PROCESSES FOR ADJUSTING FEDERAL FINANCIAL RELATIONS: EXAMPLES FROM AUSTRALIA AND CANADA

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[From the book, *Fiscal Relations in Four Countries: Four Essays,* Paul Boothe, ed. Ottawa: Forum of Federations, 2003]

PART 1: THE CONTEXT AND ISSUES

a) The importance of processes for adjusting federal financial relations

The allocation of financial resources to each order of government within a federation is a fundamental feature for its effective operation. It is the allocation of these sources that enable or constrain governments in the exercise of their constitutionally assigned legislative and executive responsibilities. Furthermore, taxing powers and expenditure are themselves essential instruments affecting the ability of the various governments within a federation to influence and regulate the economy.

But the issue is not simply one of constitutionally defining taxing and expenditure powers and intergovernmental transfers. Because the values of different revenue sources and the costs of different expenditure responsibilities inevitably change over time, no constitutional financial allocations can be expected to remain permanent. Consequently, all federations have found it necessary to establish processes and institutions for adjusting from time to time the intergovernmental financial relations. Among the elements requiring regular adjustment have been the vertical imbalances arising from changes in the revenue and expenditure requirements of each order of government, horizontal imbalances in the revenue capacities and expenditure needs among the different constituent units arising from different paces of development, the consequent need to adjust intergovernmental transfers in order to respond to these changing

imbalances, and the need to adjust arrangements for tax co-ordination in the light of changing conditions.

As a result, a major feature of intergovernmental financial arrangements in *all* federations has been the regular process of negotiation and bargaining between governments about these adjustments. In these continuing processes, federal-provincial (state) conflicts, conflicts between rich and poor provinces (states), conflicts between different interests in different provinces (states), and conflicts between political parties have all had to be accommodated.

b) The significance of context

While the need for processes facilitating regular adjustment to correct vertical imbalances in revenues and expenditures, horizontal imbalances, transfer arrangements and tax co-ordination is common to all federations, differing contexts affect the particular form that the processes of adjustment may take in a particular federation.

The adjustment of federal financial relations cannot, therefore, be considered purely analytically and technically in isolation from the particular social, political and constitutional context within which they occur. The processes and dynamics for adjusting federal financial relations are affected by the degree and kinds of social fragmentation and diversity and the particular form of the political institutions with which they interact: for instance, the degree and kinds of social diversity (linguistic, ethnic, religious, cultural and historical), how this diversity is territorially distributed, and whether this diversity is cumulatively reinforced or cross-cutting will have a significant influence.

The kinds of federal political and constitutional arrangements varies significantly among federations. The variables include the degree of legislative and administrative centralization and decentralization, the actual original constitutional allocation of taxing powers, expenditure responsibilities and provision for financial transfers, the extent to which there are areas of concurrent jurisdiction or constitutional requirements for administration of federal legislation by state governments, the extent to which financial arrangements for local government are embodied in the constitution or simply left to the discretion of provincial (state) governments,

the extent of intergovernmental collaboration, interaction and autonomy, and the degree to which government of constituent units participate in or influence federal government policy-making. These factors affect intergovernmental financial arrangements and the processes for their adjustment.

The dynamics of the intergovernmental bargaining related to the adjustment of financial relations are also affected by the extent to which governments at each level are characterized by the separation of executive and legislative powers, such as in the presidential and congressional systems in the United States and the Latin American federations, and in the Swiss collegial executive systems, or by fused parliamentary executives as in many of the Commonwealth and European federations. In parliamentary federations, the common tendency to predominance of executives in their legislatures has meant that the primary arena for negotiating adjustments to the financial arrangements has been through the processes of "executive federalism," focusing upon the executives representing the federal and provincial (state) units of governments.

