Budgetary Federalism:

Balance of Interests and Contradictions

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1 Introduction

Historically, a federal system was a departure from the paradigm model of the nation state. Sovereignty is divided in practice, however rationalised in theory. Citizens have rights and obligations in relation to at least two levels of government. People within the national territory are subject to different laws, differently administered, depending on where they live. There are some public decisions in relation to which the national majority is not entitled to prevail. Government is more complex. Democratic accountability correspondingly is more difficult to secure.

Given this tension with traditional democratic principles, why are federal forms of government adopted? A somewhat defensive explanation is that, for practical reasons that differ between federations, unity is not possible but union of some kind is sought. More positively, however, at least for some communities, the divergence from the paradigm may be a virtue. Divided sovereignty limits power and acts as a brake on its abuse. Diverse populations may be better served by multiple loyalties and the flexibility to tailor law to local circumstances. Democracy may be enhanced by making governments more responsive to local needs and increasing the opportunities for democratic participation.

All federations combine principles of federalism with those of representative government. Each federation is designed to capture the benefits of the former without unduly jeopardising democratic accountability. Typically, this involves three elements. The first is a deliberate judgement about what should be done centrally and what should be the responsibility of constituent units. The second is the establishment

of a set of democratic institutions within each jurisdiction, operating broadly in accordance with the same principles that apply to their counterparts in unitary systems. The third, qualifying the second, is the institutional representation of the constituent units at the centre, at least in an upper House of a bicameral legislature.

Federal systems necessarily also divide responsibility for budgetary decisions. Because of the significance of such decisions, the manner in which this is done can have a profound effect on the federal division of power as a whole. Equally importantly for present purposes, however, the nature of budgetary decisions means that the division of responsibility for them affects representative government as well. Approval of taxation and expenditure by the elected representatives of the people is recognised as a central constitutional principle in all democratic systems, whatever the other differences between them. The authority of popularly elected Parliaments over taxation and expenditure is the mechanism through which, in the last resort, they can hold governments to account. Interference with these arrangements, as is common in federations, suggests the need for compensating procedures, to secure democratic accountability. Ironically, the relative reluctance of courts to intervene in budgetary decisions, which is attributable to their nature, raises questions for the protection of federal principle as well.

This paper explores the design and operation of systems of budgetary federalism. Its purpose is to identify the implications for both federalism and representative government of the way in which responsibility is divided, in form and in practice and of the way in which budgetary decisions are made. The paper is divided into two substantive parts. The first deals with the instruments of budgetary federalism: expenditure, revenue-raising and revenue redistribution. The second deals with the process by which budgetary decisions are made and with the tensions between federalism and representative government.

In preparing the paper, I have drawn on the series of national reports, from Australia[1], Germany[2], Japan[3], The Netherlands[4], Poland[5], France[6] and the United States of

[1] Alexander Reilly
[2] Werner Heun
[3] Mitsuaki Usui

America[7]. Between them, they reflect a wide variety of differences in constitutional systems that are important for the purposes of this subject. In particular, they offer a contrast between civil law[8] and common law federations[9]; formal federations[10] and unitary systems in which local government[11] or distinct territories[12] have some constitutionally guaranteed autonomy; presidential,[13]semi-presidential[14] and parliamentary[15] approaches to representation; systems that constitutionally mandate co-operation between jurisdictions[16] and others that use more informal procedures[17]; supra-national[18] and national federal structures.[19] The Australian paper also draws attention to a further dimension of the theme: the application of the principles of budgetary federalism to indigenous communities, seeking a measure of autonomy in governing their own affairs.

The conclusions of the paper bear out the hypothesis suggested by the title of this session. Fiscal federalism, like all other aspects of federalism, balances the competing interests of centre and constituent units. The more extensive notion of budgetary federalism, however, requires a further balance to be struck, between the demands of federalism on the one hand and representative government on the other. This is a notoriously difficult exercise. It is further complicated by the changing world context, including the ambiguous effects of globalisation that appear, paradoxically, to call both for increased central co-ordination and for greater local control. The design and operation of budgetary federalism are likely to be topical and contentious issues for some time to come.

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[4] H.G. Warmelink
[5] Wlodzimierz Nykiel
[6] Robert Hertzog
[7] Laurence Claus
[8] Germany
[9] The United States and Australia
[10] Australia, Germany and the United States
[11] Japan, The Netherlands, Poland, France
[12] The Netherlands
[13] The United States
[14] France, Poland
[15] Australia, Germany, Japan, The Netherlands.
[16] Germany, Japan, The Netherlands. Australians differ over the extent to which their Constitution is "co-operative": Australian Report, 16. On any view, however, it has some express co-operative features: see, for example, section 51(xxxvii); section 77(iii).
[17] As a generalisation, Australia and the United States
[18] The European Union; see in particular Dr H.G. Warmelink, "Budgetary Federalism: Financial Relations of The Netherlands" and Professor Hertzog "Le Systeme Financier Local en France".
[19] Australia, Germany, the United States.

2 Instruments of fiscal federalism

(1) Introduction

Fiscal federalism engages two governmental powers in particular. The first is the power to spend. The second is the power to raise revenue, principally through taxation but also through borrowing and the imposition of charges of various kinds. This part examines the interests at stake in dividing these powers between governments in a federal system and in determining the extent and manner of their devolution to local government within a single jurisdiction.

These interests are complex. While on one view expenditure and taxation are merely another two functions that, like all governmental powers, require allocation between jurisdictions for the purposes of federalism, their nature and significance raise additional considerations. Some go to the heart of the federal model and determine where the balance lies between substantial jurisdictional autonomy and more mutually supportive arrangements. Others affect the operation of the federal system in practice. Collectively, the powers to tax and to spend are central to the broader task of fiscal and economic management, which generally is not assigned specifically as an area of federal competence but which requires attention nevertheless. Over time, its performance tends to concentrate fiscal power at the centre, whatever the formal constitutional allocation of power may be. This tendency in turn explains the significance of the third dimension of the topic of budgetary federalism: the allocation of revenue receipts between jurisdictions. Each of these dimensions is dealt with separately below.

