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**Financial relations in comparative perspective**

1. This essay aims to reassess the use of federal arrangements when addressing institutes, mechanisms, and machineries that scholars usually include among ‘intergovernmental financial relations’. It is indisputable that financial relations are the most relevant features (if not the essential characteristics) of what, paraphrasing Friedrich, we may term as “federalising and regionalising processes.”<sup>1</sup> Revenue and spending powers – as well as solidarity mechanisms – allow subnational units and local government to finance and carry out their functions; and these tiers of governments are thus enabled “*in achieving their policy objectives within their constitutionally assigned legislative and executive responsibilities*”<sup>2</sup>.

However, a rapid and rough survey of the different federal (and regional) constitutional designs discloses a lack of homogeneity in the ways financial federal arrangements are enhanced. Constitutions set indeed different mechanisms for the allocation of financial powers – and financial relations take different forms and often serve distinct functions in different constitutional contexts.

Such a survey reveals that different constitutional designs adopt differentiated concepts of ‘financial relations’. First, these may be treated as a subject matter included in the list of specified heads of legislative powers assigned to the different levels of government, such as in Canada – and, to a bigger extent, in South Africa.<sup>3</sup> As for the Canadian constitutional legal system, sec. 92(2) of the *Constitution Act 1867* expressly limits provincial taxing power to “the raising of a revenue for provincial purposes”.<sup>4</sup> Second, financial relations may be considered as the presupposition allowing constitutionally assigned legislative and administrative responsibilities to work. In South Africa, the Constitutional Court construes revenue-raising powers as a legislative subject matter. In *Premier: Limpopo Province v Speaker: Limpopo Provincial Legislature and Others* (CCT 94/10) [2011] ZACC 25, and in *Premier: Limpopo Province v Speaker of the Limpopo Provincial Legislature and Others* (CCT 94/10) [2012] ZACC 3, the Constitutional Court established that only the National Parliament enjoys “*plenary legislative power within the bounds of the Constitution*”, whereas “*the legislative authority of provinces is circumscribed [...] Provinces have no power to legislate on a matter falling outside Schedules 4 and 5 unless it is a matter ... expressly assigned to the province by national legislation ... Financial management of provincial legislatures is a matter that is listed neither in Schedule 4 nor in Schedule 5 to the Constitution. It follows, therefore, that it is a matter that falls within the legislative competence of Parliament*”.

Third, the distribution of finance, in general, and the assignment of revenue-raising powers, in particular, may reflect the allocation of functions. This approach was typical in dual-federalist approaches such as that of the early federative period of the USA, Canada, Australia and Switzerland, where the financial autonomy and the discharge of responsibilities matched the distribution of

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<sup>1</sup> See C. J. Friedrich, “New Dimensions of Federalism,” 57 *Proceedings of the American Society of International Law at Its Annual Meeting (1921-1969)* (April 25-27, 1963), 238-240; C. J. Friedrich, *Trends of Federalism in Theory and Practice* (New York: Praeger, 1968), 24; M. Burgess, *In Search of the Federal Spirit: New Comparative Empirical and Theoretical Perspectives* (Oxford: Oxford University Press, 2012).

<sup>2</sup> R. L. Watts, *Comparing Federal Systems* (Montreal et al: McGill-Queen’s University Press, 3<sup>rd</sup> edition, 2006), 106.

<sup>3</sup> See section 214 of the 1996 Constitution. See below 6.

<sup>4</sup> See P. W. Hogg, *Constitutional Law of Canada* (Toronto: Carswell 2011, 5<sup>th</sup> edition), 6-21. See also *Reference re legislative jurisdiction of Parliament of Canada to enact the Employment and Social Insurance Act* (1935, c. 48), [1936] S.C.R. 427, at 434-435, per Duff C. J. Dissenting. The words “for provincial purposes” might be given a restrictive operation: “the power to legislate for taxation [...] is concerned with taxation for the purpose of raising monies for the exclusive disposition of the local legislature”.

legislative powers – and such approach is still the operational rule in Switzerland<sup>5</sup>. As for the USA, dual federalism was the rule in financial relations before 1913 – that is, when the XVI Amendment was eventually ratified: the Congress and subnational legislatures could only impose taxes in those fields the constitution assigned to them; and national and subnational taxing powers were limited to the raising of revenues only for their respective purposes.<sup>6</sup>