Different combinations of interacting factors tend to require their own distinctive processes for adjusting intergovernmental financial relations. Technical financial solutions that do not take account of how they interact with the social, economic, political and constitutional context have therefore, in practice, tended to be counter-productive.

c) Issues arising in processes of intergovernmental financial bargaining

In the processes for adjustment of intergovernmental financial relations a number of issues commonly arise. One is reconciling the need for flexibility to adapt to changing conditions with the need to provide stable arrangements enabling governments to plan ahead. Another is the impact that changing financial arrangements may have upon the degree of centralization and decentralization with the federation. Also, there is the issue of the impact of changes increasing or decreasing the autonomy or dependency of one level of government upon the other. Yet another issue is the extent to which adjustments are reached collaboratively by the different orders of government working together, or unilaterally by different governments.

One particular issue arising in federations has been the extent to which the spending power of each order of government has been limited to its constitutionally specified legislative and executive jurisdiction or has, in the interests of flexibility, been broadly unrestricted. In most federations, governments have been understood to possess a *general* spending power, either as a result of judicial review and convention in the older federations or explicitly in the constitutions of many of the new federations (Watts 1999b). This has enabled federal governments to use this general spending power to pursue their own objectives in the areas of state or local jurisdiction by providing conditional cash transfers or matching grants to induce state or local governments to provide services or meet standards they could not otherwise afford. While widely used in many federations to facilitate flexibility and intergovernmental collaboration, this practice has often been contentious, being viewed as a way of distorting state or local priorities and subverting their autonomy. Consequently, in a few federations the exercise of the federal spending power in areas of exclusive provincial (state) jurisdiction has required the consent of representatives of the constituent units, either through their representatives in the federal second legislative chamber or through intergovernmental negotiations.

Broadly speaking, there have been two conflicting models for the adjustment of federal financial arrangements. One has been a centralist approach based on assumptions of federal government superiority for steering the national economy, and therefore giving the federal government a predominant or even unilateral role in adjusting the financial arrangements. The other is a federalist approach that assumes that the states or provinces should have a say in changes affecting their fiscal independence and, therefore, requiring mutual agreement among governments within a federation in the processes for adjusting financial arrangements. In practice there have often been elements of both these approaches, with the latter counteracting the former.

d) Procedures for adjusting financial relations

In terms of actual procedures for adjusting intergovernmental financial relations, four typical patterns may be identified (Watts 1999a: 53-5 and Table 13). In Australia, India and South Africa, although in different forms, standing or periodic independent expert commissions established by the federal government have been given the primary task of determining changes

to the distributive formula and recommending these to the federal parliament. A second pattern, found in Pakistan and Malaysia, is the constitutional provision for an intergovernmental council composed of federal and state representatives as the primary forum to reach agreement on modifications to the financial arrangements at periodic intervals. A third pattern is that found in Germany, Switzerland, Austria, the United States and Belgium, where grants to states are determined by the federal legislature with some effective formal participation by state governments, legislatures or interests within the federal institutions determining these transfers. A fourth pattern is that found in Canada, where the determination of financial transfers lies ultimately with the federal government whose legislature contains no effective representation of provincial governments or interests. While that is the formal situation in Canada, because of the importance of intergovernmental financial issues, in practice federal-provincial financial relations have been the subject of extended discussions in the extra-parliamentary arena of innumerable committees of federal and provincial ministers and officials, and the source of much political polemics between federal and provincial governments (Bird 1994: 304-305).

e) Canadian and Australian Experience

In considering processes for adjusting federal financial arrangements, this article focuses particularly on the Canadian and Australian experiences. These two have certain features in common (Bird 1994: 309-310). Each has a similar historical origin constituting an aggregation of former British colonies. Each has a British parliamentary system at both levels of government with the result that federal-provincial problems are resolved largely by the adversarial processes of "executive federalism." Each has a small number of provinces (states) but is dominated by two provinces or states that combined have a majority of the federal population. In each, formal constitutional amendment has been difficult to effect and, therefore, adaptation has had to be achieved through other evolutionary processes.

But there are significant differences, not the least in their federal financial arrangements. Taxing powers, as well as legislative and administrative authority, are far more centralized in Australia than in Canada. While both have equalization transfers, there is greater emphasis upon equity in Australia and more upon provincial autonomy within Canada. Regional differences are sharper in Canada, and in addition the linguistically and culturally distinct Quebec has no

parallel in Australia. It is not surprising then that there are noteworthy differences in the processes for adjustment of federal financial relations in these two federations.