(2) Spending

Superficially, the federal division of the power to spend might be expected to match the general division of functions or powers. On this assumption, the scope of the power to spend is likely to be a significant issue only where the division of powers is constitutionally controlled, which typically occurs in a federal system.[20] On this

[20] It may occur in relation to local government as well, as is the case in Germany (Basic Law Article 28) and Japan (Constitution Article 94). See also the discussion of the significance of a general competence power in France: Hertzog, op.cit. 6.

assumption also, the manner of the division of power over spending will be affected by the design of the federal model. Common law federations such as the United States and Australia typically divide powers vertically, by reference to subject matter, or substantive function. In these federations, all stages of decisions with respect to an assigned function tend to lie within the competence of the jurisdiction concerned.[21] In Germany, by contrast, as Dr Heun notes, "the competences for legislation, administration and adjudication are assigned to different levels of government".[22] Under this model, power to spend in principle should lie with the jurisdiction with responsibility for administration and thus, in many cases, with the Lander.[23]

In fact, in no federation is the outcome as straightforward as the model suggests. The differences between these two distinct approaches to the division of power, however, make it convenient to deal with them separately. In the common law federations of the United States and Australia, the question of the alignment of the division of power over spending with the general distribution of powers is significant for the integrity of the federal design. To the extent that the spending power is broader than the substantive power assigned to the centre, it has the potential to undermine the division of power, either directly, by enabling national spending programs in areas not otherwise within national power or indirectly, through conditional grants to the constituent units. In such a case, a broad spending power may affect the principles of representative government as well, by providing an incentive to avoid recourse to the legislature, beyond the bare requirements of legislative appropriation.

In both the United States and Australia the central power to spend exceeds the substantive assigned powers. In the former, as Professor Claus argues in his national report, the scope of the spending power[24] is set to attract new attention, in the wake of Supreme Court decisions restricting the reach of the commerce clause.[25] Battle may not yet have fully been joined; on present indications,[26] however, the limits on the

[21] Cheryl Saunders "Administrative Law and Relations between Governments: Australia and Europe Compared" (2000) 28 *Federal Law Review* 263-290. There is a partial exception in Australia for adjudication: Constitution sections 73, 77 (iii).
[22] National Report; see also W. Heun, "The Evolution of Federalism" in C. Starck (ed) *Studies in German Constitutionalism* (1995), 167.
[23] See Basic Law Articles 83, 104a.
[24] Generally regarded as derived from Article 1 section 8 clause 2.
[25] *United States v Lopez* 514 US 549 (1995).
[26] *South Dakota v Dole* 483 US 203 (1987)

power to spend, if any, are vague and difficult to enforce. In Australia, the spending power is more explicitly tied to the allocation of Commonwealth power but extends beyond it to encompass at least whatever is required by the "character and status of the Commonwealth as a national government".[27] Ironically, in Australia, the development of the direct spending power may have been inhibited by an express constitutional power to make conditional grants to the States,[28] which has been held effectively to be unlimited, subject to some small, unrealised potential to infringe other constitutional guarantees and the need to avoid legal coercion.[29]

There is another possible limit on the scope of the spending power in federations where the Constitution requires uniformity of federal taxation. In the United States the argument for such a limit is strengthened by the derivation of the spending power from the power to tax "to pay the Debts and provide for the common Defence and general Welfare of the United States". In his national report, Professor Claus argues for a requirement that federal spending be "common and general", thus precluding use of the spending power to deny federal benefits to the people of any State that declines to accept grant conditions affecting the exercise of State power. This argument has not (yet) found acceptance: in *Dole* itself a majority of the Court upheld the validity of legislation[30] authorising a proportion of federal highway funds to be withheld from a State in which the purchase or possession of alcohol by a person under 21 was lawful. In Australia, the spending power is distinct from the power to tax, but the latter is qualified by a prohibition on "discrimination between States or parts of States".[31] A similar issue thus arises, at a general level: can the grants power be used to undermine the guarantee of non-discrimination in taxation? So far the answer is yes, although blatant avoidance may now be unwise.[32] The courts have also refused to accept that a grant program constitutes a "law of revenue" for the purposes of the prohibition against preference in section 99.[33]

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[27] *Victoria v Commonwealth & Hayden* (*AAP case)* (1975) 134 CLR 338, per Mason J.
[28] Australian Constitution, section 96.
[29] For an analysis see Cheryl Saunders "Towards a Theory for Section 96: Part 1", (1987) 16 *Melbourne University Law Review* 1.
[30] 23 USC § 158.
[31] Section 51(ii).
[32] *W.R. Moran Pty Ltd v Deputy Federal Commissioner of Taxation (NSW)* (1940) 63 CLR 338
[33] *Victoria v Commonwealth* (1926) 38 CLR 194. Section 99 precludes preference between States or parts of States in any "law or regulation of trade, commerce or revenue".

Inquiry into why the spending powers have developed in this way throws some light on the dynamics of the jurisprudence of fiscal federalism. Central flexibility to spend in the national interest has practical attraction, at least in circumstances in which there is no regulatory competition with the States. Coupled with the generality of the constitutional provisions to which the spending power is attributed, and the legally "non-coercive" character of spending, these may affect the willingness of courts to involve themselves in the oversight of decisions of governments and legislatures in matters of this kind. Thus in the United States, Professor Claus notes that the Court itself has "questioned whether 'general welfare' is a judicially enforceable restriction at all".[34] Similarly in Australia, as long as the spending power was attributed to the requirement for moneys to be appropriated "for the purposes of the Commonwealth" there was a view with significant judicial support that such purposes were for the Parliament to determine.[35] By the time that view prevailed, the source of the spending power was attributed instead to the executive power, to the extent that the Commonwealth was 'engaged' in the funded activities.[36] Mere payment to a recipient, however, may still be authorised by an appropriation, once characterised as a "rara avis in the world of statutes...[which] does not create rights, nor ...impose duties", and thus is not susceptible to constitutional review.[37]

The very different model used to divide power in Germany makes it less likely that questions about the scope of the constitutional power to spend will arise. Nevertheless, under the German model a problem of a different kind arises, about the source of the means for meeting expenditure where Lander act as agents for central authorities[38] or co-operative arrangements are involved.[39] The Basic Law anticipates the difficulty of this departure from the norm, by requiring the Federation to meet the resultant expenditure or conferring power on the Federation to apportion the expenditure.[40] Whatever questions of principle are raised by the exercise of this power in practice, this provision has the advantage of drawing attention to the issue. By

[34] United States National Report, quoting *South Dakota v Dole* 483 US at 207 n.2
[35] *Attorney General for Victoria v Commonwealth (Pharmaceutical Benefits* case) (1945) 71 CLR 237, per Latham CJ and McTiernan J.
[36] *Victoria v Commonwealth & Hayden* (*AAP case)* (1975) 134 CLR 338, per Mason J
[37] Ibid.
[38] Basic Law chapter VIII
[39] Basic Law chapter VIIIa
[40] Article 104a

contrast, the funding of additional obligations imposed by federal decisions on constituent units in the United States and Australia is treated almost entirely as a political issue.