Further, financial relations imply autonomy and fiscal responsibility: each level of government should rely on appropriate proceeds in order to finance its own expenditures. On the one hand, such *correspondence* between proceeds, functions and expenditures is the “golden rule” that traditionally governs federal relations in the USA, in Switzerland and in Germany.<sup>7</sup> On the other hand, correspondence presides the distribution of both tax bases and legislative powers related thereto, since taxes shall be levied or collected under the authority of law.<sup>8</sup>

There also are exceptions to this rule – and therefore the allocation of revenue legislative powers does not necessarily correspond to the same criteria presiding the distribution of legislative competences. This is particularly apparent in Austria, where legislative and revenue powers between the *Bund* and the *Länder* are allocated according to different criteria. Whereas the distribution of legislative powers is enshrined in the federal Constitution (*Bundes-Verfassungsgesetz* – hereinafter: B-VG), revenue powers are set forth in the ‘special’ Financial Constitution Act of 1948 (*Finanz-Verfassungsgesetz* – hereinafter: F-VG), to which article 13 B-VG expressly refers.<sup>9</sup>

2. Despite this variety, it is possible to examine the different mechanisms implementing financial relations, to detect analogies and differences between them, and therefore to outline the major models through which subnational responsibilities are financed.

For this purpose, this essay will use the method that falls under the umbrella of comparative legal studies,<sup>10</sup> which has proven to be extremely useful in cross-national analyses. Comparative law does not merely aim at systematising “the legal material of one legal system, also using the knowledge of other legal systems for the purpose”; but it also aims at “verifying similarities and differences, classifying institutions and systems, ordering knowledge and creating prescriptive models”.<sup>11</sup>

It follows that comparative legal scholars are accustomed to examine a vast array of forms of financial relations – and, when addressing these relations, they usually propose classifications, which are the outcome of an analysis of the different federal and regional constitutional designs. The comparative method permits the detecting of analogies and differences between federal constitutional designs resting on the above-mentioned mechanisms of revenue and spending powers. It then allows us to classify the different mechanisms and to group them on the ground of their common traits. Finally, it

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<sup>5</sup> See Article 47.2 of the federal Constitution amended in 2004 (and entered into force in 2008): the Confederation “*shall leave the Cantons with sufficient sources of finance and contribute towards ensuring that they have the financial resources required to fulfil their tasks*”. See G. Kirchgässner, “Swiss Confederation,” in A. Shah and J. Kincaid (eds.), *The practice of Fiscal federalism: Comparative Perspectives* (Montreal et al.: McGill-Queen’s University Press, 2007): 318-343, at 329; G. Kirchgässner, “Finanzföderalismus in der Schweiz”, in Peter Bußjäger (eds.), *Perspektiven des Finanzföderalismus in Österreich* (Innsbruck et al.: Studienverlag, 2013): 39-70, at 46 et seq.; R. Kägi-Diener, “Art. 47”, in B. Ehrenzeller, P. Mastrorardi, R.J. Schweizer, K. A. Vallender (eds.), *Die schweizerische Bundesverfassung* (Dike-Schulthess: Zürich/St. Gallen-Basel/Genf, 2008), 875-881.

<sup>6</sup> See *Pollock v. Farmers’ Loan & Trust Company*, 158 U.S. 601 (1895). See L. H. Tribe, *American Constitutional Law* (Foundation Press: New York, 2000): 842-843; W. Fox, “The United States of America,” in A. Shah and J. Kincaid (eds.), *The practice of Fiscal federalism*, at 349 et seq.

<sup>7</sup> See below, para 3.

<sup>8</sup> See, among others, sections 91(3), 92(2) and 92(9) of the *Constitution Act 1867*; section 83 of the *Commonwealth of Australia Constitution Act 1900*; section 265 of the Indian Constitutions; section 96 of the Constitution of Malaysia.

<sup>9</sup> See P. Bußjäger, “Reforms on Fiscal Federalism in Austria”, in Gerhard Robbers (ed.), *Reforming Federalism - Foreign Experiences for a Reform in Germany* (Peter Lang, Frankfurt am Main et al., 2005): 59-67; M. Stelzer, *The Constitution of the Republic of Austria. A Contextual Analysis* (Hart Publishing, Oregon and Portland, 2011): 153.

