency of the reasons put forth by the state to justify the transfer of AC competences to the state because of the territory that the social phenomenon addressed affects.

In effect, it is an undisputed fact that, with exceptions that are not relevant to our argument here, the ACs' competences refer to phenomena or activities that fall within their territory and that their provisions have territorial efficacy. However, this does not mean that the object of these competences has to be limited to the handful of phenomena that nowadays occur **exclusively** within the territory of the respective autonomous communities. This can clearly be seen in a repeated constitutional jurisprudence, which is not always heeded, that enshrines a principle of vast practical importance aimed precisely at contributing to ensure that the competences of the ACs are not transferred to the state by the mere fact that the object of these competences have a scope of, extend to or affect a territory larger than the territory of the autonomous community itself. This principle takes specific shape in the demand that public action on these supra-autonomous phenomena, if they are within the competences of the ACs, be territorily fractioned so that each AC can act on the part that falls within its territory. If this fractioning is impracticable, cooperation instruments among the ACs affected must be drawn up, and if this is also unfeasible, the state may set up coordination mechanisms so that the ACs exercise their respective competences.

However, the state's practice continues to use the supra-autonomous territorial scope of the objects of the competences to take on the competences over them in the material or functional realms in which these competences belong to the ACs. There are increasingly

frequent examples of state laws that reserve for the state the competence over social phenomena that encompass the territorial scope of more than one AC in matters in which all the communities have exclusive or at least shared competences. What is more, because in actuality the matters covered by the competences are not physical or social phenomena but public actions on these phenomena, the state can artificially – legally – create these supra-autonomous objects simply by designing public actions with a supra-autonomous scope.

The state uses many several techniques in order to reach such a goal: in this sense, for instance and with an increasing frequency, the technique of establishing “National Plans” on a large variety of issues, often with very limited practical consequences and on matters of AC competence.<sup>23</sup> Another technique is the creation of state-wide bodies lying upon material matters which fall under the exclusive powers of the ACs, or, at least, under their legislative developing powers.<sup>24</sup> A technique to recentralize powers recently commonly used by the state is that of becoming the “single national authority” as required with more and more occurrence by EU legislation. Yet, in several directives and regulations the EU demands not only just one interlocutor per member-state, but also the existence of a single national authority of domestic coordination. Strictly speaking and given the institutional neutrality of the content of the EU legislation, if such an institution should aim to coordinate activities that fall under the competences of the ACs, such a coordination role should be warranted by the ensemble of the ACs. This is tends to occur, at least partially, in other federal EU member-states. In contrast, in Spain, single authority ends always assumed by the state, which, in turn, manages to get competences back, even executive competences.<sup>25</sup>

By this easy way of proceeding, in almost all the areas of AC competence a two-pronged or overlapping circuits of superimposed competences is being created: the state-wide one – and even in some cases, simply a scope larger than the territory of a single CA – which is allocated for this single reason to the state, and the autonomous community circuit which covers phenomena that take place exclusively within the territory of the respective AC. Needless to say, the state-wide or national circuit –

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<sup>23</sup> During the last years have been created, for exemple, the “National Plan of the official Controls of the dairy sector operators” (RD 1728/2007), the coordination of which is reserved for the State; the National Irrigation Plan for the improvement and consolidation of irrigation” (RD 1725/2007), the execution of which is reserved for the State; the “National Plan to control de honey-bee diseases (RD 608/2006); the “National Plan for the reduction of emissions” (order 77/2008) or the “National Plan of control of the fruit producers” (RD 864/2008).

<sup>24</sup> Some of the many exemples of collegiate coordination organs which are interadministratives structure are the Council of Library Cooperation (RD 1573/2007) or the Council of the National Parks Network (RD 12/2008).

<sup>25</sup> This happens in fields as diverse as youth (f.e. the Decision 1719/2006/EC wich creates the aid programm “Youth in action” and provide for the creation of national aggencies and the Sapanish Governement reserve the management of ths programm to the State “Youth Institut”. In other cases a coordinating organ is created such as, for exemple, the RD 227/2008, already mentioned, that creates a committee of olive-oil tasters adscribed to the State Ministry of Agriculture that assumed competences that until this moment where ACs competences.

articulated by the National Plans, national institutions, etc. – for the territorial scope of the phenomena that are the target of regulation and action is the one that is more important practically speaking, while the local circuit, allocated to the ACs, is small in scope, residual and at times folkloric. For example, along with professional training centres, which are the competence of all the autonomous communities and were at one point transferred to them, the state has created national reference centres in the realm of professional training (Royal Decree 229/2008). As well, along with the olive oil tasters accredited by the ACs, state tasters were recently created (Royal Decree 227/2008) whose functions include being the only ones authorised for imports and exports of olive oil. There is also a two-pronged circuit for purebred animal breeding groups or animal by-products not meant for human consumption (Order APA/467/2008, dated the 14<sup>th</sup> of February 2008, which includes a call for 2008 subsidies targeted at organisations and associations of breeders for the conservation, selection and fostering of pure cattle breeds, and Order PRE 488/2008, dated the 15<sup>th</sup> of February 2008, publishing the Agreement of the Council of Ministers approving the comprehensive national plan on animal by-products not meant for human consumption, respectively). A lot of examples can be given of this phenomenon.