PART 2: THE CANADIAN EXPERIENCE

a) The context

Canada, when it was federated in 1867, became the first federation in the world to combine federal institutions and the Westminster form of parliamentary institutions. This has created political dynamics quite distinct from the earlier federations with non-parliamentary executives established in the United States and Switzerland. The Canadian model is of interest because a number of federations established since, both in the Commonwealth and in Europe, have combined federal and parliamentary institutions. These include Australia, India, Pakistan (at certain periods), Malaysia, Nigeria (for a period), Germany, Australia, Belgium and Spain.

In terms of constitutional allocations of revenues, in Canada both the federal and provincial governments have broad taxing powers in the fields of personal and corporate income tax and sales taxes. The result is overlapping tax jurisdictions that make the taxation and revenue system rather complex. Their access to income taxes (personal and corporate) and sales taxes has enabled the provincial governments to finance a large portion of their expenditures out of their own revenues. Nevertheless, since the federal government also has access to these tax sources, there has always been a discrepancy between the revenue capacity of the provinces and their extensive expenditure responsibilities, which have included such expansive and expensive areas as health, education and social services.

There are also considerable differences in the size, population and economic wealth of the provinces that have resulted in variations among them in revenue capacity and expenditure needs. As a result, there has developed an extensive and complex system of intergovernmental transfers. However, with one exception there is no constitutional provision governing these transfers. The exception is the inclusion in the Constitution (added in 1982) of the commitment to a set of principles (but not the detailed formula) that are the basis of the equalization system. Section 36(2) of the *Constitution Act, 1982*, commits the federal government to “the principle of

making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation." Otherwise, in constitutional terms, the ultimate constitutional authority for determining financial transfers rests with the federal government and Parliament. The possible scope of such transfers is broadened by the fact that although there is no explicit constitutional provision for a "federal spending power" in areas of exclusive provincial jurisdiction, judicial interpretation of the Constitution has given the federal government a wide degree of discretion in how it chooses to use its spending power for purposes within areas of exclusive provincial jurisdiction (Watts 1999b: 3-6).

In examining the processes for adjusting financial relations within Canada, an important distinction that has to be recognized is that between constitutional provisions and actual practice. In strictly constitutional terms, the Canadian federal government is placed in a predominant position, both in terms of the scope of its legislative and executive jurisdiction and in terms of the allocation and adjustment of finances. In practice, however, because of the economic, linguistic and cultural diversity, political forces have over the years strengthened enormously the political leverage of the provincial governments. In the processes for adjusting the financial relations, although the constitutional authority ultimately lies with the federal government, the federal government has found it politically necessary to engage in extensive negotiations and bargaining with the provincial governments and to reach agreements with them regarding intergovernmental transfers and even some aspects of fiscal policy.

b) The processes for intergovernmental financial negotiations

Since major formal amendment of the Constitution in response to changing social and economic circumstances has proven to be extremely difficult in Canada, federal-provincial financial arrangements have evolved largely through the non-constitutional processes of intergovernmental relations. "Executive federalism," i.e., negotiations between the executives from each order of government, has produced adjustments to the arrangements for financial transfers from the federal government to the provinces. These have enabled the federal government to pursue general policy objectives in areas of exclusive provincial jurisdiction while

at the same time leaving the provinces a major role in designing and financing the programs that meet the federal government's Canada-wide objectives.

These processes have been flexible enough to accommodate many of the particular needs of the provinces, although the concerns of Quebec for a greater degree of fiscal and policy autonomy and of the larger and wealthier provinces such as Ontario and Alberta to pursue their own economic strategies have placed some strain on the arrangements.

