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REFORMING FISCAL FEDERALISM FOR GLOBAL COMPETITION

A Summary of Conference Proceedings

On October 12 and 13, the Western Centre for Economic Research, with funding from the Donner Canadian Foundation, sponsored a conference with the theme *Reforming Fiscal Federalism for Global Competition*. The focus was federalism in Canada and Australia. These countries, though they have much in common in historical and cultural background and institutional structures, nevertheless possess federal systems that have evolved in rather different ways.

EXISTING FEDERAL SYSTEMS: CONSTITUTIONAL BACKGROUND AND STRUCTURE

Stanley Winer and Allan Maslove of the School of Public Administration at Carleton University compared fiscal federalism in the two countries. They emphasized the respective constitutional frameworks and structural features of each fiscal system.

The authors identified the single most important fact about fiscal federalism in the two countries as the much greater degree of centralization in the Australian system, particularly with regard to the power to tax. This higher centralization is reflected in their respective fiscal institutions. The framers of the Australian constitution (in the debates of 1891 and 1897-98) considered and explicitly rejected the British North America Act (1867) as a model, a decision most apparent in how fiscal powers are specified.

The Australian constitution, unlike the Canadian, contains no explicit list of taxing and spending powers or responsibilities of state governments. Although the power to levy indirect taxes is not constrained by the 1900 Australian constitution, subsequent judicial interpretation has not favoured the states. In Canada, however, though the 1867 assignment of taxing powers to the provinces did not include indirect taxation, judicial interpretation has left the provinces with more or less unrestricted powers in these fields. Unlike Canada though, the Australian constitution has no provision for the assumption of state debt by the Commonwealth government.

Winer and Maslove point out that neither the Australian nor the Canadian constitutions seriously restrict either the amount or national distribution of funds that may be transferred to the states or provinces by the central government.

The authors find it difficult to understand how constitutional provisions have resulted in the present observed fiscal assignments in each country. Nevertheless, the greater fiscal centralization in Australia is found in the effective distribution of tax bases, in the extent of tax harmonization reducing the state and local costs of collecting taxes, and in the importance of central government grants as a source of state revenues. The Commonwealth raises about 70% of all government revenues compared with the Canadian federal government share of some 45%. The Commonwealth government accounts for about 50% of expenditures on goods and services (excluding transfers) compared with a federal figure of 40% in Canada. Central government grants to the states amount to 50% of state revenues in Australia, while in

Canada the comparable figure is less than 30%. They point out that local government direct spending is also more important in Canada, thus making decentralization not only greater in magnitude, but also greater across *three* levels of government.

Winer and Maslove also comment on the manner in which the respective fiscal systems deal with disparities between states and provinces. They find the structure of the equalization system more comprehensive in Australia, with the formula taking into account inequalities not only in potential revenue sources but also in anticipated expenditure needs. The Australian arrangements also provide quite limited discretion for states in acceptance and use of these grants.

The authors find the difference in policy processes and fiscal institutions to be consistent with differences in the degree of fiscal centralization. In Canada, cabinet ministers from the provinces meet with their counterparts in the federal government on a more or less equal basis for bargaining purposes. In Australia, tax sharing arrangements, for example, have been unilaterally offered to the states by the Commonwealth, and unilaterally terminated as well. They point to the existence in Australia of the quasi-independent Commonwealth Grants Commission—on which states are formally represented—that recommends division of an equalization grant among the states, but with the amount unilaterally set by the Commonwealth government.

Winer and Maslove then turned to the evolution of fiscal federalism over the past decade. In Canada, they found pressure from high deficits producing alterations in fiscal arrangements, sometimes by unilateral federal decisions and sometimes by agreement. On balance, they do not see a reversal of long standing trends toward increasing decentralization. They find this a stark contrast with Australian developments where commonwealth dominance in public finances, particularly in taxing authority and in the control of economic policy has been affirmed. Perhaps the only institutional development countering this trend was the creation in 1992 of the Council of Australian Governments (COAG), providing semi-annual meetings of first ministers.

Winer and Maslove offered demographic and economic reasons for the differences in fiscal centralization between the two countries. One is that,

even with allowance for the "French fact", Canada is more ethnically diverse than Australia. Another is the higher degree of urbanization in Australia, where 60% of the population live in the five largest urban areas. With a high concentration of population, administrative decentralization can more easily accommodate diversity, thus mitigating the demand for constitutional decentralization. A third reason is that economic regions in Canada more nearly coincide with, or are contained within provinces, so that provincial governments voice regional economic interests.