Nonetheless, to close this brief exposition we must stress that the lack of horizontal relations among all the ACs to exercise their competences also contributes to strengthening the state's prominent role with regard to phenomena with a supra-autonomous community scope. In fact, that lack of horizontal relations among all the autonomous communities is a specific feature of Spain which has no parallel in any other politically decentralised state and often provides arguments to support the centralising actions of the state.

### **3.5 Development and application of European law and the “single national authorities”**

Despite the fact that both European principals and Spanish Constitutional Court rulings and the new statutes of autonomy proclaim the principle of the domestic institutional neutrality or “blindness” of the European law -according to which the ACs should develop and apply European law on the matters in which they have competences that are recognised as theirs in practice- the vast majority of the directives and regulations that need to be transposed, are transposed by the state, by its invoking a variety of basic or transversal competences that it holds, usually 149.1.13 SC, but also 149.1.1, 149.1.11<sup>26</sup> and 149.1.18.<sup>27</sup> It confers an absolutely hypertrophic scope to these articles (the extraordinary detail to which the state basic laws and decrees reach when transposing directives is a good example of this hypertrophy).<sup>28</sup>

<sup>26</sup> Monetary system. Foreign credits, exchange and convertibility; the general bases for the regulation of credit, banking and insurance.

<sup>27</sup> The bases of the legal system of the public administrations.

<sup>28</sup> Among the many examples, the Royal Decree cited in the previous footnote regulates the colour (yellow) of the seals used on egg containers, the size of the lettering on the labels, etc.

As a complement to these competences, to justify this disproportionately central role of the state, it also uses, usually implicitly, the argument of its accountability to the European Union in the case of non-compliance with the duty to transpose. Likewise, it should also be said that as a general rule the ACs have shown a passive attitude to this situation, due perhaps to negligence, to a lack of technical know-how or maybe to the erroneous belief that the transposition of European law is a mechanical task that does not entail any innovative capacity and, as a result, one that is not “politically” important.<sup>29</sup>

The argument of the state’s accountability to the European Union is indeed a weighty one. Non-compliance with the transposition of directives and sanctions for Spain are relatively frequent, although recently there have been some improvements in the matter. However, we should prevent this fact from being used as a justification for distorting the internal system for allocating competences and giving the state competences a disproportionate scope. In order to avoid this pernicious effect, other solutions are preferable, such as the Italian solution which legally recognises the possibility for the state to act on behalf of the ACs that do not transpose the directives that it is their job to transpose within the deadlines set by the Union. However, it should be made clear that the state’s substitution is provisional, that is, that the state norm is applicable only when the transposition deadline has passed and until the transposition done by the competent autonomous community enters into force.

As I already have mentioned, together with the transposition of the EU law, the Spanish central government is also recentralizing powers back through assuming the role and functions of single national authority in matters that fall under the powers of the ACs.

#### **4. The new statutes of autonomy and the distribution of competences**

Early in 2002, Catalonia and the Basque Country embarked on a process of reforming their respective statutes of autonomy. After that, nine of the 17 ACs joined this process. The proposal for reform in the Basque Country was rejected by the state parliament because it deemed that it ran counter to the constitutional provisions. In contrast, the new statutes of Valencia (2006), Catalonia (2006), the Balearic Islands (2007), Aragon (2007), Andalusia (2007) and Castilla y León (2007) were approved and have entered into force. Currently there are five draft reforms of statutes of autonomy in different phases of development.

One of the primary goals of the new statutes is to expand and, above all, to **improve the quality** of competences of the respective ACs. Specifically, they aim to:

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<sup>29</sup> To cite just a single example that this is not so, the transposition of the Community directives on the commercialisation of eggs via Royal Degree 226/2008, which includes a requirement for a quality certificate that is not included in the European directive and has notable economic importance.

- Guarantee, to the limited extent that the law can do so, the exclusiveness of exclusive competences (without this prejudicing the way, either exclusive or cooperative, that these competences are exercised).;
- Limit, also within the modest limits of legal norms, the expansiveness of the state's basic competences and its horizontal competences – especially those contained in articles 149.1.1 and 149.1.13 SC;
- Add a regulatory power to the executive competences of the ACs with *ad extra* effects –not just organisational effects as it was until now;
- Try to ensure that the state's economic promotion activities are adapted to the constitutional system of allocating competences and that they do not illegally condition the autonomous communities' exercise of their competences;
- Try to ensure that the ACs are not deprived of their competences by the mere fact that the phenomena covered by these competences encroach into the territory of other ACs;
- Include foreign action as an authority inherent in the ACs' competences;
- Provide for the ACs' participation in the European Union's institutions and decision-making processes that affect their competences;
- Contribute to putting into practice the principle of the internal institutional neutrality of European law; and
- Foster, as mentioned above, participation in the exercise of certain state competences that especially affect the territory or the competences of the respective ACs.