Broadly speaking, two sets of transfers to the provinces have been developed. One intended to deal with vertical imbalances has evolved over the last forty years from a set of shared-cost programs relating separately to health, post-secondary education and social assistance into a single, major block transfer – the Canada Health and Social Transfer, instituted in 1996-7. Shared-cost constitutional transfers, often using 50 per cent sharing formulas, were abandoned for health and post-secondary education in 1977 and for welfare in 1996. The CHST transfers are now basically equal per capita transfers intended to assist the provinces in financing health, post-secondary education and social welfare programs. The conditions attached are so general as to make these transfers basically unconditional in character (Watts 1999b: 58).

The second set of transfers that has been developed are the completely unconditional equalization transfers intended to assist low-income provinces. As a result of intergovernmental negotiations, these too have evolved since the early post-World War II period. The Canadian equalization system has always focused on equalizing tax capacity differences across provinces; there is no attempt to equalize for differing provincial expenditure capacities or needs. Over the years, the representative tax system, which calculates equalization transfers on the basis of a province's ability to raise revenues from a given set of tax bases, used by the provinces has been modified in the light of experience. It now takes account of over forty tax bases in order to define a common tax base against which to measure the tax capacity of a province. This common tax base is derived from a representative set of five provinces (excluding Alberta and the four Atlantic provinces because of their distorting special circumstances). Provinces above the standard receive nothing (e.g., Alberta, Ontario and, for most of the recent past, British Columbia) while provinces that fall below the standard qualify for these transfers.

While the CHST and equalization block transfers now represent the largest proportion of transfers (generally over 85 per cent), there do remain some much more specific and smaller shared-cost programs in areas like highway transportation, immigration and infrastructure (Vaillancourt 2000: 209.)

In terms of the processes that have produced these arrangements, the key point to note is that while they have been implemented by the federal government under its constitutional authority, the evolution of these arrangements has been the product of intense intergovernmental negotiation and bargaining. In terms of the adjustments of financial arrangements, much of these deliberations have occurred in the frequent meetings of finance ministers (of the federal and provincial governments), supplemented by the even more numerous meetings at the bureaucratic level between civil servants in the federal and provincial governments. A significant feature is that even when the negotiations have related to health, post-secondary education or social assistance programs, it has been the finance ministers and their bureaucrats in the federal and provincial governments that have dominated the process. Nevertheless, sectoral meetings of other ministers or bureaucrats have also on occasion been involved. Where negotiations have become particularly critical, financial issues have sometimes been considered at First Minister's Meetings involving the federal prime minister and the provincial premiers. Not infrequently, in order for the provinces to develop a concerted strategy in relation to the federal government, financial issues have been discussed in advance at the Annual Premiers' Conference or at the various regional conferences of premiers.

Two other features of the Canadian intergovernmental financial relations should be noted. One has been the practice of permitting specific provinces to "opt out" of a particular federal-provincial scheme without financial penalty. This has provided an added flexibility, particularly in accommodating Quebec's insistence upon its distinctiveness and autonomy. The other is the development of co-ordinated tax-collection agreements. For most provinces, the federal government has collected the income taxes autonomously levied at different rates by the provinces on condition that they use a common, federally established base (all provinces except Quebec participate in the personal income tax collection agreements and all provinces except Alberta, Ontario and Quebec participate in the corporate income tax collection agreements). Unlike income taxes, sales tax harmonization is much less well developed in Canada, although

three Atlantic provinces (New Brunswick, Nova Scotia and Newfoundland) have fully harmonized their sales taxes, as a result of a financial incentive provided by the federal government. An agreement with Quebec has led to a harmonization in that province under which that province collects the GST (goods and services tax) for the federal government.

c) Summary and assessment

While the various intergovernmental meetings have been extensive and have been fundamental to the evolution of the system of financial transfers, and also to the arrangements for tax co-ordination, it has to be emphasized that these intergovernmental meetings have no constitutional status, nor are there formal rules such as voting requirements for decision-making. Their efficacy has rested simply upon the political leverage of the participants and upon reaching some sort of consensus that is then implemented by federal legislation. The federal government has played a leading role in the intergovernmental negotiations and bargaining, largely from the influence and inducements it can bring to bear from the use of its spending power and its ultimate constitutional ability to exercise this power unilaterally. However, the power and influence of the federal government is severely constrained by the fact that it lacks the constitutional jurisdiction to implement many policies. The federal government therefore has had to take care not to generate disagreements with the provinces that would then lead to resistance from the provinces to co-operating with the federal government on policy issues.