In concluding, the authors returned to their theme emphasizing the considerable difference in the two countries' degree of fiscal centralization. They do not

believe it easily explained by differences in the constitutional assignment of fiscal powers. This gap between the constitutional and effective assignment of powers in both countries leads to a number of questions:

- What role has the constitutional assignment of fiscal powers played in understanding present day fiscal federalism?
- Would the effective assignment of powers in either country been different if no reference to fiscal powers were present in either constitution?
- Given fluidity in the division of effective fiscal powers, is it worthwhile to debate and reform the constitutional framework?

AUSTRALIAN COMMONWEALTH-STATE FINANCIAL RELATIONS

Professor **Cliff Walsh**, Executive Director of the South Australia Centre for Economic Studies of Adelaide and Flinders Universities and former Senior Economic Advisor to the Australian Prime Minister, considered a number of issues in Australia including tax powers, microeconomic reform and intergovernmental relations. Walsh acknowledged that in the Australian federal system the division and sharing of fields between governments limit the potential use of coercive power. Overlapping roles and responsibilities reflect the dynamism and responsiveness of federal systems of government. In this constitutional setting a workable system of intergovernmental arrangements is essential for coordination and the identification, mediation and resolution of conflict.

He identified two key features of Australia's current Commonwealth-State financial arrangements. The first is "vertical fiscal imbalance" (VFI): the fact that states are denied access to revenue sources commensurate with their spending responsibilities. They are highly dependent on grants from the Commonwealth's excess of revenue resources over its own-purpose outlay needs. The second is the system to assess how Commonwealth transfers should be distributed between the states to achieve "horizontal fiscal equalization" (HFE). These have wide ranging effects on the efficiency of public sector decision making, on the program of microeconomic reform, and for the future performance of the Australian economy. He judged the first (VFI) as notable for its negative consequences, while the second, in contrast, makes an outstanding contribution in terms of efficiency, equity, stability, and ongoing competitive reform.

Walsh provided a broad perspective on Australian fiscal federalism. Australian states' and local governments' share in real and financial asset management (84% of essential economic and social infrastructure and 49% of public sector debt) and public sector employment (78%) reflect their responsibility for providing the vast majority of economic and social services to people and business. In contrast, the Commonwealth's own-purpose spending is principally on transfers payments, defence, foreign affairs, telecommunications and aviation. Own-purpose outlays are approximately equally split between the Commonwealth and the state/local sectors. However, the state/local sector raises only about 25% of taxation revenues. Australia has the highest degree of VFI among the industrialized world's federal systems. The fiscal dominance of the Commonwealth has contributed to negative features of state policies including wasteful competition to attract new business development, unsuccessful attempts as venture capitalists, and other regulatory and policy failures.

Walsh outlined three vitally important direct consequences of fiscal imbalance:

- (a) state governments do not have access to tax fields sufficient to pay for own-expenditures;
- (b) sufficient accountability in the use of those revenue sources is therefore lacking;
- (c) fiscal imbalance contributes to an imbalance in the federal system.

Amplifying these consequences, Walsh related a number of avenues where difficulties arise. There is increasing centralization of decision making power in areas where the states have the principal role, so that

the capacity of different levels of government to respond to voters, community groups, and other interests is prejudiced. Accountability and responsibility for political decisions lack transparency. Effectively, links are absent between government decisions on public sector activity and the responsibility for raising revenue to fund them. The dependence of the state/local sector on Commonwealth grants has institutionalized conflict in Ministerial Councils. The states find it difficult to engage in medium term budget planning because of the ability of the Commonwealth to set grant totals and alter pre-announced formulae. The large share of grants in states' funding results in them receiving "ratings" from international financial agencies higher than their less "dependent" counterparts in other federations.

Walsh then turned to the tax bases of the states. The bases are much narrower than those available to the Commonwealth. Since the Commonwealth enjoys exclusive jurisdiction (since World War II) over personal and corporate income and sales taxes, the states are limited to payroll taxes, stamp duties, licenses, tobacco, alcohol and gasoline taxes, gambling and insurance, and levies on public sector enterprises. State governments regard public utility prices as the closest thing they have to broad based taxes on individuals with the result that needed microeconomic reforms often are perceived as at best revenue limiting, and at worst, revenue reducing. State taxes, on balance, impose greater distortions compared with Commonwealth sources of revenue. About three-fifths of state taxes fall on business inputs with distortion to input decisions and productivity. For example, states have sought to attract industry through negotiated concessions on business input taxes. He suggested that

the overall efficiency costs of the 21% of tax revenues raised from the states might not fall far short of the efficiency costs of the 74% raised by the Commonwealth.