There is no question that not all the reformed statutes or all the proposed reforms pursue all of these objectives, nor, when they do, that they do so with equal intensity and using the same techniques, yet generally speaking these goals are broadly shared. We cannot set out to analyse either the techniques used by the different statutes to achieve these goals or the legal and political problems that these proposals have aroused.<sup>30</sup> But to close this contribution it is enough to say that if what the new statutes establish is applied in practice, the functioning of the system for allocating competences might undergo a major change, allowing the ACs to recover full political autonomy. However, we must accept the many difficulties that arise when trying to bring about this change, which entails not just amending a few state laws or transferring from the state to the ACs economic means or staff, rather it affects “legislative practices” that are deeply rooted and thus very difficult to change (the conception of the basic laws, the transversal competences, the promotion activity, etc...). Indeed, to date, two years after the first reformed statutes of autonomy have entered into force, the changes have still been quite limited, as is shown in some of the examples mentioned above which correspond to the last two years. However, we should bear in mind that introducing changes in “legislative

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<sup>30</sup> About these two questions, and with all due apologies for citing myself, interested readers might consult the following. With regard to the techniques used: Carles Viver, “Les competències de la Generalitat a l'Estatut de 2006: objectius, tècniques emprades, criteris d'interpretació i comparació amb altres Estatuts reformats” in the collective book entitled *La distribució de competències en el nou Estatut*. Institut d'Estudis Autònoms, Barcelona, 2007. With regard to the legal problems: “En defensa dels Estatuts d'autonomia com a normes jurídiques delimitadores de competències. Contribució a una polèmica jurídicocostitucional” in *La Revista d'Estudis Autònoms i federals*, 2005 issue (there is a translation into Spanish).

policies” always requires some time. It remains to be seen how the system of allocating competences in the State of the Autonomies evolves in the forthcoming years.



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## **The Evolution of the Distribution of Powers in the Canadian Federation**

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### **Introduction**

From a relatively centralized distribution of powers at its creation in 1867, Canada has over 141 years evolved into one of the most decentralized federations in the world. This evolution has occurred not so much as a result of constitutional amendments as from the federal character of Canadian society shaping the governmental practices affecting the application of the distribution of powers. The distribution of federal and provincial responsibilities has adapted and evolved to meet changing economic, social and political conditions and policy agendas. Over the 141 years the distribution of powers has proved remarkably flexible, enabling increased centralization in emergency times such as World Wars I and II, but otherwise the general trend has been a progressive relative decentralization in times of peace.

### **The Constitutional Distribution of Powers, 1867**

The Canadian constitution which emerged in 1867 was the product of two powerful motives. One was to unite the British North American colonies in a federal state strong enough to defend itself from the threat of the United States and to facilitate the transportation and economic linkages among them. This provided the impetus for a relatively high degree of centralization and concentration of powers in the new federation composed of four provinces, Ontario and Quebec in central Canada and Nova Scotia and New Brunswick bordering the Atlantic with a total population of 3.5 million people. The second powerful motive was to separate the preceding Province of Canada, which in 1841 had been created as a union of the still earlier provinces of Upper Canada and Lower Canada, into its two historic parts, renamed Ontario and Quebec. By doing so, it was intended that the deadlocks which had plagued the Province of Canada under the Unitary Act of Union 1841 would be avoided by giving the French Canadian majority within Quebec substantial autonomy over their own affairs and the English majority in Ontario an escape from the restraints imposed upon them by the Act of Union. Consequently, the distribution of powers incorporated in the British North America Act 1867 (relabelled in 1982 the Constitution Act 1867) attempted to

strike a balance between the centralization required for defence, transportation and economic development and the decentralization needed to permit each of the provinces, and particularly the French Canadian majority within Quebec, to develop their own distinctive social, religious and legal institutions and practices.

The distribution of powers incorporated in the constitution of 1867 reflected the tensions between these centralizing and decentralizing motives. In some respects it established a distribution of powers so centralized that K.C. Wheare described it as quasi-federal.<sup>1</sup> The colonial relationship between Britain and its colonies seemed to be reproduced in Ottawa's relationship to the provinces giving the federation some unitary characteristics.<sup>2</sup> The provincial lieutenant governors who were appointed by the governor – general were given the power to reserve provincial legislation for approval by the federal government, and section 90 expressly allowed the federal government to “disallow” any provincial legislation. Section 92 (10) (c) also enabled the federal government to declare provincial works within federal jurisdiction. Furthermore, section 91 appeared to give the federal government sweeping residuary power to “make laws for the Peace, Order and good Government of Canada” on any matter not assigned exclusively to the provinces.

Balanced against this, however, was the list of exclusive provincial powers in Section 92 which included in Section 92 (13) “property and civil rights in the provinces”. Given the legal meaning of these words generally attributed to them at that time, this granted to the provinces a very extensive exclusive jurisdiction.<sup>3</sup> Furthermore, Section 92 (16) assigned an exclusive residual, power to the provinces over “Generally all matters of a merely local or private nature in the province”.