(3) Revenue-raising

Public moneys may be raised in several ways: by taxation, charges of various kinds and borrowing. This part of the paper focuses on taxation. Increasing reliance on revenue raised through charges and fees, which is a current phenomenon in many countries, driven by the philosophy of "user-pays", may have implications for representative government. From the standpoint of federalism, however, it presents no special difficulty. Charges are likely to be closely linked with particular functions, and thus to be dependent on the general division of power. Borrowing raises more complex questions in practice, if the jurisdiction with power to spend does not have adequate taxation resources of its own. Nevertheless, with the notable exception of Australia, most federal Constitutions assign power to borrow to each jurisdiction with power to spend, implicitly or explicitly.[41] For this reason the issue of borrowing is considered later, in the context of central surveillance of sub-national budgets, in which it most frequently is raised.

Taxation in a federal system raises two types of issues. The first is the division of power to impose taxation. The second concerns limits of other kinds, if any, on the power to tax. Both are dealt with below. A potential third issue, the manner of the collection and allocation of revenue raised by taxation is postponed to the next part.

(a) Division of taxation power

The division of power to impose taxation in a federation is affected by two competing sets of considerations. The principles of both federal autonomy and representative government suggest the need for each jurisdiction to be self-sufficient in raising revenue, or at least as self-sufficient as possible. This may be achieved by conferring a general power of taxation on each jurisdiction, leaving the actual assignment of taxes to be sorted out in practice, on the basis of pragmatic considerations, including

the effects of interjurisdictional competition. Alternatively, particular taxes may be assigned to the centre and others that are more local in character to constituent jurisdictions, so as to try to achieve a balance of taxation resources and expenditure needs. On the other hand, macro-economic considerations, particularly at a time of intense international economic competition, tend to favour greater centralisation of taxation power. Similarly, taxpayer resistance to multiple tax burdens or duplicated procedural requirements creates pressure for some rationalisation of taxation arrangements in federations, which in practice is likely to lead to centralisation.

There are two standard models for a vertical division of powers in a federal Constitution, through which self-sufficiency may be achieved. Specified powers may be allocated concurrently to both centre and constituent jurisdictions[42] or some or all powers may be allocated exclusively to a chosen sphere of government.[43] Usually, in such cases, the division of taxation powers broadly follows the scheme for the general division of powers. Problems specific to taxation nevertheless may arise, drawing attention again to the differences between powers associated with fiscal federalism and other, more substantive, powers. For example, where taxation power is divided concurrently there may be a question about whether inconsistency is possible, giving paramountcy to federal law, as happens in other functional areas. In Australia, at least, the answer so far appears to be that there can be no inconsistency between a federal and State taxation law, because a power to tax for federal purposes is qualitatively different from a power to tax for State purposes.[44]

Particular forms of taxation, moreover, may call for a departure from the general model for the allocation of powers. Most obviously, even in a "free competitive system", where concurrent powers are the norm, the imposition of customs duties is likely to be assigned exclusively to the centre, to secure the customs union that is a characteristic of all federations. It is possible to analyse such a case as a conflict between the conceptual design of the federation and the specific goal of achieving a customs union, in which the latter has prevailed. Given the competing considerations

[41] Central governments in unitary systems, in contrast, generally exercise legal control over borrowing by devolved units: see, for example, s. 5 Local Government Finance Act, Japan.
[42] As in the United States and Australia
[43] As in Canada

identified earlier, it is sometimes tempting to identify other goals that might be met through exclusive central powers over taxation, justifying further departure from the general model. Thus in Australia, exclusive power to impose duties of excise has been conferred on the Commonwealth as well[45] and has been explained by the High Court as necessary to secure to the Commonwealth "a real control of taxation of commodities".[46] As the Australian example shows, however, the greater the departure from the general model the greater the need to make compensatory provision and the greater the difficulty of doing so in a manner that is consistent with underlying constitutional principle.

There are at least two important variations on the standard vertical assignment of tax powers that typifies common law federations.[47] Both are more consistent with a horizontal division of powers, exemplified by the German federal model. Nevertheless, they have potential attraction both in common law federations and in some devolved systems, as a response to the pressures for centralisation and improved macro-economic management. One variation centralises the imposition of taxation but constitutionally assigns all or part of the proceeds of particular taxes to the constituent jurisdictions.[48] This technique will be considered again in the next part, in the context of the allocation and reallocation of tax revenues. Suffice it to say here, however, that it represents an interesting compromise between local autonomy and central fiscal management. Its effectiveness and acceptability depends on the procedures by which central decisions about taxation are made, to ensure that the responsibilities and interests of all jurisdictions are taken into account. In Germany this is achieved through the Bundesrat,[49] which for this purpose has no counterpart in the common law federations. The second variation also centralises the imposition of taxation (and may also assign the proceeds) but in addition allows each constituent jurisdiction to adjust

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[44] *State of Victoria v Commonwealth* (1957) 99 CLR 575 per Dixon CJ [40]. The link suggested in Dr Heun's paper, between revenue authority and object authority may suggest the same idea (p.6).
[45] Australian Constitution section 90
[46] *Parton v Milk Board* (1949) 80 CLR 229, 260
[47] Cf France, National Report, op.cit. 8
[48] Basic Law, Article 106. In Australia, the proceeds of the federal goods and services tax presently are assigned to the States by legislation: A New Tax System (Commonwealth-State Financial Arrangements) Act 1999 (Cth) section 13
[49] Basic Law article 105(3)

the rate of central tax, within limits, for its own purposes.[50] Again, the effectiveness of this technique suggests the need for some co-operation at the time at which the central taxation is imposed, so as not unacceptably to erode the tax base to which the adjustments may be made.

(b) Limitations on the power to tax

In a federation, there may be limitations on a power to tax beyond restrictions on the types of taxation that may be imposed. This section considers three types of such limitations. The first affects the capacity of the centre to use its taxation power to discriminate between constituent jurisdictions. The second concerns the territorial limits on taxes imposed by constituent jurisdictions. The third deals with the capacity of governments in a federation to tax each other.

The Constitutions of both the United States and Australia preclude use of the federal power of taxation to discriminate between States. In the United States, indirect taxes, including federal income taxes,[51] are subject to the requirement in Article 1 section 8 of the Constitution that "all Duties, Imposts and Excises shall be uniform throughout the United States". In Australia, reacting against the difficulties encountered in the United States with both the concept of uniformity and the distinction between direct and indirect taxation, the federal power to tax provides that taxation must not be levied so as to "discriminate between States or parts of States".[52]

Provisions of this kind are attributable to the constitutional significance of sub-national organisation in federal systems. They are designed to prevent the centre from unfair treatment of the people organised in their constituent units, using formal inequality as a relatively simple measure of unfairness. Thus defined, however, fairness is secured at the expense of the capacity of the centre to assist the people in particular regions in time of need. By contrast, in a unitary system such as Japan, the Constitution may recognise a principle of uniformity in taxation but may also allow

[50] Constitution of Poland, article 168; Scotland Act 1998 Part IV. In Japan, the general consumption tax at the prefecture level is a proportion of the national tax: Usui, op.cit. p.5. Legislation to authorise State tax surcharges or rebates was enacted in Australia in 1978, but never used: Income Tax (Arrangements with the States) Act 1978 (Cth).
[51] XVI amendment, Constitution of the United States

departure from it where there are "sound reasons" for doing so in the case of a particular area. It is an apparent paradox of the federal form of government that constitutional barriers against the abuse of federal power may also preclude beneficial action to assist underprivileged regions.