He sketched his view of how the states might gain more independent revenue raising capacity (under a revenue neutral condition) through a flat tax rate on the taxable incomes of individuals. The Commonwealth would reduce its tax rate by an equivalent amount. He suggested that a state flat tax of 5% would generate collective revenues for the states approximately equal the present levels of Commonwealth grants. Walsh expressed a preference for this alternative rather than giving the states access to the sales tax field. A broad based consumption tax would best be left to the Commonwealth.

Walsh does not believe that state access to the income tax would inhibit macroeconomic management. He pointed out that the present situation of a large VFI and high degree of centralized fiscal power has not produced an Australian macroeconomic performance superior to that of other mature federations. For him, the Commonwealth's lead role in coordinating counter-cyclical policy is consistent with allowing the states to apply a uniform tax rate to taxable incomes.

He concluded that Australia badly needs fiscal policy coordination through a process of negotiation *in lieu* of control by the Commonwealth. A suitable vehicle would be a National Fiscal Coordination Council of Treasurers/Finance Ministers operating under a new Financial and Fiscal Agreement. He stated that the resulting change in the working of the federal system under such an agreement would contribute more fundamentally to reform than any conceivable change in the constitution.

MANAGING DOMESTIC ECONOMIC INTEGRATION: AUSTRALIAN AND CANADIAN APPROACHES

Thomas Courchene, Director of the John Deutsch Institute for the Study of Economic Policy at Queen's University, presented a comprehensive overview of how Australia and Canada have preserved and promoted their internal economic unions.

He began by considering constitutional provisions relating to internal economic union. These he identified as "free trade" clauses; federal regulatory power; and provisions relating to individual mobility.

In Courchene's view the free trade clause in the Australian constitution (Section 92) has been subject to much more judicial review and interpreted more broadly than the similar clause in the Canadian constitution (Section 121). Review of s.121 has been narrow, and the section understood as relating to "goods" while not encompassing services, capital or persons.

The Commonwealth trade and commerce power [s. 51(i)] has also been interpreted by the courts to extend far into intrastate matters, in part because the Australian constitution—like the American, but unlike the Canadian—contains no list or enumeration of exclusive provincial/state powers. In contrast, partly because the Canadian constitution contains a listing of provincial jurisdictions, the trade and commerce power [s. 91(2)] has been interpreted as having a far narrower reach. He pointed out that the force of these provincial powers is such that the residual power in the Canadian federation was for years effectively vested in the provinces. The effects of judicial interpretation in Australia are that in the area of industrial relations, for example, Commonwealth legislation has sweeping application to private sector wages and working conditions. Canada is at the polar opposite. Minimum wages and working conditions are a provincial matter except for industries (e. g. banking and nuclear plants) that fall explicitly under federal regulation. One very significant result of Commonwealth authority is that wages have been used as a vehicle for income redistribution. He pointed out that there are far fewer differences in labour/leisure ratios across economic space in Australia.

Individual mobility rights in Australia are guaranteed by s.92 and more explicitly by s.117. Portability of social services across states is less of a challenge in Australia because many of these services are delivered by the Commonwealth government. In Canada, until 1982, there were no specific provisions in the constitution relating to the mobility of individuals.

The Charter of Rights and Freedoms in the 1982 constitution contains mobility provisions subject to certain exceptions, including discrimination of out of province residents in land ownership, and the right of low income provinces to give preferences in hiring to local residents. Courchene concluded that Australia has a freer internal market than does Canada.

He then turned to the ways in which international agreements, which are all about ceding some measure of sovereignty, influence the broader issue of the balance of internal powers. He pointed out that historically the courts in Australia and Canada have taken diametrically opposite positions on the application to sub-national governments of international treaties and agreements. In Australia (as in the American and Swiss federations) the national government is relatively free to require sub-national government compliance with international treaties. Canada is an exception since the *Labour Conventions Case* (1937) denied Parliament the power to implement aspects of an international convention coming under provincial constitutional responsibility. Courchene stated that the Canadian situation may change because of Article 103 of the FTA, requiring that the respective federal governments take all 'necessary measures' to assure compliance by state, provincial and local governments. He regarded the principle of "National Treatment", on which the FTA is based, as an important factor in bringing about the 1994 Canadian *Agreement on Internal Trade* (AIT). Further, the NAFTA contains riders on labour/social policy and the environment. These are likely to have a bigger impact on federations like Canada, where much of the responsibility for these areas remain in provincial jurisdiction. Still another consideration is that NAFTA's opening of the external border making possible a north-south by-pass eliminated the advantage of internal trade barriers for the provinces.