A distinctive feature of the 1867 distribution of powers in Canada was its form which departed from that of the preceding U.S. and Swiss models. Where the preceding federal constitutions had stipulated the exclusive and concurrent jurisdiction of the federal governments but left unspecified a substantial residual power to the states or cantons, the Canadian constitution specifically listed not only the exclusive (section 91) and concurrent (section 95) federal powers, but also the exclusive provincial powers (sections 92 and 93). The emphasis was on dividing jurisdiction in terms of exclusive federal powers (29 matters in Section 91) and exclusive provincial powers (16 matters in Section 92 plus education in Section 93). Only two matters – immigration and agriculture were placed under concurrent jurisdiction in Section 95. Thus, the form of the constitutional distribution of jurisdiction emphasized the exclusivity of federal and of provincial powers. Furthermore, with the exception of criminal law for which the legislative jurisdiction was assigned to the federal government but the administration of

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<sup>1</sup> K.C. Wheare, *Federal Government*, 4<sup>th</sup> ed. (London: Oxford University Press, 1963), p. 19.

<sup>2</sup> F.R. Scott, “Centralization and decentralization in Canadian Federalism,” *The Canadian Bar Review*, 29 (1951) reproduced in Garth Stevenson, ed., *Federalism in Canada* (Toronto: McClelland & Stewart, 1989), pp. 52-80, see esp. pp. 56-59.

<sup>3</sup> W.R. Lederman, “Unity and Diversity in Canadian Federalism: Ideals and Methods of Moderation”, *The Canadian Bar Review*, 53 (1975) reproduced in Garth Stevenson, *op. cit.*, pp. 142-164, see esp. pp. 146-8.

justice was assigned to the provinces, the allocation of legislative and administration responsibility for each subject was assigned to the same government. Thus, except for the case of criminal law and its administration, each order of government had exclusive jurisdiction not only for legislation but also administration, regulation, taxation and expenditure relating to a subject. There was no constitutional provision for the delegation of legislative powers. Nor was there in 1867 any constitutional bill of rights limiting either order of government in the exercise of its assigned jurisdiction.

In terms of the scope of powers assigned by the 1867 constitution to the two orders of government, both orders of government were granted substantial powers. The federal government was given the basic powers required for nation-building: defence, the regulation of trade and commerce, navigation and shipping, transportation, banking and currency. It was also given exclusive jurisdiction over criminal law and over “Indians and land reserved for Indians”.

The provinces were given exclusive jurisdiction under Section 92 not only over “property and civil rights” (which as already noted above had at that time an extensive connotation) but also over management of public lands, hospitals and charitable institutions, local government, the incorporation of companies and the administration of justice. Section 93 also gave the provinces exclusive control over education subject to some rights for religious minorities. Over time, with growing governmental activity and programs in relation to public health, education and social welfare, the importance of these areas of exclusive provincial jurisdiction became important elements in the progressive increase in the relative role of the provinces within the federation.

The two areas placed under concurrent jurisdiction in 1867, immigration and agriculture, were matters which were crucial to the development of Canada at that time, and thus involved both orders of government.

### **The Evolution of the Federal-Provincial Balance Since 1867**

Over the 141 years since the Canadian federation was established both the federal and provincial governments have in fact expanded their activities, but the latter have done so at a greater rate with the net effect that the relative balance between them has shifted strongly in favour of the provinces. Indeed, while the distribution of powers at the origin of the Canadian federation was relatively centralist in comparison with many other federations, by the beginning of the 21<sup>st</sup> Century, in terms of federal government revenues and expenditures as a proportion of total (federal-state-local) government expenditures Canada and Switzerland ranked as the most decentralized federations in the world.<sup>4</sup>

It should be noted that over the 141 years of Canada’s existence the process of relative decentralization has not always been even. During the first World War and again at the

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<sup>4</sup> Ronald L. Watts, *Comparing Federal Systems*, 3<sup>rd</sup> ed. (Montreal and Kingston: McGill, Queen’s University Press, 2008), pp. 101-3.

end of the Great Depression in the late 1930s, through the Second World War and the period of postwar reconstruction the provinces were happy to hand over much control to Ottawa and there was a massive centralization. The federal government took control of most taxation powers and social programs including unemployment insurance and old age security. In most other peace-time periods, however, the role of the provinces has expanded more rapidly than that of the federal government with the long-term net effect that in relative terms the balance has tilted heavily in favour of the provinces.

### **Impact of geographic, social and economic factors**

In 1867 Canada had a population of just 3.5 million and the federation consisted of just four provinces: Ontario, Quebec, Nova Scotia and New Brunswick. Within the first decade, Manitoba (1870), British Columbia (1871) and Prince Edward Island (1873) were added. In 1905 the prairie provinces of Saskatchewan and Alberta were created, and in 1949 the province of Newfoundland and Labrador joined the federation. Thus, Canada now consists of ten provinces plus three territories in the sparsely populated Canadian North – Yukon, the Northwest Territories and Nunavut. The total population of the federation is now nearly ten times that in 1867, numbering over 31 million. Most of this population lives in a narrow band less than 200 kilometres wide next to the U.S. border but stretching nearly 6,000 kilometres from east to west.