These considerations throw light on some of the standard problems that have arisen in connection with the interpretation of limitations of this kind on the power to tax. One such problem is whether guarantees of uniformity or non-discrimination should be given substantive rather than formal effect. A substantive interpretation would permit variations in taxation to suit the different needs of different regions, although at the cost of exposing the courts to evaluating the constitutionality of legislation on unfamiliar bases, to which they may be unsuited. Another problem, which has arisen in both the United States and Australia despite the differences in the wording of their respective Constitutions, is whether any departure from uniformity by reference to geographical area is permitted. In both countries, the courts at various times have sought to isolate discrimination between the States "as... States",[53] or by reference to the political identity of States,[54] from discrimination by reference to "neutral factors"[55], which may at times include geographical differences. It is difficult in practice to draw such distinctions, as Professor Claus' analysis of *Ptasynski* shows.[56] The prudent course thus is assume that non-discrimination implies uniformity, however much that may hinder the capacity of a central government to adjust its fiscal policies to assist needy regions. The hindrance would be greater still if the prohibition on discrimination between States in taxation were construed to require corresponding limits on spending; a conclusion that so far has been resisted in both federations.[57]

Unlike the legally sovereign state itself, all sub-national jurisdictions, whether in a federal or unitary system, are likely to have limited power to legislate extraterritorially. In a unitary system, such limits can be attributed to the extent of the power that is delegated to sub-national authorities. The hybrid status of sub-national

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[52] Section 51(ii)
[53] *R v Barger* (1908) 6 CLR 41, 107-8
[54] *United States v Ptasynski* 462 U.S.74, 78 (1983)
[55] 462 U.S.at 85
[56] Claus, op.cit. 19
[57] See for example *South Dakota v Dole* 483 US 203 (1987); *Deputy Federal Commissioner of Taxation v Moran* (1939) 61 CLR 735

units in a federal system calls for a different explanation. Sometimes territorial limits are inherent in the constitutional powers of sub-national jurisdictions: the power of Canadian provinces to make laws in relation to property and civil rights in the province" is an example.[58] Where a power is capable of having effect outside geographical boundaries, however, there will be a question whether some more general territoriality principle applies. Potentially, taxation is such a power, unless the taxation that may be imposed is tied to a geographical tax base, as is the case, for example, with land tax. The issue arises in both the United States and Australia, where the States have broad constitutional powers to tax. In both countries, the courts have accepted that a valid exercise of the powers require a "nexus" between the subject matter of the legislation and the State concerned. Superficially, the rationale is different. In Australia, territorial limits originally were attributable to the colonial status of the States. They are now justified by the need to avoid conflicts between the laws of constituent units in a federal system.[59] In the United States, territorial limitations are attributed to the federal commerce clause and the due process requirements of the 14th amendment, rather than to the demands of federalism per se.[60] In both cases, however, the territoriality principle plays a role in avoiding duplication.[61]

A third type of limit concerns the capacity of the respective spheres of government to tax each other. This issue is not confined to federations; the question whether it is appropriate for governments to pay tax arises within a unitary system as well.[62] In a federation the issue tends to arise in a more acute form, however. Where an immunity exists, it is likely to be entrenched by the Constitution, by implication if not expressly, on the grounds that it flows directly from the federal relationship itself.

Again, this is an issue that typically arises within a common law federation, as a consequence of the manner in which power is distributed. In both the United States and Australia, the courts have held that the central government effectively is immune

[58] Constitution Act 1867, section 92(13)
[59] *Union Steamship Co of Australia v King* (1988) 166 CLR 1
[60] *National Bellas Hess Inc v Department of Revenue of Illinois* 386 US 753 (1967)
[61] *Goldberg v Sweet* 488 US 252, 261 (1989)
[62] See for example, Professor Usui's report on Japan, p. 6.

from State taxation.[63] In the United States, a further principle has been developed to protect those dealing with the central government from discriminatory taxation on this ground.[64] While sometimes attributed to the structure of the federation, these conclusions can be justified on the grounds of democratic principle as well, in the sense that the federal government, as taxpayer, is unrepresented in State legislatures by which taxes are imposed.[65] In both countries, moreover, the centre can use its position of constitutional supremacy to protect its agencies and those with whom it deals from State taxation, as long supporting central power can be found.[66]

In both countries also, the States enjoy some limited immunity from federal taxation. The principles are similar; the States are immune from taxation that would discriminate against them or impair their existence or capacity to function.[67] Typically, immunities of this kind are implied from the nature of the federation established by the Constitution. In Australia, in addition, the property of each sphere of government is given express immunity from taxation by the other.[68] The High Court has explained the purpose of the section as to protect the "financial integrity" of the Commonwealth and the States.[69] Nevertheless, the concept of a "tax on property" has been narrowly construed, to distinguish taxes on the holding of property, which fall within the protection of the section, from taxes on transactions affecting property, which do not.[70]

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[63] *New York v United States* 326 U.S. 572 (1946), cited in Professor Claus' national report; *Essendon Corporation v Criterion Theatres Ltd* (1947) 74 CLR 1

[64] See the cases cited in Professor Claus' national report, p. 10. There is probably a similar rule in Australia, which has not developed so clearly because the practical tax base of the Australian States is so much smaller: see, however, the reasoning in *Gazzo v Comptroller of Stamps* (1981) 149 CLR 277 .

[65] See the discussion of *Washington v United States* 460 US 536 (1983) in Professor Claus' national report. In Australia, Dixon J cited "the nature of the Federal Government, its supremacy, the exclusiveness or paramountcy of its legislative powers, the independence of its fiscal system and the elaborate provisions of the Constitution governing the financial relations of the central government to the constituent States" in explanation of the immunity: (1947) 74 CLR 1, 22.

[66] For the United States, see Professor Claus' national report, p. 7. For Australia, see *Australian Coastal Shipping Commission v O'Reilly* (1962) 107 CLR 46; but cf.*Gazzo v Comptroller of Stamps* (1981) 149 CLR 277, in which the Commonwealth was found to lack power to exempt from a non-discriminatory State tax an instrument of transfer executed pursuant to an order of a court exercising federal jurisdiction.