These intergovernmental negotiations have played a major role in enabling the adjustment of the federal financial relationships to respond over time to changing circumstances. Their informal character and the reliance upon intergovernmental consensus has meant, however, that a sense of trust between governments has been a crucial requirement. During the early 1990s the federal government's gradual reduction in projected funding increases of existing jointly financed programs, and its unilateral decision (in order to reduce its own deficits) to do so, left the provinces with the burden of compensating for this reduction of transfers. This made it increasingly difficult for the provinces to predict and plan their budgetary revenues and expenditures. As a result of the unilateral federal reduction in support for existing programs in the early and mid-1990s, the provinces became extremely reluctant to enter any new joint agreements with the federal government, thus exerting a considerable constraint on the ability of intergovernmental processes to respond to changing economic and social circumstances. This

illustrates how important the nurturing of a sense of intergovernmental trust is to effective processes for adjustment.

A recent effort to re-establish a sense of trust has been the Social Union Framework Agreement (SUFA) of 1999. As a result of provincial pressure, this agreement includes new limits on the federal use of its spending power, provides for advance consultations prior to renewal of or significant changes in social transfers to make federal funding more predictable for the provinces, and includes a dispute-resolution mechanism. Since this agreement was reached only recently, it remains to be seen what the long-term impact of the SUFA will be upon intergovernmental trust and consensus (Lazar 2000: 29-31).

PART 3: THE AUSTRALIAN EXPERIENCE

a) The context

Australia, when it became a federation in 1901, like Canada, combined federal and parliamentary institutions. But it added some unique adaptations, including a directly elected Senate in which the states are equally represented, together with a procedure that can in certain circumstances, when they fail to reach agreement, lead to the double dissolution of both houses of the federal Parliament. As in Canada, the combination of federal and parliamentary institutions has focused intergovernmental relations upon executive intergovernmental processes.

The major issues in the realm of federal finance have been: (1) correcting the relatively extreme fiscal imbalance arising from the considerably greater centralization of revenue raising in Australia by comparison with Canada; (2) fiscal equalization among the states taking account not only of differential revenue capacities but, unlike Canada, also of differential expenditure needs; and (3) co-ordination of public borrowing.

b) The processes for adjustment of federal financial relations

As in Canada, most of the institutions and processes for the adjustment of the Australian federal financial relations are not directly grounded in the Constitution but have evolved over the century of the federation's operation (Galligan 2000: 226). Exceptions were the formal constitutionalization by constitutional amendment in 1927 of the Loan Council, first established in 1923 to co-ordinate public borrowing; and the inclusion in the Constitution, from the beginning, of section 96 that explicitly extends the federal spending power to include possible payments to the states. While, as in Canada, many of the processes for adjusting financial-state financial relations and transfer were in Australia developed as a result of non-constitutional intergovernmental negotiation and agreement, in Australia there has been a much stronger tendency to establish formal institutions to facilitate these intergovernmental processes. Notable, for instance, have been the establishment of such formal bodies as the Loan Council (1923, and constitutionalized 1927), the Commonwealth Grants Commission (1933) and the Council of Australian Governments (1992).