<sup>10</sup> On the comparative method see, among others, R. David, *Les grands systèmes de droit contemporains* (Paris: Dalloz, 1974); R. Sacco, “A Dynamic Approach to Comparative Law (Installment I of II)” 39(1) *The American Journal of Comparative Law* (Winter 1991), 1-34; R. Sacco, “A Dynamic Approach to Comparative Law (Installment II of II)” 39(2) *The American Journal of Comparative Law* (Spring 1991), 343-402; K. Zweigert and H. Kötz, *Einführung in die Rechtsvergleichung auf dem Gebiete des Privatrechts* (J.C.B. Mohr, Tübingen, 1996), 31 et seq.; J. C. Reitz, “How to Do Comparative Law” 46(4) *The American Journal of Comparative Law* (Autumn 1998), 617-636; P. G. Monateri (ed), *Methods of Comparative Law: an Intellectual Overview* (Cheltenham-Northampton: Edward Elgar Publishing, 2012).

<sup>11</sup> L. Pegoraro, “The Comparative Method and Constitutional Legal Science: New Trends”, in A. Mordechai Rabello and A. Zanotti (eds.), *Developments in European, Italian and Israeli Law* (Milan: Giuffrè, 2001), 113-129, at 117.

orders knowledge and devises “prescriptive models”, which are “a synthesis of complexity by logical categories” useful for the advancement of comparative legal studies.<sup>12</sup>

The comparative method thus highlights the unitary function of financial relations: the power of levying taxes, of imposing fees, as well as equalization mechanisms allow constituent units to fully discharge their constitutional<sup>13</sup>. Financial relations thus concur in enhancing both responsibility and accountability of the constituent units, and preserve their constitutional “*guaranteed autonomy*”<sup>14</sup>.

This unitary function underpinning the different forms of financial relations take under the different federal and regional constitutions, permits to detect what we may label as the ‘common traits’ that allow handling the variety of forms and therefore to group them and devise those prescriptive models of intergovernmental financial relations.

Hence, this common traits uphold a classification of the different mechanisms of intergovernmental financial relations – and the proposed classification allows us to organise what we have already defined as the complexity and heterogeneity of forms financial relations take and therefore include these multifarious mechanisms into three categories: ‘revenue powers’, ‘equalization mechanisms’, ‘spending powers’.<sup>15</sup> Further, the comparative method examines the way these mechanisms interrelate under federal and regional constitutions. In this regards, proceeds transferred to constituent units under equalization mechanisms count as a part of the revenue side. Solidarity is construed as to provide subnational units with additional funds: on the one hand, funds increase constituent units’ fiscal capacity; on the other, they support the discharge of responsibilities.

The comparative method thus makes it possible to offer that synthesis of complexity and to “systematically organise knowledge” required under legal taxonomies and categories.<sup>16</sup> This is particularly true when it comes to assess how constitutions allocate revenue powers – that is, the “tax-assignment problem”, as scholars with a background in public finance term it.

Federal and regional constitutions have recourse to several mechanisms for allocating revenue-raising powers among the orders of government. To this extent, they stipulate that raising powers are exclusive, concurrent or shared. In addition, revenue-raising powers can be allocated at the federal level, which in turn distributes the financial resources between the different tiers of government. Criteria presiding the distribution of revenues are set forth in the Constitution (as in Germany and Switzerland), in acts at legislative level (as in Belgium, Italy, Spain), in agreements signed between federation and constituent units (as in Austria). Anyway, the cooperative rule, the concentration of revenue powers in the hands of the federations and equalizations should not contradict the “*constitutional protection of fiscal distributions to the [constituent units] so that they might, to some extent, fulfil their const mandates and ... policies independent of the national government*”<sup>17</sup>.

Although the criteria for the allocation of these powers vary from state to state according to the constitutional provisions, the comparative method permits to deliver a classification of principles presiding the distribution of revenue-raising powers. These are the *competitive* and the *cooperative rule*. The competitive rule is typical of a dual-federal distribution of finance, whereas the cooperative rule reflects several factors federal and regional states have been experiencing for the last decades – and the adoption of either the competitive or the cooperative rule has practical implications. The centralizing trends in financial relations, the passing of dual federalism,<sup>18</sup> as well as the advent of cooperation in intergovernmental relations, solidarity and equalization led to what we may label as ‘social federalism’. The federal government had to ensure minimum standards of income, health, education, and welfare to all citizens through and entails an action to be performed at the national level, such as the German

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<sup>12</sup> L. Pegoraro, “The Comparative Method and Constitutional Legal Science, at 117 and 126.