With this growth have come fundamental changes in the Canadian economy and society. While agriculture and agricultural exports still play an important role, industrialization and with it urbanization in such major centres as Montreal, Toronto, the Calgary-Edmonton corridor, and Vancouver have led to the development of distinctive regional economies. Manufacturing and finance have become concentrated in Ontario and Quebec, the Atlantic provinces and British Columbia have focused on fishing and forestry, Manitoba and Saskatchewan particularly on agriculture, and Alberta on the production of oil and gas. With these differences in their economic bases has gone a drive for “province-building” with each province pressing to manage its own development.

Immigration and the expansion of the Canadian population has also changed the character of Canadian society fundamentally. In 1867 the vast proportion of Canadians were of British or French descent although with a significant minority of Aboriginal peoples. The main differences were between the predominantly French and Roman Catholic population of Quebec and British and Protestant population elsewhere. But subsequently western settlement in the late 19<sup>th</sup> and early 20<sup>th</sup> century saw an influx of Eastern Europeans in the western regions, and after World War II a flood of immigration from Central and Southern Europe to central Canada further adding to the complexity of Canada. In recent decades another wave of immigrants from India, China and other Asia countries, particularly to British Columbia, has further diversified the population. Immigration has changed the character of Canadian society in three ways. First, although the old English-French duality remains significant, Canadians of neither British nor French descent now represent a roughly equal proportion of the population. The resulting diversity of population, particularly in major cities such as Toronto, Montreal

and Vancouver where the majority of recent immigrants have settled, has led to the introduction of policies of “multiculturalism”. Second, since most of the new immigrants have adopted English as a language, the bilingual balance has shifted. While 85 percent of the Quebec population is francophone, the proportion of francophones within the total Canadian population has shrunk to one-quarter. During the latter half of the 20<sup>th</sup> Century this trend has heightened the concerns of Québécois that their culture and identity were under increasing threat. A third impact has been the result of the differing regional concentrations of each wave of immigration. This has reinforced the strength of the distinctive regional interests and provincial identities. These strengthened provincial loyalties have been further reinforced by assertive provincial governments engaged in “province-building”.

Another feature of the changing character of Canadian society has been the growing assertiveness of Canada’s original inhabitants, the Aboriginal peoples. In the latter half of the twentieth century their struggle for land claims and self government, together with their generally distressed economic and social conditions, became a significant issue not only for the federal but also the provincial governments. While in 1867 Section 91 (24) of the constitution assigned to the federal government jurisdiction over “Indians and lands reserved for Indians”, the development of Aboriginal land claims and self-government has increasingly had a bearing on provincial responsibilities, especially as more and more Aboriginals have moved off reserves to live in large cities.

The general effect of all these geographic, social and economic factors has over the 141 years been to substantially erode the federal government’s dominance. With the increasingly federal character of Canadian society, the various centralizing (quasi-unitary) features of the constitution which had been frequently used in the early decades after 1867, fell into disuse. Although the powers of reservation and disallowance, and the public works power remain to this day in the constitution, they have not been used now for over 50 years. This is because they have come to be seen as incompatible with the political reality of contemporary Canadian society. Furthermore, such policy fields as health, education and social policy which when assigned to the provinces in 1867 were fairly restricted in scope, have in the last half century become major and substantial areas of public policy and expenditure increasing the political importance of the provinces. Furthermore, the provinces have used their ownership of natural resources as a basis for assertive province-building policies in alliance with their local economic elites. Thus, without resorting to constitutional amendments, simply through the shifting importance of policy fields assigned to the provinces and the impact of societal developments upon the federal government’s use of its own powers, there has been a progressive shift in the relative dominance from the federal to the provincial governments.

### **Adjustment by constitutional amendment**

The British North America Act, 1867, was an Act of the United Kingdom Parliament and, therefore, it was assumed when it was enacted that any amendment would require another Act of that Parliament. As the Canadian federation evolved towards

independence from Britain, the issue of the appropriate Canadian process for constitutional amendments and the relative role of the federal Parliament and the provincial legislatures in any such process became a matter of contention. Lack of agreement left the matter unresolved at the time of the Statute of Westminster, 1931, which in other respects recognized Canada's independence from Britain. Consequently, it was not until the "Patriation" of the Canadian constitution in 1982 that there was a set of formal Canadian amendment processes.<sup>5</sup> Prior to that any formal amendment to the distribution of powers was by a United Kingdom Act on the recommendation of the Canadian Parliament. In fact, between 1867 and 1982 only two direct amendments were made to the 1867 distribution of powers, both during the period of World War II wartime and postwar centralization: in 1940 unemployment insurance was made an exclusive federal power becoming Section 91 (2A), and in 1951 the federal Parliament was given power to legislate for old age pensions by the addition of Section 94 A, which made this an area of concurrent jurisdiction, although the position of the provinces (and especially Quebec) was protected by placing this power under concurrent jurisdiction with provincial paramountcy in cases of conflict between federal and provincial legislation on this subject. At the time of the adoption of the Constitution Act 1982, a further adjustment to the distribution of powers was incorporated, largely at the insistence of Alberta, when the exclusive powers of the provinces over natural resources were clarified and they obtained a concurrent power to regulate inter-provincial trade in natural resources and to levy indirect taxes on these resources.<sup>6</sup>