He concluded that the impact of commercial free trade on Canada would be a more expansive judicial reading of the trade and commerce power [s.91(2)]. In Canada, the direct and indirect impacts of the FTA and NAFTA are serving to erode internal barriers. In contrast, the Australian constitution and its judicial interpretation have delivered a freer internal market.

Courchene then turned to some innovative ways in which Australia has used legislative and regulatory action to coordinate and harmonize policy across state boundaries. Perhaps the most important is the principle—adapted from the European Union—of

Mutual Recognition. He believed that the principle as applied in Australia is one that Canada should be monitoring closely.

In 1992 the Australian Heads of Government signed on to a program for mutual recognition of regulations and standards relating to the sale of goods and the registration of occupations, called the Mutual Recognition Agreement (MRA). To assure the binding of all signatories, the states requested the Commonwealth under its "peace, order and good government" power [s.51(xxxvii)] to legislate and implement the MRA. Goods that can be sold lawfully in one jurisdiction may be sold in any other, even though the goods may not comply with all the details of the regulatory standards in the second jurisdiction. If a person is registered to carry out an occupation in one state, they can carry out the equivalent occupation in any other without the need for further assessment of qualification. One observer has concluded that under the MRA the states are ceding sovereignty to each other through mutual recognition of their respective regulatory systems. An underlying premise is that the parties are confident that the standards set by other states are acceptable. An important consequence of MRA has been acceleration in the development of national standards in those areas related to public health, safety and the environment.

In the area of regulatory reform the *Competition Principles Agreement* established agreed principles covering the micro-economic reforms of public monopolies, state enterprises, ports, self-regulating professional organizations, agricultural marketing boards, etc. Because the states would be large budgetary losers from these reforms, there was agreement from the beginning that they would receive some financial compensation in return for implementing these reforms.

Company law changes have also contributed to freer Australian internal markets. The Alice Springs Agreement of 1990 effectively "federalized" company law with each of the states adopting verbatim, the text of Commonwealth law and then enacting it as their own. Canadian company law is far from the harmonized, even uniform, Australian regime. Courchene illustrated this with a discussion of security law and the financial sector generally. He regarded the great differences in the Australian and Canadian approaches to company law as illustrative of the fact that where harmonization is essentially automatic in Australia, substantial creativity is required in Canada.

Courchene then considered integration initiatives in Canada. Some of these have been innovative, such as in personal and corporate income taxation, where substantial harmonization has occurred within

decentralization. Ottawa collects free of charge the provincial portion of the income tax subject to (a) provincial acceptance of federal definitions of income and deductions/credits, and (b) the provinces limit themselves to applying a single rate of tax against federal tax owing. The latter preserves the underlying progressivity in federal tax rates. On the corporate side all provinces have agreed to a formula which allocates profits across provinces for firms operating in more than one province.

He pointed out that the federal spending power in Canada plays a crucial role in preserving and promoting the internal economic union by converting various provincial programs into "national" programs. The federal-provincial grants system prohibits residency requirements for access to provincial welfare, and portability provisions exist with respect to federal cash transfers for health.

Provincial retaliation has also been used as a means of enhancing internal economic union. He gave as an example retaliation by Ontario to restrictions imposed by Quebec on out-of-province construction workers. While hesitating to suggest that any federation should resort to such measures to enhance internal union, he did indicate that any decentralized federation has no choice but to resort to a very wide ranging set of instruments to preserve unified economic space.

Courchene then turned to the Canadian Agreement on Internal Trade. He judged its provisions on labour mobility to be much weaker than the principles applied under Australia's MRA. He was highly critical of the provision in the AIT that provides an exception for regional economic development. It implicitly sanctions a mounting of inter provincial barriers. His position is that any regional disparities policy should be limited to the formal equalization program.