The most contentious aspect of Australian federal financial relations has been the extreme vertical fiscal imbalance (1995: 226). This has been the result of two factors: first, as a result of judicial interpretation of the Constitution, the federal government has retained a monopoly over income taxation after the Second World War; second, the exaggerated judicial interpretation of "excise duties" has prevented the states from levying broad-based consumption or general sales taxes. As a result, the federal government levies the lion's share of revenue and the states are heavily reliant on federal transfers to meet their expenditure needs. Consequently, by comparison with Canada, in the mid-1990s intergovernmental transfers constituted 40.7 per cent of Australian state revenues, while in Canada the comparable figure was 19.8 per cent (Watts 1996a: 48). Although the proportion has varied over time, in recent years, virtually half of these in Australia took the form of unconditional general purpose assistance transfers (compared to over 90 per cent unconditional block transfers in Canada). These unconditional transfers have ensured some state autonomy in their application. Nevertheless, the states have no autonomous control over the size of these transfers. In an effort to address this vertical imbalance, when the federal government in 2000 instituted the new GST (goods and services tax, a form of VAT), it was agreed that the proceeds should be transferred to the states. While the revenue generated has

assisted the states, accountability for its levy remains out of state hands since the GST is levied by the federal government.

For a long period these issues were considered regularly at meetings of the Premiers Conference (the meetings of federal and provincial premiers) and adjustments were as a result made in both the substantial general purpose assistance grants and the functional special purpose grants. In this respect, the process of executive intergovernmental deliberations influencing federal adjustments was not unlike that in Canada. Since the 1980s, however, the allocation of these general revenue grants has been combined with the allocation of equalization transfers, and the Commonwealth Grants Commission (see below) has been given the task of recommending the allocation of the entire pool of general revenue grants to the states, although the Premiers Conference is still involved in negotiations about the overall size of the pool.

The development of financial equalization in Australia has gone through a number of stages. The need for assistance to poorer states was foreseen in the original constitutional provision enabling federal financial assistance to any state on terms and conditions the federal government saw fit (Galligan 1995: 221). From 1910 to 1933, ad hoc federal assistance was granted to some needy states. In 1933 this was made more systematic when the Commonwealth Grants Commission (CGC) was established to make independent recommendations to the federal government on the special claims of states. Over the forty years up to 1973 the CGC developed an elaborate fiscal equalization methodology, and its annual reports during that period were a rich source of material on the issues, concepts and methodology for tackling equalization issues. The stature and independence of the CGC was enhanced by the consistency with which the federal government accepted and implemented its recommendations.

In 1973 the role of the CGC was changed radically from that of recommending separate supplementary equalization grants to the "claimant states," to that of determining the "per capita" relativities for all states for establishing the allocation of the entire pool of general revenue grants to the states (including those dealing with the substantial vertical imbalances of revenue and expenditure). In this process, since 1981 the CGC has applied a comprehensive revenue and expenditure equalization methodology. Since 1989 the Territories have been included in its recommendations. When the new GST replaced the general revenue grants as the pool for the

distribution of transfers to the states in 1999, it became the CGC's responsibility to recommend the relativities for distribution, subject to overview by a federal-state ministerial council.

The current definition of the equalization program, as pronounced by the CGC in 1999, is that "State governments should receive funding from the Commonwealth such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the same capacity to provide services at the same standard."

The CGC methodology involves five steps: (1) preparation of a standard state budget of revenues and expenditures (with an implied balance); (2) measurement of disability factors in each state; (3) application of disabilities as a ratio of the national average to standard revenues and expenditures for each state; (4) aggregation of relativities for each state; and (5) application of the relativities for each state to the available revenue pool. This methodology produced in 1998-1999 relativities of 0.90032, 0.86273 and 0.94035 in New South Wales, Victoria and Western Australia, and of 1.00775, 1.20764, 1.61001, 1.10358 and 4.84095 in Queensland, South Australia, Tasmania, the Australian Capital Territory and the Northern Territory. The result was a variation in the per capita transfer from $1,010 in Victoria to $1,886 in Tasmania and $5,670 in the Northern Territory.

It should be noted that in contrast to Canada, the Australian process involves a representative tax *and* expenditure approach. The disability factors represent positive or negative deviations from the mean of state practices, reflecting both differing needs and costs that are measurable, significant and unrelated to policy preference (i.e., outside the control of a state government). In this assessment, considerable ongoing judgement is required on the part of the CGC. Not surprisingly, a continuing issue has been the scope of revenues and expenditures to be included in the calculations.