Under the Constitution Act, 1982, formal amendments to the distribution of powers normally require passage by Parliament and by the legislatures of two-thirds (seven) of the provinces representing at least 50 percent of the federal population.<sup>7</sup> There is in addition a process for bilateral amendments agreed to by the federal Parliament and a particular province under which an asymmetrical adjustment may be made.<sup>8</sup> To date, neither of these processes have been employed for an adjustment to the distribution of powers, although the bilateral process has been used three times to alter minority language and educational rights in New Brunswick, Quebec and Newfoundland and Labrador.

### **Adjustment by judicial review**

Adjustment to the distribution of powers by judicial review has been far more significant in the evolution of the Canadian federation than formal constitutional amendments.

Between 1867 and 1949, the Judicial Committee of the Privy Council in the United Kingdom served as Canada's highest constitutional tribunal. From 1896 on in a series of significant cases the Judicial Committee in its interpretation of sections 91 and 92 of the

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<sup>5</sup> The Constitution Act, 1982, sections 38-49.

<sup>6</sup> The Constitution Act, 1867, section 92A.

<sup>7</sup> Constitution Act 1982, sections 38-40.

<sup>8</sup> Constitution Act, 1982, section 43.



British North America Act 1867, came down strongly in favour of the provinces. Critics of Lords Watson and Haldane have pictured them as “bungling intruders who, through malevolence, stupidity, or inefficiency channelled Canadian development away from the centralized federal system wisely intended by the Fathers”.<sup>9</sup> Others such as Alan Cairns, and W.R. Lederman have defended the Judicial Committee’s decentralist interpretation both as consistent with the meanings of the terms and logic of the original constitutional document, and as in tune with the developing character of the Canadian federal society.<sup>10</sup> The general effect of the rulings of the Judicial Committee was, in the process of balancing the two lists of federal and provincial exclusive powers, to interpret broadly the expressly prescribed exclusive provincial powers in the constitution and constrain the federal exclusive list accordingly. Thus, by contrast with the impact of judicial review in the United States and Australia where the courts have interpreted federal jurisdiction and associated “implied powers” broadly at the expense of the unstated residual powers of the states, in Canada the express listing of exclusive provincial powers in Section 92 provided a brake upon broadening interpretations of federal jurisdiction.

An illustration of the way in which judicial review of the particular form of the Canadian distribution of powers has imposed constraints on federal dominance is in the field of international affairs. The federal government has exclusive power to make international treaties and agreements, to represent the Canadian interest in international bodies, and to define foreign policy. But in a crucial decision in 1937, the Judicial Committee of the Privy Council ruled that while the federal government had exclusive jurisdiction over the negotiation and ratification of treaties, that authority did not extend to the implementation of matters under provincial jurisdiction. Such matters in a treaty require for their implementation provincial legislation. In the Judicial Committee’s off-quoted view: “while the ship of state now sails on larger ventures and into foreign waters she still retains the watertight compartments which are an essential part of her original structure”.<sup>11</sup> This has had two effects: first, a tendency on the part of the federal government to avoid as far as possible treaties affecting matters under provincial jurisdiction, and second, when entering into such treaties affecting areas of provincial jurisdiction (as for instance was the case in the Canada-US Free Trade Agreement) consulting the provinces extensively during the negotiation of international agreements. This is in sharp contrast with such federations as the United States and Australia where treaties, once ratified, bind all internal governments, and where over time the negotiation of treaties and international agreements has expanded the scope of federal jurisdiction.

The Judicial Committee of the Privy Council, located in Britain was by the mid-twentieth century increasingly viewed by Canadians as a relic of colonialism. Consequently, in 1949, it was removed as the last court of appeal, this role being assumed by the

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<sup>9</sup> Alan Cairns, “The Judicial Committee and Its Critics”, *Canadian Political Science Journal*, 1971 (reprinted in Garth Stevenson, ed., *Federalism in Canada: Selected Readings* (Toronto: McClelland & Stewart Inc., 1989), p. 81, referring to V.C. MacDonald, Bora Laskin, Frank Scott, and A.R.M. Lower.

<sup>10</sup> Cairns, *op. cit.*, pp. 81-141; W.R. Lederman, “Unity and Diversity in Canadian Federalism: Ideals and Methods of Operation”, in Stevenson, *op. cit.*, pp. 142- 164.

<sup>11</sup> *Attorney General for Canada v. Attorney General for Ontario* [1937] A.C. 326.