In concluding, Courchene turned to the relationship between competitive federalism and the promotion of an economic union. Because Canada is more decentralized than Australia, the scope for the exercise of competitive federalism is much greater. Australia, he suggested, is more interested in devolution to markets, so that market competition (e.g., workers' compensation paid to private insurance, some prisons privatized, the Australian pension plan flowing through private intermediaries) substitutes for Canadian-style decentralization. Competitive federalism implies that different jurisdictions will and should experiment with alternative design, delivery and incentive procedures though these have the potential to fragment the economic union on a geographical/jurisdictional basis.

Courchene outlined some of the issues in executive federalism that arise at a practical level. The key factor here is that Canada should no longer be viewed as a single economy but as a series of quite distinct, cross-border economies. The growth in foreign trade, particularly with the United States, and the differences in the importance of foreign relative to domestic markets between regions, complicate pursuit of an internal economic union. The east-west provisions are superimposed on an increasingly north-south trading system. This led him to the conclusion that special emphasis in the internal union should be placed on the mobility of human capital, that is one area where the east-west market is still relevant. For Courchene similar challenges exist in Australia given inter-state differences in the relative importance of foreign and domestic markets.

Finally, he advanced some hypotheses about how centralization/decentralization, trade flows and the internal common market interact in the two countries.

In the Canadian case, the increasing north-south trade orientation and the decentralized nature of the country suggest that the federation has the required flexibility through competitive federalism to ensure the regions remain internationally competitive. However, there are genuine fears that competitive federalism on the social policy front could lead to unraveling of the east-west social safety net. Devolution of the social envelope embodied in the 1995 federal budget indicates that Canada may be overdoing the role of competitive federalism on the social union side.

In the Australian case he found opposite circumstances. There, a thorough economic union (nationwide pay scales, narrow skilled/unskilled wage differentials) may be inconsistent with the forces of globalization, and differences in the dependence of individual states on internal as opposed to international markets. The consequence may be a stifling of competitive federalism on the economic front.

THE ASSIGNMENT OF TAX FIELDS BETWEEN GOVERNMENTS

Bev Dahlby and **Sam Wilson**, Professors of Economics at the University of Alberta addressed two specific questions:

- Has the division of tax powers influenced the tax and expenditure mix of the two countries?
- Has the division of tax powers affected the overall level of taxation in the two countries?

They considered the fiscal externalities that may arise with alternative tax assignments to be the most relevant for these questions.

They turned first to a consideration of the inter-jurisdictional fiscal externalities that occur in a federal state. These can occur directly through changes in consumer or producer prices; through the provision of public goods; or indirectly by altering the tax revenues or expenditures of other governments.

Dahlby and Wilson first considered tax externalities. Two types of externalities have been widely recognized and discussed. One occurs when part of a tax burden is borne by individuals who do not reside in the jurisdiction imposing the tax (a hotel tax) which causes the levying government to underestimate the social marginal cost of public funds. The second occurs when a tax base can move from one jurisdiction to another, putting downward pressure on state tax rates and revenues. The eventual demise of estate taxes in Australia and Canada is an example.

The authors direct most of their attention to the case of indirect vertical externalities. These occur when a tax rate change by one level of government affects the tax revenue of another. Examples are found in the absence of harmonization between federal and state personal income taxes in the United States, and the taxation of cigarettes by federal and provincial governments in Canada. They consider the tax base overlap problem equivalent to the common property resource problem of over exploitation by the private sector when property rights in a resource are neither defined nor enforceable. In overlapping tax bases the problem created is that both levels of government will underestimate the social marginal cost of raising tax revenues if they neglect the revenue losses incurred by other governments. In previous work Dahlby has estimated these costs to be very high in the Canadian case, and the authors called for more empirical work on the fiscal consequences of tax base overlap. In their judgment vertical tax externalities are a ubiquitous and inevitable characteristic of a federal system with independent state/province taxing authority. To give each level of government its own tax base is probably superior to allowing different levels of government access to the same tax base.

Dahlby and Wilson then turned to expenditure externalities. They gave three cases of expenditure externalities:

(a) pollution abatement by one state benefiting the residents of another by lowering cross-border emissions (direct horizontal);

(b) an economic development grant provided by one state attracting investment that would otherwise have occurred elsewhere in the federation (indirect horizontal);

(c) interdependence between the federal government's provision of UI benefits and the welfare programs of the provinces (indirect vertical).