[67] *South Carolina v Baker* 485 U.S. 505, cited in Professor Claus' national report, p. 8; *State Chamber of Commerce and Industry v Commonwealth* (1987) 163 CLR 329

[68] Constitution section 114

[69] *Commonwealth v Queensland* (1987) 162 CLR 74 per Mason, Brennan and Deane JJ

[70] Ibid.

(4) Revenue allocation

(a) Introduction

In a system in which the allocation of tax-raising powers were neatly aligned with the expenditure obligations of each jurisdiction, it would be less relevant to consider separately the question of revenue allocation. With the possible exception of the United States, this rarely occurs, however. In consequence, the principles and procedures for revenue allocation and re-allocation between jurisdictions are important components of the budgetary arrangements for most federations. In this regard, moreover, the issues that arise are often shared with unitary countries, which have devolved power to sub-national jurisdictions, and which finance sub-national functions or co-operative arrangements through revenue allocation in various forms.[71] Broadly similar issues arise also in connection with the European Communities and the Union, where reasons of history, democratic legitimacy and accountability suggest that taxes should continue to be raised nationally, necessitating transfers of various kinds to the European level.[72]

Revenue raised by one jurisdiction may be allocated to others with or without conditions attached. An allocation of general revenue, to be spent at the discretion of the recipient jurisdiction, compensates for the concentration of capacity to raise revenue and recognises the entitlement of the recipient to share in the proceeds. General revenue allocation thus is a response to the centralisation of taxation power in the interests of fiscal management or taxpayer convenience, as in Germany and Australia.

In many federations the Constitution explicitly or implicitly also allows revenue to be transferred on condition from one jurisdiction to another.[73] In this case, revenue reallocation becomes a means by which the revenue-raising jurisdiction (usually the centre) can influence the policies of other jurisdictions, to correct regional disparities[74] or to secure objectives of its own.[75] Depending on the scope of the central

[71] France, National Report, op.cit. 7
[72] Warmelink, op.cit. 9
[73] In the United States the power derives from Article 1 s 8; in Australia from section 96; in Germany from Article 104a. See generally the national reports from the United States, Australia and Germany.
[74] Heun, op.cit. 9

spending or grants power, this mechanism may enable the centre to direct the way in which sub-national powers are exercised or not exercised and local revenues are spent. In this case, in practice, it may modify the constitutional allocation of powers for federal purposes. The extent of the modification may be minimised by revenue substitution, which in turn can be countered by a requirement for matching payments, at the cost of further inroads into sub-national budgetary autonomy.[76] Typically a conditional grants power is not coercive, so that sub-national jurisdictions cannot be forced to accept revenue offered on unpalatable terms. In practice, however, political and economic pressures may make it difficult to decline a grant.

General revenue allocation is consistent with federal principle, but departs from traditional accountability principles by breaking the nexus between taxing and spending. Superficially conditional grants more closely approximate the traditional expectation of representative government that the jurisdiction that raises the taxes is responsible also for their expenditure, although the autonomy of sub-national governments in a federal system is likely to inhibit central scrutiny of expenditure to a degree. Budgetary federalism tends to be characterised by ongoing tension between the use of untied allocations, which recognise sub-national autonomy but preclude central control of expenditure and conditional grants, which extend national policy making capacity at the expense of local autonomy. Comparable tension can be identified in many unitary systems as well.[77]

The remainder of this part focuses on two aspects of general revenue allocation that raise additional questions of principle. The first is the process of vertical distribution, by which the total to be allocated is determined. The second is the manner in which the total is distributed horizontally, between recipient jurisdictions. In practice the two processes are sometimes, but not always, distinct.

[75] For example the proposed response of the Clinton administration to the invalidation of the firearm possession laws in *United States v Lopez* 514 US 549 (1995), cited in Claus, op.cit.
[76] Heun, op.cit. 9

(b) Vertical distribution.

If a concentration of revenue raising capacity necessitates allocation of some of the revenues to other jurisdictions, there are questions about the basis on which this is to be done and the rationale for it.

The approach most conducive to the autonomy of the recipient jurisdictions, which also assists to clarify the locus of accountability, is to constitutionally assign the proceeds of particular taxes to particular jurisdictions. The German arrangements are of particular interest in this regard. Article 106 of the Basic Law provides that the revenues from income tax, corporations' tax and turnover tax are to accrue to the Federation and the Lander jointly, pursuant to a broad constitutional framework.[78] Similarly, in what Professor Warmelink describes as the "semi-federal" context of the Netherlands Antilles, the proceeds or parts of the proceeds of particular taxes raised by the country are compulsorily transferred to the insular land territories.[79] In Australia a range of different mechanisms has been used. For much of the 100 years of Australian federation revenue has been redistributed in accordance with a formula prescribed by federal legislation or even, in more recent decades, pursuant to a Commonwealth executive undertaking to maintain the previous level of revenue allocation in real terms.[80] Since 2000, however, the proceeds of the new Goods and Services tax have been assigned to the States by Commonwealth legislation.[81] It is too early to tell whether the GST will be perceived over time as effectively a State tax, albeit imposed and collected by the Commonwealth for reasons of convenience and constitutional validity.[82]

The formal assignment of the proceeds of taxes raised by one jurisdiction to meet the expenditure needs of others acknowledges sub-national autonomy while retaining the convenience of national imposition and collection. It also creates a need for co-

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[77] See the national reports from The Netherlands, Japan and Poland.
[78] Dr Heun points out that these taxes yield approximately 2/3 of total tax revenue: Heun, op.cit. 7
[79] op.cit. 5.
[80] Cheryl Saunders "Federal Fiscal Reform and the GST" (2000) 11 *Public Law Review* 99.
[81] A New Tax System (Commonwealth-State Financial Arrangements) Act 1999, section 13
[82] There is presently some controversy over whether the GST should be presented as a Commonwealth or a State tax in the budget papers: see 2002-3 Budget Paper No.1, Appendix A; Pat Barratt, "Financial Reporting by Governments – the Road to Damascus" November 2001, http://www.anao.gov.au/

operation and co-ordination, however, with considerable potential for friction if the need is not met. The nature and purpose of co-operation depends on particular arrangements that are in place. In Germany, where the Basic Law requires agreement on the apportionment of some taxes the formal mechanism for co-operation is the Bundesrat, which must consent to the legislation by which the apportionment is made.[83] The consent of the Bundesrat is also required to legislation imposing or varying the shared taxes themselves.[84] In Australia an early attempt at tax sharing failed, in part because the Commonwealth did not adequately recognise the significance of consultation with the States on changes to the shared tax base. By contrast, the GST legislation provides that the rate and base "are not to be changed unless each State agrees to the change."[85] While the requirement is almost certainly legally unenforceable, it has some political significance. In a less welcome acknowledgement of State interest in the tax, the arrangements also require the States to meet the costs of administration of the tax,[86] creating a need for further intergovernmental agreement over tax administration budgets and performance.[87]