Supreme Court of Canada. Some critics have viewed the Supreme Court, its members appointed by the federal government, as an instrument of the central government rather than as an impartial arbiter of federal-provincial disputes. Peter Hogg, however, analysing the record of the Supreme Court since 1949 has concluded that “provincial governments have won as many victories before the Supreme Court as they have suffered defeats; the Supreme Court has not departed very significantly from the doctrines laid down by the Judicial Committee before 1949; and there is no evidence that the central governments have deliberately appointed “centralists” to the bench or that they could do so if they tried”.<sup>12</sup> Thus, the Supreme Court of Canada continues to serve as an active guardian of provincial powers by comparison with the Supreme Court of the United States and the High Court of Australia which have powers to do so but “have virtually abandoned the notion that there are fields of legislative jurisdiction reserved to the states”.<sup>13</sup>

### **The Distribution of Financial Power**

The distribution of finances within a federation significantly affects the general distribution of powers and degree of decentralization for two main reasons: first, financial resources enable or constrain governments in achieving their policy objectives within their constitutionally allocated legislative and executive responsibilities; second, taxing powers and expenditure are themselves important instruments for affecting and regulating the economy.

In Canada, under Sections 91 and 92 both the federal and the provincial governments have been given a wide range of parallel taxing powers. Furthermore, in Canada the provinces own their own natural resources. The net effect is that in comparative terms, federal government revenues (before intergovernmental transfers) as a percentage of total federal-state-local government revenues at 47% (2000-2004) are next to Switzerland at 40.0% the lowest among contemporary federations (most of which range between 60 and 90%).<sup>14</sup> Thus, in terms of own-source revenues the Canadian provinces have come to benefit from a high degree of autonomy. Consequently, provincial dependence on intergovernmental transfers as a percentage of provincial (or state) revenues at 12.9% are lower in Canada than any other federation where the range is from 24.8% in Switzerland to 96.1% in South Africa.<sup>15</sup> Furthermore, although at one time in the early decades after World War II a considerable portion of Canadian federal financial transfers in support of provincial social programs were conditional in character, political pressure exerted by the provinces has led to a situation where by the beginning of the 21<sup>st</sup> century virtually all federal transfers to the provinces were unconditional or only semi-conditional in character. Consequently, federal conditional grants now

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<sup>12</sup> P.W. Hogg, “Is the Supreme Court of Canada Biased in Constitutional Cases”, *Canadian Bar Review*, 57 (1979), reprinted in Stevenson, *op. cit.*, pp. 165-183, see also p. 16. W.R. Lederman also concurs with this assessment, *op. cit.*, p. 153.

<sup>13</sup> Stevenson, *op. cit.*, p. 16.

<sup>14</sup> R.L. Watts, *op. cit.*, Table 9, p. 102.

<sup>15</sup> *Ibid.*, Table 11, p. 105.

represent only 3.7% of total provincial revenues.<sup>16</sup> Thus, in comparative terms, while the Canadian provinces do still depend on federal transfers including unconditional equalization grants, their dependence on federal financial transfers is far lower than in most federations and hence their financial autonomy is correspondingly substantially greater.

As to the processes for resolving issues of intergovernmental financial arrangements, in Canada the processes of executive federalism have predominated.<sup>17</sup> Ultimate decisions do lie with the federal government and federal legislation, but in practice for each five year period renewal of the financial arrangements has usually been preceded by extensive federal-provincial negotiations involving federal and provincial officials and finance ministers to arrive at an agreed program. Occasionally, as has happened recently, disputes over proposed modifications have led as well to the appointment of advisory independent commissions.<sup>18</sup>

### **The Spending Power of Governments**

One area in which judicial review in Canada has not constrained the federal government is in the exercise of its spending power in areas of exclusive provincial jurisdiction. Thus, although the federal government may not legislate or regulate matters under exclusive provincial jurisdiction, federal governments in Canada have frequently used their spending power to make grants in support of provincial programs in order to encourage provinces to implement federal priorities and to undertake direct spending in such areas as culture, research and student aid. But while such federal spending has not been successfully challenged in the courts, it has been politically contentious. Provincial governments have complained that the unilateral federal use of its spending power undermines their autonomy in areas assigned by the constitution exclusively to them. It has been this contention that has led in recent decades to the almost total abandonment of federal conditional transfers in favour of unconditional or only semi-condition transfers. It also led to the federal-provincial Social Union Framework Agreement (SUFA) of 1999 in which all the provinces (except Quebec) recognized the federal spending power in exchange for a promise by the federal government that in future it would not proceed with grants in areas of exclusive provincial jurisdiction without the consent of a majority of the provinces. More recently still, faced with continuing pressure from Quebec in opposition to federal spending in areas of exclusive provincial jurisdiction, Prime Minister Harper has indicated that avoiding such uses of the federal spending power would be a policy of his government.

It should be noted that while provinces have generally opposed the unilateral use of the federal spending power in areas of exclusive provincial jurisdiction, provinces themselves, including Quebec, have frequently used their own spending power in an

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<sup>16</sup> *Ibid.*, Table 13, p. 108

<sup>17</sup> *Ibid.*, pp. 112-6.

<sup>18</sup> The Expert Panel on Equalization and territorial Finance, 2006.

area of federal exclusive jurisdiction, international relations and trade, to established their own provincial offices in other countries and to send trade missions abroad.