<sup>13</sup> R. L. Watts, *Comparing Federal Systems*, 106; P. W. Hogg, *Constitutional Law of Canada* (Carswell, Toronto, 2011), 6-21 et seq.

<sup>14</sup> G. Sawyer, *Modern Federalism* (Watts: London, 1969), 27, See also W. Riker, *Federalism: Origin, Operation, Significance* (Boston: Little, Brown & Co., 1964), 6; E. Aja, *El Estado Autonómico. Federalismo y hechos diferenciales* (Alianza Editorial, Madrid, 2003, 2<sup>nd</sup> edition), 134; P. W. Hogg, *Constitutional Law of Canada*, 5-3.

<sup>15</sup> Scholars consider these three features as the constitutive parts of financial relations: see R. L. Watts, *Comparing Federal Systems*, 95 et seq.; R. L. Watts, J. Kincaid, “Introduction,” in R. L. Watts and R. Chattopadhyay (eds.), *Emerging Issues in Fiscal Federalism*, a cura (New Delhi et al. 2008) xi ss.

<sup>16</sup> L. Pegoraro, “The Comparative Method and Constitutional Legal Science: New Trends”, 119.

<sup>17</sup> Heinz Klug, *The Constitution of South Africa*, 254.

<sup>18</sup> For this expression see Edward S. Corwin, “The Passing of Dual Federalism” 36(1) *Virginia Law Review* (March 2011), 1.

basic law and the Italian and the Spanish constitutions uphold. However, centralization is considered an unavoidable mechanism granting all citizens the possibility of enjoying comparable services without having to be submitted to excessively different tax rates<sup>19</sup>.

The main instruments that ensure centralisation and the advent of social federalism are the equalization mechanisms (grants, tax rental agreements, vertical and horizontal equalization), which aim at bringing each constituent units' rent up to the per capita average of the federation, and to "*correct the fiscal inefficiencies and regional inequities arising from the differential fiscal capacities of various jurisdictions*" by providing them with additional or further sources<sup>20</sup>. The assumption is held by the South Africa's Constituent Assembly: the debate over regionalism and the demands for provincial autonomy "*required the establishment of commitments and the creation of institutions that would guarantee the equitable distribution of resources to the different regions*"<sup>21</sup>.

By contrast, the competitive rule leads to interregional competition: in order to attract companies, new businesses and to create new jobs – as well as to widen tax bases –, constituent units compete by reducing costs, tax rates, as well as by introducing tax exemptions so that firms, companies and individuals are influenced to locate in a particular region. However, "*taxes [...] can be the source of distortions in resource allocations [...] as taxed units (or owners of taxed items) seek out jurisdictions where they can obtain relatively favourable tax treatments. High excise taxes in in one jurisdiction, for example, may lead purchasers to bear unproductive travel costs in order to purchase the taxed items in jurisdictions with lower tax rates*"<sup>22</sup>.

By contrast, the cooperative rule aims at setting and implementing national minimum standards for supplying regional services. Furthermore, it does not only "*serve national equity objectives*"; it also aims at reducing "*wasteful interjurisdictional expenditure competition*"<sup>23</sup>. Cooperation may require a concentration of revenue powers at the federal level of government, which will play the above-mentioned redistributive role, and avoid sharply different tax levels among constituent units. Furthermore, such centripetal tends undermine the area of guaranteed autonomy attributed to constituent units by the constitution, making them dependent on the revenue share of the joint taxes, as well as on the volume of transfers from the national to the subnational levels of government.

Hence, federal and regional states have been elaborating manifold mechanisms, which counterbalance the centralizing effects stemming from the allocation of major revenue powers at the national level. This occurs in Canada and Australia – which have been experiencing such centralization from the Second World War onwards –, in India, Italy, South Africa, Austria and Spain – where the centralization of finance at the national level is directly embedded in the constitution –, as well as in Germany, where the attempts of constituent units to obtain higher tax autonomy have never been successful. In this respect, the creation of new cooperative mechanisms for governing intergovernmental financial relations was favoured by the abandonment of the dual-federalist approach. Dual-federalism has been replaced by cooperative federalism, which thus shapes the mechanism governing solidarity and equalization.