They pointed out that vertical expenditure externalities can also occur through their effect (over time) on the revenues of other levels of government. For example, spending on education by a state government can raise the earnings potential of its residents by making them more productive, thus increasing the federal government's tax revenues.

Much research is required to determine the significance of these externalities for the fiscal behaviour of federal and sub-national governments.

Dahlby and Wilson turned to the application of the framework they outlined for Australia and Canada. They find that given the limited taxing powers of the Australian states, direct horizontal tax externalities are

of limited importance in Australia. In Canada there is much more potential, especially with respect to provincial excise and sales taxes. Differentials in these taxes contribute to cross-border shopping. In Australia a form of vertical tax base overlap occurs because the states' payroll tax base is wage income which is also taxed through the Commonwealth's personal income tax.

Expenditure externalities are potentially important in Australia because of the states' responsibility for education and infrastructure despite their absence from the income tax field.

They asked if the division of tax powers has influenced the tax mix in Australia and Canada. Their conclusion is that, in aggregate, differences in the mix of the two countries cannot be completely explained by differences in tax assignment. Has the division of tax powers affected the overall level of taxation in the two countries? Whatever gaps exist in the ratio of tax revenues to GDP are not attributable to tax assignments but to other factors such as economic performance, demographic variables, or other fiscal institutions.

RESPONSIBILITIES FOR REGIONAL STABILIZATION: CANADIAN AND AUSTRALIAN EVIDENCE

Paul Boothe and Jeffery Petchey, of the Departments of Economics at the University of Alberta and Murdoch University respectively, asked the question: does the need for fiscal stabilization imply anything about the assignment of expenditure and taxation responsibilities to national and regional governments?

They began by reviewing the literature on role assignments. The view there was that responsibility for the stabilization role should be assigned to the national government for three reasons: first, regional economies are more 'open' and therefore fiscal stimulus from regional governments is less effective; second, regional debt financing will result in liabilities that are more 'external' to the region; and third, national shocks dominate regional ones and thus should be counteracted at the national level. The authors indicated that empirical evidence cast doubt on these three arguments, in part due to the fact that regional economies have become increasingly specialized due to globalization.

They suggested also that the view assigning the role for stabilization to the national government implicitly assumes that the compensatory fiscal

stimulus must be substantial. However, recent macro modeling in the debate over European integration casts some doubt on this view.

Boothe and Petchey pointed out that much of the literature on fiscal stabilization misses the role of intergovernmental transfers which in Canada include Equalization grants, Established Program Financing (EPF), and the Canada Assistance Plan. With respect to Equalization grants they suggest that the effect on stabilization will depend both on eligibility for equalization and whether the province is included as one of the five provinces used to calculate the standard. At best EPF has a passive stabilizer effect for those provinces not receiving equalization, since the sum of their tax points plus regional transfers is independent of regional economic circumstances. CAP is now capped for the three provinces not receiving equalization, and thus is not an active stabilizer should any of the three provinces be subject to negative shocks.

Turning to Australia, Boothe and Petchey indicated that the effects of transfers on regional stabilization is simpler to understand. There are two types of transfers from the Commonwealth to the

states: conditional or Special Purpose Payments (SPP), and unconditional or Financial Assistance Grants (FAG). SPPs are larger than FAGs but are generally unresponsive to regional economic conditions. FAGs, whose overall size is determined exclusively by the Commonwealth government, are Australia's counterpart to Equalization grants in Canada. However, the important difference is that in the case of FAGs both expenditure need and revenue capacity are equalized. Full equalization of revenue and expenditure means that they act as a powerful stabilizer.

Boothe and Petchey then asked the question: how much do regional fluctuations (defined as deviations from a quadratic trend line) in the two countries differ? In the Canadian case they identified substantial regional differences, while in Australia regional fluctuations are strongly related. They suggested further research is required to determine whether this different experience is attributable to underlying economic structure or to government policy.

They then considered the relationship between federal and provincial stabilization policy—automatic and discretionary—and regional fluctuations. In the Canadian case, taking the period from 1961-93, they found fiscal policy as a whole negatively correlated with regional economic fluctuations, with these counter-cyclical properties primarily coming from the

impact of automatic stabilizers. The results of provincial fiscal policy they found to be generally similar to the federal, their counter-cyclical character due primarily to the operation of automatic stabilizers. If anything, discretionary policy was pro-cyclical for both levels of government.