(c) Horizontal distribution

Revenue raised by the centre for expenditure by sub-national jurisdictions must be distributed between them in some way. One option is to distribute revenue by reference to "local yield" or, in other words, the proportionate contribution of each jurisdiction to the total available for distribution. This option most closely simulates arrangements under which each jurisdiction taxes for its own purposes. Any other basis for distribution of the total between jurisdictions, even by reference to population numbers, takes need into account in some way. These other options thus involve a subsidisation of some units by others, directly or through the filter of the centre. In this sense, they amount to "equalisation", although the term tends to be reserved for arrangements that have explicit regard for economic and social disadvantage. Even where revenue is distributed initially by reference to local yield a

[83] Article 105; see also Dr Heun's reference to the "very arduous round of discussions" between federal government and Lander, in determining the quota for distribution of the VAT: op.cit. 7-8
[84] Article 105(3)
[85] A New Tax System (Commonwealth-State Financial Arrangements) Act 1999, section 11.
[86] Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations 1999, clause 37
[87] 2002-3 Budget Paper No.3, *Federal Financial Relations 2002-2003*,8.

subsequent process of equalisation may occur. This is the case in Germany, for example, where the Basic Law itself requires "reasonable equalisation of the financial disparity of the Lander".[88]

The practice of equalisation is not confined to federations.[89] It has some interesting additional dimensions in federations, however, due to the tension between sub-national autonomy and the implications of nationhood.[90] On the one hand, federations that use fiscal equalisation demonstrate some commitment to national solidarity, in the form of diminishing the disparities in circumstances between constituent jurisdictions. On the other hand, the commitment to sub-national autonomy, by definition associated with federations, tends to mean that equalisation funds are not tied to function or task. In these circumstances, equalisation can do no more than improve the capacity of disadvantaged regions to improve their own conditions and offers no assurance that improvement will occur or even be attempted.[91]

In many countries, equalisation principles are confined to measurement of fiscal capacity including, potentially, access to a broad range of revenues, extending beyond taxation resources alone. Even in these cases, an element of expenditure need may be built into the calculations if, for example, fiscal capacity is measured on a per capita basis. In other countries expenditure needs are taken directly into account. Thus in both Japan and Australia a complex exercise is undertaken regularly to identify revenue and expenditure categories, to determine standards and to calculate the shares of the redistributed revenue to which each jurisdiction is entitled.[92]

(5) The interests and contradictions of fiscal federalism

The fiscal arrangements for any federation exemplify the tensions within federalism itself, between unity and diversity, or union and sub-national autonomy. These

[88] Article 107(2); Heun, op.cit. 10
[89] Japanese national report, p.9; see also the particularly interesting practices in the equalisation of funds between jurisdictions within the Kingdom of The Netherlands: Warmelink op.cit.3
[90] Dr Heun notes that the German Constitutional Court requires that equalisation arrangements "find the appropriate middle ground between autonomy, individual responsibility and the preservation of the individuality of the Lander on the one hand, and the common solidarity and the joint responsibility for their existence and autonomy on the other hand": op.cit.11.
[91] Heun, op.cit. 9
[92] Usui, op.cit. 10; Reilly, op.cit.9

tensions lie principally between the centre and sub-national jurisdictions, although in certain circumstances they may also divide the regions themselves, between rich and poor or powerful and weak. In the context of fiscal federalism, the tensions between centre and regions are manifested in various ways, including competing views of an appropriate assignment of tax powers and the oscillation between tied and untied grants that characterises many federations in practice. Tensions between regions typically surface in debate about the extent of fiscal equalisation,[93] but may also be seen in the inconsistency between constitutional prohibitions on central discrimination in taxation, but not on discrimination in spending. In a sense, they are typified by the apparent paradox that federalism encourages resort to fiscal equalisation but discourages imposition of a mandatory requirement for the funds to be used to eliminate disadvantage. From the perspective of federal principle, this is not a paradox at all, but an example of federalism in action.

Fiscal federalism also raises some additional, qualitatively different issues, however. In part this is due to the characteristics of the instruments employed[94] and in part to the significance of the interests at stake. Thus, in some federations, the central power to spend is more extensive than central power to make laws and, on one view, unlimited. Doctrinally, this may be explained on the ground that a power to spend is not coercive, as a matter of law, and thus is less susceptible to judicial review. Its effect on the operation of the federation in practice, however, may be profound. Distinctive issues arise also in connection with taxation power. Ambiguity about whether taxation is a substantive power in its own right or merely a mechanism for raising money for the business of government underlies the doubt that exists in Australia about whether inconsistency between tax laws is possible. The intrusive nature of taxation including, perhaps, its traditional association with sovereignty helps to explain why, in both the United States and Australia, governments enjoy a degree of immunity from taxation by each other.

[93] In Germany, Dr Heun reports that equalisation of the former East German Lander has been achieved largely through use of central funds: National Report, op.cit. 9. A review of the system is presently under way in Australia: see "Review of the Allocation of Commonwealth Grants to the States and Territories, Background Paper", commissioned by the "donor" jurisdictions of New South Wales, Victoria and Western Australia.

[94] Professor Hertzog makes observations to similar effect: op.cit. 2.

These issues are not confined to federations. As a generalisation, however, in non-federal systems, their significance is proportionate to the priority given to autonomy at the sub-national level, simulating in part the tensions within federalism. Recurring themes in central/local relations, in systems under which local governments have substantial legal autonomy, include the balance between general and specific purpose funding,[95] the scope and underlying philosophy of fiscal equalisation[96] and the bases on which general revenue allocations from the centre to local units are made.[97] Where local government has constitutional status, there may be additional questions about the meaning and effect of sections affording constitutional protection, including the scope of local power to tax[98] and local entitlement to basic financial resources[99]. Where local government is a significant third sphere in a federal system, a particular question may arise about its relationship with the centre, including the extent to which it can receive funds directly from the centre.[100]

The analysis so far has been confined to the balance of interests and contradictions within fiscal federalism. The next section deals with the tensions between fiscal federalism on the one hand and representative government on the other as the second, important dimension of budgetary federalism.

3 Representative government in a federation

(1) Fiscal aspects of representative government

Typically, representative government is given practical effect through a presidential, semi-presidential or parliamentary system. For present purposes, all three share some key principles. A legislature, comprising elected representatives of the people, authorises the imposition of taxation. The moneys thus raised are credited to a central fund. The legislature authorises withdrawals from the fund, for expenditure purposes.