The CGC consists of four members appointed by the federal government. In the period since 1933, however, the CGC has established a reputation for independence. It has an official staff of about fifty, based in Canberra. It holds hearings, conducts site visits, has frequent meetings with state and territory Treasury Departments, and then exercises its discretion in making recommendations. The political context for its work is provided by the Financial Premiers Conference, which bargains over the terms of reference for the CGC reviews,

advocates an overall pattern for intergovernmental transfers and debates the effects and future of equalization. Ultimately, the final say on the amount of the pool of general revenue grants and other funds to which equalization is applied lies with the Federal Treasurer. The 1999 Agreement, basing the distributable pool including equalization upon the new goods and services tax, has given the states greater revenue certainty. In practice, federal governments in Australia have made few changes to the relativities recommended by the CGC. What debate there has been, has been over what funds get put into the distributable pool and what gets included in the formula in the first place.

Another area where Australia has developed a formal intergovernmental financial institution has been public sector borrowing. First established in 1923 and then formally given constitutional authority by a constitutional amendment in 1927, the Loan Council was composed of federal and state representatives, with a formal voting rule, and able to make decisions binding on both levels of government. Under the decision-making rule, each state had one vote and the federal government had two votes plus a casting vote (i.e., to carry the day the federal government had to have the support of at least two of the six states). By the 1990s, however, with the increasing resort to privatization and contracting out, the call on public borrowing had declined and the role of the Loan Council diminished. Its role has now been modified to that of limited collective monitoring (Galligan 1995: 232-234).

Yet another example of the institutionalizing of intergovernmental relations in Australia was the establishment in 1992 of the Council of Australian Governments (COAG). Its task has been to oversee the intergovernmental collaborative processes and particularly to make the Australian economic reunion more effective. Including not only the heads of the federal and state governments but also a representative of local government, it has systematized the organization, terms of reference and decision-making rules of the various sectoral intergovernmental ministerial councils that come under its overview.

c) Summary and assessment

A number of authors have singled out the elaborate Australian system for intergovernmental financial adjustments and equalization as a particularly distinctive feature of

the Australian federation (Gramlich 1984; Matthews 1994; Galligan 1995: 254). Like Canada, in Australia the processes for adjusting federal-state financial relations have been predominantly within the context of inter-executive negotiations and bargaining. What has distinguished the Australian approach from the Canadian, however, has been the much more extensive development of formal institutions for these processes. Although often not embodied in the Constitution, such bodies as the Financial Premiers Conference, the Commonwealth Grants Commission, the Loan Council and the Council of Australian Governments typify this approach.

Also contrasting with Canada has been the effort in the process of equalization to correct horizontal imbalances by taking account not only of variations in capacity to raise revenue but also of differences in expenditure needs (i.e., capacity to deliver services).

The Australian example is a particularly important one because it has been a pioneer among federations in developing formal procedures and institutions for the adjustment of federal-state financial arrangements, and because it has been the model that has most influenced many subsequent federations in Asia and Africa.

PART 4: CONCLUSION

The Canadian and Australian examples of processes for adjusting federal financial relations provide a number of common lessons:

(1) Intergovernmental interdependence is unavoidable in federations and collaboration between governments is essential. Because constitutional allocations of revenue sources and expenditure responsibilities can never be balanced precisely, intergovernmental adjustments in the form of transfers have proved necessary not only in Canada and Australia but in all federations.

(2) Federations require the establishment, either constitutionally or more often extra-constitutionally, of formal and informal processes and institutions for adjusting federal financial arrangements. These are needed both to correct inevitable vertical and

horizontal imbalances of revenues and expenditures and to adapt over time to changing values of revenue sources and costs of expenditure responsibilities.

(3) To preserve the principle that in a federation neither order of government should be subordinate to the other, the processes of adjusting financial relations should not be subject solely to unilateral determination by one or other order of government within the federation. In those cases where the constitution has assigned ultimate authority to the federal government to determine the level and scope of transfers, in both Canada and Australia federal political realities have generally forced the federal government to become involved in various processes of negotiation and bargaining with the provincial or state governments before applying adjustments to the financial arrangements.