In Australia, Boothe and Petchey found over the period from 1981-95 that federal automatic stabilizers are counter-cyclical while discretionary policy seems generally pro-cyclical. Commonwealth grants to the states are counter-cyclical in at least half the states. At the state level the pattern is similar to the Canadian, with stabilization achieved mainly through the automatic components of policy, and discretionary policy pro-cyclical in the majority of the states.

The authors also presented case studies of two discretionary programs, one for each country: the Infrastructure Works Program in Canada, and the One Nation Program in Australia. In both instances it is arguable that their overall effects may turn out to be pro-cyclical rather than counter-cyclical.

Boothe and Petchey conclude that the need for fiscal stabilizers does not have implications for assignment of spending and taxing responsibilities within a federation. Absent the stabilization policy criterion, the criteria used to assign these powers should be found in the other major roles of government.

IS THERE A PARTISAN COMPONENT IN INTERGOVERNMENTAL TRANSFERS?

Robert Young, Professor of Political Science at the University of Western Ontario, considered whether the federal governments are more likely to make transfers to state and provincial governments of the same partisan persuasion.

In principle, Young suggested, there are reasons to expect that central governments might tend to favour their party colleagues at the sub-national level. These include the fact that the provision of funds allows provincial governments to increase spending, thereby enhancing party loyalty and improving chances for reelection. There are, however, important counter-arguments. One is that provincial governments, and premiers in particular, represent provincial interests regardless of partisan considerations. Another is that because the party systems are not well developed let alone thoroughly integrated in either country, partisanship is marginal at best. A third is that for central government politicians concerned with reelection, greater impact could be obtained from direct

spending rather than transfers to provinces.

Young referred to anecdotal evidence concerning partisanship and transfers, particularly in the case of special purpose grants. He found few systematic studies in Canada in a public choice framework. On the other hand in Australia much work has been done on the issue, though the results do not lend evident support to any particular model of political behaviour.

He discussed a number of preliminary quantitative models he has recently developed and tested to answer the question of partisanship in Canadian federal-provincial grants. The results to date do not support either the social welfare or public choice models.

CHALLENGES IN REFORMING FEDERALISM

Four panelists presented their views on challenges in reforming federalism. They were **Tom Courchene**; **Al O'Brien**, Alberta Deputy Provincial Treasurer; **Cliff Walsh**; and **John Wright**, President of the Saskatchewan Insurance Corporation and one of Saskatchewan's former Deputy Ministers of Finance.

Courchene emphasized the differences in regional disparities between the two countries. Australia has substantially lower regional disparities. He suggested that this might result from a number of factors:

- (a) more equal distribution of economic activity across the country;
- (b) the limited access of states to taxation bases;
- (c) a centralized industrial relations system generating equal wage grids across the country;
- (d) a centralized social security system with poorer segments of the population treated identically regardless of their state of residence.

The danger for Australia is that institutionalization of these rigidities impede needed adjustments in an increasingly competitive international environment.

Canada, he pointed out differs markedly in terms of the last three elements. However, in Canada entrenched disparities have been dealt with through a policy of large transfers into the poorer provinces. He suggested that this policy is no longer viable and Canadians are now required to rethink and rework their east-west social contract. For Canada, actions to increase labour mobility are essential. He also stated that a federal commitment to hold transfers to the provinces at no less than their 1996-97 budgetary levels would be necessary step to maintaining the social safety net.

Al O'Brien saw the need to address four key issues in Canada. He identified these as:

- (a) over regulation exemplified, for example, by overlapping federal and provincial jurisdictions in agriculture and the environment;
- (b) the replacement of intergovernmental transfers by transfers to persons;
- (c) the need for a single national tax collection agency;
- (d) the importance of addressing the present confusion with regard to aboriginal issues, including the financing of aboriginal programs.

John Wright expressed a great need for the rationalization of tax jurisdictions. He suggested that we should not minimize the fear of job loss in the federal bureaucracy as an impediment to this rationalization. He agreed with O'Brien's view on the need for a national tax collection agency. At the same time he expressed concern about whether the federal government can preserve federalism and hew to its announced fiscal agenda.

In reforming federalism, **Cliff Walsh** stressed the dangers of simply 'institution shopping' in other countries with a federal system in the search for better ways. He gave a history of recent fiscal development in Australia which have raised hopes for a more collaborative type of federalism. He saw COAG as holding substantial promise as a forum for the genuine discussion of issues of national importance. What is required is a guiding set of principles supportive of positive relationships, and for resolving issues about roles and functions.