[95] Poland, National Report, op.cit. 3; Germany, National Report, op.cit. 15; The Netherlands, National Report, op.cit. 10
[96] Poland, National Report, op.cit. 5; Japan, National Report, op.cit. 9; Germany, National Report, op.cit. 15; Australia, National Report, op.cit. 22 (equalisation payments to indigenous communities)
[97] Poland, National Report, op.cit. 3; Japan, National Report, op.cit. 5; Germany, National Report, op.cit. 13; The Netherlands, National Report, op.cit. 5;
[98] Japan, National Report, op.cit 4;
[99] Germany, National Report, op.cit. 15;
[100] Germany, National Report, op.cit 16;

Mechanisms are established to monitor compliance with expenditure authority. In this way, those who raise taxes are responsible and seen to be responsible for their expenditure and can be held to account for it. In addition, in a parliamentary system, the power to refuse to appropriate moneys is the ultimate sanction that ensures executive responsibility to Parliament and facilitates the removal of a government that has lost the confidence of the House on which its existence depends.

This section considers the impact of federalism on the operation of these principles. Superficially they are consistent with federalism, in the sense that most federations accept the budgetary autonomy of all jurisdictions as a necessary and appropriate feature.[101] In this respect, a federation is distinguishable from other systems, in which the principles of representative government require the elected national legislature to exercise ultimate control.[102] On the other hand, budgetary autonomy in a federal system is rarely, if ever, complete. All federations involve extensive intergovernmental interaction, at least in practice and often by deliberate design. Co-operative arrangements are a familiar phenomenon, whether mandated by the Constitution or not.[103] The degree of interdependence tends to be particularly marked in fiscal matters, for reasons that have been canvassed already.

Federalism affects budgetary autonomy and hence the fiscal principles of representative government at the centre, as well as in sub-national jurisdictions. The nature of the conflict differs substantially between spheres, however. For this reason, they are treated separately below.

(2) The budgetary autonomy of sub-national jurisdictions

The budgetary autonomy of sub-national jurisdictions typically is diminished by two sets of factors. The first is a shortfall in the own tax sources of sub-national jurisdictions and their consequential reliance on revenue reallocation. The second is central surveillance of the economic decisions taken at sub-national level, with or without a constitutional mandate for doing so.

[101] Heun, op.cit. 4
[102] Hertzog, op.cit., 5; Nykiel, op.cit. 3
[103] National Report, Australia, op.cit. 15

The traditional fiscal principles of representative government are best preserved in a federation by assigning to each sphere adequate tax powers for its own purposes, obviating the need for revenue transfers and maintaining the link between taxing and spending. In this case, each jurisdiction functions as a unitary system within the powers allotted to it. The United States most closely approaches this model, the use of conditional grants aside. No other federation does so. Where a federal Constitution authorises joint tasks, which by definition involve two jurisdictions, or the effective delegation of tasks from one jurisdiction to another, complete budgetary autonomy is impossible for this reason as well.[104]

The main difficulties for compliance by sub-national jurisdictions with fiscal accountability principles are as follows. In most federations, sub-national governments derive substantial revenue from sources other than the moneys raised by their own legislatures. In addition to this disturbance of a key accountability mechanism, this also means that such government lack control over the amounts available for expenditure, inhibiting economic planning. In making expenditure decisions, moreover, they are not subject to the same pressures for fiscal restraint that apply to governments that need to approach the taxpayers themselves, to fund new initiatives. Legislative control can be reasserted by subjecting transferred revenues to a requirement for legislative appropriation. The other difficulties are less tractable, within a dualist federal model. Outside that paradigm, however, the example of Germany suggests another way in which problems of accountability and public perceptions of accountability at the sub-national level can be met: by a constitutional assignment of the proceeds of taxes to sub-national jurisdictions on a basis that establishes their right to them and authority for them. Unless the arrangements are transparent, however, this will improve accountability at the sub-national level at the expense of the accountability of the central legislature, under the authority of which the taxation has been imposed.

Conditional, specific purpose or categorical grants raise similar difficulties in a more extreme form, from the standpoint of sub-national jurisdictions. All federations,

[104] Germany, National Report, op.cit. 3

including the United States, use payments of this kind.[105] They represent another source of funding for sub-national governments over which their legislatures have no necessary suasion. Moreover, by definition, they are tied to purpose, requiring the exercise of sub-national authority in a ways for which there can be little, if any, accountability to sub-national legislatures. Dr Heun notes the potential for categorical grants to be substituted for other moneys that might otherwise have been spent program in question, leaving the sub-national jurisdiction with as much effective discretion over expenditure as it had before (incidentally defeating the intention of the central government and legislature).[106] As he also notes this effect can be avoided by requiring central funds to be matched by the sub-national jurisdiction, albeit at further cost to the budgetary autonomy of the latter in determining use of its own funds.

It would be unusual for a federal Constitution specifically to allocate a power over national economic management to the centre.[107] It would be difficult to maintain a meaningful vertical division of powers, in such a case. Economic management takes place even in federations, however. Pressure for it increased markedly over the decade of the 1990s, in the face of the surge of international economic competition that, for a time, accompanied the end of the cold war. In practice, in most federations the centre has some capacity to monitor and control sub-national budgetary decisions, whatever the theoretical position. In some cases this power is explicit. Thus in Germany, for example, the Federation can enact a budgetary law that applies to both the centre and the Lander.[108] An example of a different kind comes from Australia, where intergovernmental agreements about borrowing have enabled substantial control of State borrowing decisions by the Commonwealth since the 1920s and which in more recent times have been used to ensure transparency in public borrowing decisions, including introduction of minimum standards for the financial information that must be included in the budget papers of each State.[109] More often, central influence is less formal, effected through intergovernmental co-operation and consultation,

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[105] Professor Claus notes that in 1993 conditional payments to the States totaled $195 billion. In Australia, in 2002-3, grants subject to a condition of some kind are estimated to amount to $22.3 billion. By contrast, approximately $30 billion is estimated to be paid in general revenue funds, including the proceeds of the GST ($29.4 billion).
[106] Op.cit. 9
[107] Although see Basic Law Article 74 (11), (16), which may come close to it.
[108] Article 109(3)
[109] 2002-3 Budget Paper No. 3, *Federal Financial Relations 2002-02*, 33.

underpinned by the relatively greater financial strength of the centre, which is a feature of most federations. In European federations, further control is exerted through the budgetary restrictions imposed by the Treaty of European Union.[110]

Whatever its source, this phenomenon also disturbs traditional accountability principles. Government join together to make decisions about taxing, spending and borrowing; or at least are influenced by other governments in the decisions that they make. To this extent, the normal lines of accountability are affected. The problem, such as it is, can be partly overcome by the transparency of intergovernmental deliberations. Typically this is not the case, however; in part from habit and in part in the interests of encouraging frankness, through confidentiality, in the dealings of governments with one another.