(4) In parliamentary federations, of which both Canada and Australia are examples, intergovernmental financial negotiations and bargaining have typically taken the form of "executive federalism," i.e., negotiations between the executives and their representatives – first ministers, finance ministers and civil servants – of each of the governments within the federation. This has been because in parliamentary systems, although the executives are formally responsible to their legislatures, the executives through party discipline have in practice come to dominate this relationship.

While the Canadian and Australian models for adjusting federal financial relations share these fundamental features, there are also significant differences between them:

(1) Australia has relied much more on the establishment of formal processes and institutions to facilitate its processes of adjustment and co-ordination of financial arrangements, as exemplified by the Loan Council, the Financial Premiers Conference, the Commonwealth Grants Commission and the Council of Australian Governments. By contrast, Canada has relied almost totally on informal processes. The very recent Social Union Framework Agreement of 1999 marks a step towards more formal arrangements but it is too early yet to judge its effectiveness. The difference in approaches here would seem to stem both from the much more severe vertical imbalance of revenues and expenditures in Australia, imposing the need for substantial adjustments, and the extremely strong emphasis in Canada upon avoiding any arrangements that might undermine the autonomous activity

of either order of government. This contrast is illustrated by a notable ironic example. The 1991 proposals of the Government of Canada for constitutional reform included a proposal for an intergovernmental Council of the Federation as one new instrument for improving intergovernmental collaboration with a view to strengthening the economic union. In the subsequent intergovernmental deliberations, that proposal was abandoned because of the fears of some provinces that it might contribute to federal government dominance in the council, and because some provinces thought that a better alternative would be to strengthen the influence of the provinces in policy-making by establishing a Triple-E (elected, equal provincial representation, and effective) Senate. Ironically, just a year later in Australia (which since 1901 had had just such a Senate), the federal government and the states together agreed to adapt to their own uses the Canadian idea for a Council of the Federation by formally establishing their own intergovernmental Council of Australian Governments (COAG), its primary objective being to strengthen the economic union. Since its establishment, COAG has operated with varying levels of interest and influence.

(2) The differences between the Canadian and Australian processes for adjusting federal financial point to the significance of economic, social and political circumstances that influence these arrangements. For instance, among federations Canada clearly stands out in its emphasis upon provincial autonomy. The impact of Quebec's insistence upon provincial autonomy and the sharpness of economic and social differences among the other provinces have been important factors. Furthermore, the emphasis in the Canadian Constitution upon the exclusive legislative powers of each order of government and the fact that Canada has fewer constitutionally concurrent areas of jurisdiction than any other contemporary federation have reinforced this trend. A further factor is that provisions for representation of provincial governments or interests within the Canadian institutions of federal policy-making have been less than in any other contemporary federation because of the centrally appointed character of its Senate. Thus, federal-provincial bargaining on financial matters has had to focus in Canada, more than in any other federation, upon the extra-parliamentary informal processes of intergovernmental inter-executive negotiation. In Australia, where the social and political differences among the states, while significant, have not been as sharp, where the Constitution recognizes much larger areas

of concurrent jurisdiction, and where there has been a directly elected Senate, there has been less resistance to establishing formal processes and institutions for intergovernmental financial and economic collaboration.

(3) It should be noted also that differences in patterns of intergovernmental financial relations have reflected not only the particular character of the economy, social diversity and political institutions, but also the values and political culture of the particular society. Thus, for instance, in Australia the prevailing emphasis upon equity has led to the stronger drive for full equalization of revenue and expenditure capacity, affecting the character of its intergovernmental financial relations. By contrast, the Canadian federal financial relations have reflected the character of the Canadian federation in which issues of equity have been counter-balanced by a strong emphasis upon ensuring the autonomy of each order of government.

The two examples, Canada and Australia, examined in this article point to the importance of the processes of financial adjustment in each federation and of the effectiveness of collaborative processes that sustain an appropriate balance between governments within the federation. At the same time, the differences in their experiences also point to the need for such processes to be adapted to the particular circumstances of each federation.

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