Comparative legal studies then discloses analogies as far the expenditure side is concerned. In this regard, the different levels of government do not recognize any limitations to their spending power – and the assumption is held both in Canada<sup>24</sup> and in the United States of America. In Canada, "*The authority [...] to legislate in relation to the raising of money*" does not admit any limitation "*in those words as respects the purpose or purposes to which the money is to be applied*". Indeed, "*the real purpose of which is to raise 'money by any mode or system of taxation,' is not examinable by the courts as to its validity by a reference to the motives by which Parliament is influenced, or the ultimate destination of the proceeds of the tax.*"<sup>25</sup> In *United States v Butler*,<sup>26</sup>

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<sup>19</sup> See R. L. Watts, *Comparing Federal Systems*, 108, Alan Morris, "Commonwealth of Australia," 55.

<sup>20</sup> See P. W. Hogg, *Constitutional Law of Canada*, 6-8; Ronald L. Watts, *Comparing Federal Systems*, 98; A. Shah, "Introduction: Principles of Fiscal Federalism", 13.

<sup>21</sup> Heinz Klug, *The Constitution of South Africa*, 217.

<sup>22</sup> Wallace E. Oates, "An Essay on Fiscal Federalism", 37(3) *Journal of Economic Literature* (September 1999): 1120-1121. 1120.

<sup>23</sup> Anwar Shah, "Introduction: Principles of Fiscal Federalism", 30.

<sup>24</sup> *Smylie v The Queen* (1900) 27 O.A.R. 172 (Ontario Court of Appeal); *The Queen v. Board of Transport Commissioners* [1968] S.C.R. 118; *Her Majesty in right of the Province of Alberta v. Canadian Transport Commission* [1978] 1 S.C.R. 61.

<sup>25</sup> *Reference re legislative jurisdiction of Parliament of Canada to enact the Employment and Social Insurance Act* (1935, c. 48), [1936] S.C.R. 427, at 434-435, per Duff C. J. Dissenting.

<sup>26</sup> 297 U.S. 1 (1936), at 65.

the U.S. Supreme Court stated, “The Congress is expressly empowered to lay taxes to provide for the general welfare. Funds in the Treasury as a result of taxation may be expended only through appropriation ... They can never accomplish the objects for which they were collected unless the power to appropriate is as broad as the power to tax. The necessary implication from the terms of the grant is that the public funds may be appropriated ‘to provide for the general welfare of the United States’ [...]”<sup>27</sup>.

3. The comparative method not only contributes to detect analogies and differences between the different systems of financial relations that can be found under the black-letter constitution, but also to fill in the gaps between written provisions and the practice of law.

In legal comparative studies, the approach to financial relations is not confined to the mere sketch of the financial constitutional provisions. First, comparative studies scrutinise federal and regional constitutional designs; they then examine how constitutional provisions are implemented and how competitive and cooperative federalism affect financial relations in a multi-layered legal system.

To put it differently, this examination is not limited to the *law in the books*, but it encompasses the *law in action of financial relations* in order to capture “the tension between black-letter law and rules ‘in action’”.<sup>28</sup>

Nobody can question the legal relevance of such categories, which were coined by the renowned U.S. jurist Roscoe Pound in 1910 and applied by successive generations of scholars with a background in comparative law.<sup>29</sup> Legal examination of the intergovernmental financial relations upholds recourse to *law in the books* and *law in action* taxonomies, since this approach also looks at how financial relations actually work.

This is due to the fact that several constitutions do not reflect the reality of fiscal relations. This is the case of aggregative federations – such as USA and Canada –, which had rarely modified their constitutional texts in order to accommodate the law in the books to the law in action of financial relations. Finally, the flaw between the law in the books and the law in action aims at ascertaining whether constitutional provisions over financial relations are effectively implemented.