### **Intergovernmental Adjustment**

In spite of the basic structure of the constitutional distribution of powers which emphasizes the exclusive jurisdiction of each of the two orders of government and only recognizes a few areas of concurrent jurisdiction, in practice overlaps between the areas of exclusive jurisdiction have led to the need for frequent intergovernmental interaction. Indeed, much of the evolution of the distribution of powers within the Canadian federation has been not through constitutional amendment and only partially through judicial review. Rather much of it has been through intergovernmental interaction and adjustment.

Given the institutional structure in Canada of a federation relying on parliamentary institutions with strong executives fused with their legislatures, these strong executives in both orders of government have been at the centre of the processes of intergovernmental interaction.<sup>19</sup> “Executive federalism”, as it has come to be called, has been a major feature in the evolution of the Canadian federation. The institutions and processes of executive federalism have developed pragmatically rather than by constitutional specification. While the frequency of meetings of First Ministers has fluctuated, intergovernmental meetings of officials and of ministers on a wide range of subjects have in recent decades become extremely frequent.

In the area of intergovernmental financial arrangements such meetings have played an important role in the development equalization and other forms of federal transfers to the provinces. Furthermore, given the joint occupancy of major tax fields by the federal and provincial governments, considerable cooperation has been necessary to avoid conflict. A major achievement has been the development of cooperative tax collection arrangements in relation to corporate and personal income taxes through the Canada Revenue Agency. Federal conditions for these cooperative collection agreements have been progressively relaxed to give the provinces more freedom in the design of their own tax policies. Generally, these agreements have enabled a high degree of coordination within an otherwise highly decentralized taxation regime.<sup>20</sup>

The practice of executive federalism has, however, extended far beyond the field of intergovernmental financial arrangements. Meetings of officials, ministers and first ministers in terms of federal-provincial arrangements, and interprovincially (bilaterally, for regional groups of provinces, and for all provinces) on a great variety of subjects have become a regular feature. Recently, on the initiative of Quebec, an interprovincial

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<sup>19</sup> Richard Simeon and Martin Papillon, “Canada” in A. Majeed, R.L. Watts and D.M. Brown, eds., *A Global Dialogue on Federalism, Volume 2: Distribution of Powers and Responsibilities* (Montreal and Kingston: McGill and Queen’s University Press, 2006), p. 114; R.L. Watts *op. cit.*, 118-120, 143.

<sup>20</sup> Simeon and Papillon, *op. cit.*, p. 104.

Council of the Federation was formally established not only to foster interprovincial cooperation but also to enable achieving a common stand in negotiations with the federal government.

These extensive practices of consultation, negotiation, cooperation, and on occasion joint projects, have enabled governments within the Canadian federation to adapt the constitutional distribution of powers to changing conditions without resort to the complicated and generally rigid processes of constitutional amendment. Furthermore, with a constitutional distribution of powers that has emphasized the exclusive powers of each order of government, these processes have provided a pragmatic and flexible way of adjusting to changing societal conditions and needs.

### **Recent Developments**

The current federal Prime Minister, Stephen Harper, whose minority Conservative government was elected in 2006, has been more committed to provincial autonomy than any federal prime minister since the Second World War. He has supported the passage of a resolution in the House of Commons recognizing the Québécois as “a nation within Canada” and has avowed a policy of “open federalism”. He has pledged to limit the federal spending power by lowering federal taxes and thus reducing the federal government’s financial capacity to indulge in spending in areas of provincial responsibility. It is not yet clear how far he will go in the pursuit of further decentralization, but his policy of “open federalism” seems to be aimed at confining federal responsibilities into a clearer watertight compartment with the aim of reducing federal-provincial bickering.

### **Conclusion**

While the formal constitutional allocation of jurisdiction to the federal and provincial governments in Canada has gone largely unaltered since 1867, its application has proved remarkably flexible over 141 years. It has enabled centralization during wartime and progressive decentralization in times of peace. And it has enabled some asymmetrical treatment of Quebec as a distinct nation within Canada. The evolution of the balance between the federal and provincial governments has occurred largely under the impact of the changing geographical, social and economic character of the Canadian federal society which has influenced the application of the constitutional distribution of powers. This evolution has been effected largely through judicial interpretation of the constitutional specification of exclusive powers and through pragmatic intergovernmental adjustments rather than through formal constitutional amendments. Since 1867 both the federal and provincial governments have in fact each expanded and developed their roles and public activity, but in relative terms the provincial governments have, with the substantially increased role of governments in the fields of health, education, social policy and natural resource development constitutionally

assigned to them, expanded their scope much more.<sup>21</sup> The net effect has been that in terms of the balance of federal and provincial government roles, the Canadian federation which began in 1867 in a relatively centralized form, is now much more heavily weighted to the role of the constituent units than virtually all other contemporary federations with the possible exceptions of Switzerland and Belgium. The form of the Canadian constitutional distribution of jurisdiction defining explicit exclusive provincial powers has contributed significantly to this pattern of evolution.

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<sup>21</sup> For an analysis of the current scope of federal and province responsibilities in various policy fields see Simeon *op. cit.*