(3) Budgetary autonomy at the centre

Some of the impediments to the untrammelled operation of the fiscal principles of representative government at the centre are the mirror image of the difficulties of sub-national jurisdictions. In other words, many of the steps that might be taken to improve the fiscal accountability of sub-national jurisdictions worsen the position centrally, and vice-versa. Thus, from a central perspective, conditional grants are to be preferred to general payments because they enable greater control over the expenditure of moneys raised by central taxation, still falling short, however, of the scrutiny that the centre can exercise in relation to its own expenditure. Similarly, formula-based general revenue grants leave the centre free to make its own decisions about the incidence and administration of its own taxes, and in this sense are preferable to tax-sharing, which necessitates some consultation with sub-national jurisdictions. In practice, all federations strike a balance between these extremes. In principle, as argued earlier in relation to sub-national jurisdictions, these difficulties are partly overcome by a constitutional or other legal framework that imposes and legitimises alternative lines of accountability for taxing and spending.

[110] Hertzog, op.cit. 11; Heun, op.cit. 5.

Other forms of intergovernmental co-operation, considered in the earlier part in relation to sub-national jurisdictions, may affect the accountability of the centre as well, although generally in less acute form. The point may be illustrated by the Australian example.[111] The co-operative borrowing arrangements that operated between 1927 and 1995 applied to Commonwealth as well as State borrowing, with exceptions for defence and borrowings for "temporary purposes". The Commonwealth government was in superior position on the Loan Council, partly because its view almost invariably prevailed, for a mixture of systemic and practical reasons and partly because, pursuant to the Agreement, the Commonwealth borrowed on behalf of the States as well as on its own behalf.[112] Commonwealth failure to comply with the Agreement, by proposing to borrow for its own purposes without Loan Council authority, nevertheless contributed to the fall of the Commonwealth government in 1975 and precipitated legal action in the courts.[113]

There is one final respect in which federalism alters the principles of representative government, which has particular relevance for the centre. The design of most federations involves the representation of sub-national jurisdictions in central institutions.[114] Typically, this is achieved through an upper House of a bicameral legislature. Typically also, such a House is given substantial power, in recognition of its role in the federal structure. Generally, this means that the House has the authority at least to reject, and in some cases to amend, financial legislation. In both the United States and Australia, the power of the Senate may be attributed initially to the federal design, although in both cases the Senate now plays a relatively limited federal role. In Germany, by contrast, the Bundesrat is an essential operating feature of the federation, providing the means by which Lander endorsement is deemed to be obtained for a range of central decisions on fiscal questions of direct significance to them.

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[111] Another Australian example is provided by the interdependence of Commonwealth and the States in connection with the Goods and Services tax, discussed earlier in the context of the vertical distribution of general revenue funds.
[112] Australia, National Report, op.cit. 5
[113] Cheryl Saunders "Government Borrowing in Australia", (1989) 17 *Melbourne University Law Review*, 187
[114] See also the observations in Hertzog, about the constitution of the French Senate: op.cit. 17

Such arrangements represent a departure from traditional principles in the sense that the authority of the House elected in proportion to population is shared with and diluted by the authority of a House constituted on other bases. In a parliamentary system, in which a government depends on appropriations by the Parliament in order to continue in office, the existence of an upper House with a financial veto power may be more significant still. Whatever the constitutional position, in practice the outcome tends to be a compromise between the competing sets of principles. Most upper Houses in federal systems, which have power over financial legislation, use it sparingly or, in the words of Dr Heun, "with much reserve".[115] By this means, for the most part, actual conflict between principles is avoided.[116]

4 Conclusions

The conclusions of this comparative study may be stated briefly.

There is nothing surprising in the hypothesis that federalism involves a balance of interests and contradictions. Choice of a federal form of government suggests pre-existing interests. By its nature, federalism seeks to balance the competing forces of unity and central power on the one hand and diversity and sub-national autonomy on the other. This process is evident in budgetary federalism, as well as in other aspects of federal design. In the budgetary context, however, it takes particular additional forms. These are attributable to the nature of budgetary instruments and the significance of the issues at stake. The design or operation of budgetary federalism can affect the rest of the federal balance.

In the case of budgetary federalism, the interests and contradictions are not confined to the federal features of the system but also involve the interface between federalism and representative government. All aspects of a federal form of government affect representative government to a degree, but none more so than the financial arrangements. Resolution of the potential conflict invariably is a compromise, which

[115] Germany, National Report, op.cit. 4
[116] Nevertheless, it materialised in Australia in 1975, when a government with a majority in the House of Representatives lost office after it failed to secure the passage of Appropriation legislation by the Senate

is not necessarily stable. Cycles that alternately favour the financial interests of the centre and of the sub-national units are a familiar phenomenon in most federations.

There are two paradigm federal models each of which, in a pure form, meet these challenges better than most. One is the United States common law federation, with its vertical division of legislative, executive and judicial power, in which each jurisdiction is a broadly autonomous budgetary unit, allowing the principles of representative government relatively free rein. The other is the German civil law federation, characterised by its use of a horizontal division of power. While the German model also acknowledges the principle of budgetary autonomy for constituent jurisdictions, there is substantial jurisdictional interdependence, both in structure and in practice. The potential for conflict with representative government is met by acknowledging this interdependence in an explicit constitutional framework, giving some legitimacy to the development of new accountability principles. By contrast, the Australian federation incorporates elements of both models, complicating resolution of the tension between federalism and fiscal accountability principles. Constitutionally, the Australian federation is similar to that of the United States. In practice, however, fiscal power is substantially centralised. The effects of the de facto interdependence of Commonwealth and States are handled through arrangements that for the most part have no constitutional base, are complex and opaque and rely largely on political will for their enforcement.

Finally, comparison between the formal federations and the other non-federal systems represented in this study suggests that the differences between them are less than might be supposed, at least in relation to fiscal matters. For historical and political reasons, relations between a sovereign state and its dependent jurisdictions may parallel the federal relationship in many respects, as the example of the Kingdom of the Netherlands shows. Even in the more familiar context of local or regional government within an essentially unitary system, the apparently increasing tendency to provide a constitutional framework for the devolution of power[117] gives local levels a degree of autonomy and some protection from the will of the centre. In these circumstances, questions about the assignment of tax powers and the allocation of

[117] Possibly with encouragement from international economic organisations: Hertzog, op.cit. 3

financial resources are similar to those raised in many formal federations, enabling effective comparisons to be made.