The outcomes of these researches may be considered as part of the practice of the “comparative law as a subversive discipline”.<sup>30</sup> In this respect, the search for commonalities and analogies may help in the process of highlighting mutual borrowings, the historical evolution of financial relations in a specific constitutional context, as well as the transplants.<sup>31</sup> In other words, this analysis aims at detecting the dissemination of both principles and mechanisms – as well as their subsequent adaptation – governing financial relations. From this, however, it does not follow that the devising of prescriptive models support the unification of solutions adopted under different federal constitutions. By contrast, the subversive character of comparative studies reveals the fallacy of the presence of “new universals” in what has become a globalised world<sup>32</sup> – and therefore shows how the legacies and the transplants of financial relations exhibit an elevated degree of resilience in the different federal contexts that act as recipients of the transplanted solution in the field of financial relations.

This is apparent as far as the principle of correspondence is concerned. We have already said that the revenue side ensures the possibility of raising proceeds in order to meet federal, national and subnational expenditures and to fully discharge the constitutionally assigned responsibilities. To put it

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<sup>27</sup> See also *Steward Machine Company v Davis*, 301 U.S. 548 (1937); *Oklahoma v United States Civil Service Commission*, 330 U.S. 127 (1947); *Fullilove v Klutznick*, 448 U.S. 448 (1980). See William F. Fox, “The United States of America,” in Anwar Shah and John Kincaid (eds.), *The practice of Fiscal federalism: Comparative Perspectives* (McGill-Queen’s University Press, Montreal et al., 2007): 349 et seq.

<sup>28</sup> J.-L. Halpérin, “Law in Books and Law in Action: the Problem of Legal Change”, 64(1) *Maine Law Review* (2011): 47.

<sup>29</sup> R. Pound, “Law in the Books and Law in Action,” 44 *American Law Review* (1910): 12-36. On recourse to Pound’s categories by subsequent scholars see S. Macaulay, “Non-contractual Relations in Business: a Preliminary Study,” 28(1) *American Sociological Review* (1963): 55-67; K.J. Bybee, “Law in Action,” 59 *Political Review Quarterly* (2006): 415; J.-L. Halpérin, “Law in Books and Law in Action,” 46-76. For a critique of Pound’s categories see Karl N. Llewellyn, “A Realistic Jurisprudence – The Next Step”, 30 *Columbia Law Review* (1930): 431-465.

<sup>30</sup> G. Fetcher, “Comparative law as a Subversive Discipline,” 46 *American Journal of Comparative Law* (1988): 683; H. Muir Watt, *Further terrains for subversive comparison: the field of global governance and the public/private divide*, in P.G. Monateri (ed.), *Methods of Comparative Law* (Cheltenham-Northampton: Edward Elgar, 2012), 270-288, at 270.

<sup>31</sup> A. Watson, *Legal Transplants: An Approach to Comparative Law*, The University of Georgia Press, Athens (GA) 1993; D. Berkowitz, K. Pistor, J.-F. Richard, *The Transplant Effect*, in *The American Journal of Comparative Law*, 51(1), 2003, p. 163 ss.

<sup>32</sup> G. H. Muir Watt, *Further terrains for subversive comparison: the field of global governance and the public/private divide*, 272.

another way, federal and regional constitutions require correspondence between revenues, expenditures and responsibilities.

Such correspondence does not only entail equivalence between the two sides of financial relations – the revenue side and the expenditure one –; but it also establishes a close relation between financial proceeds, financial powers, and constitutional responsibilities. Last but not least, it implies financial responsibility and political accountability of the different tiers of governments. The correspondence between revenues, expenditures and discharge of responsibilities represents thus a mechanism, which allow to monitor the way governments implement constitutionally assigned policies.

The equivalence rule governs intergovernmental financial relations under manifold constitutions – both federal and regional.<sup>33</sup> In other countries, the rule is not expressly mentioned in the Constitution, such as in the United States of America. Despite this, the correspondence rule had been applied to the distribution of finance from the inception of the Federation.

The practice of comparative law as a subversive discipline discloses that such correspondence rule can be considered neither a “new universal” nor a “prescriptive grammar” in the field of financial relations. In the United States of America – and in other countries mentioned above –, the correspondence rule entails that federal and units’ expenditures match revenues. In other countries, however, this rule is not considered as the ‘golden’ budgetary rule – and its application is confined to the mere correspondence between expenditures and responsibilities<sup>34</sup>. This occurs in Germany, where the Basic Law provides us with the most accurate and precise definition of the correspondence rule. Art. 104a GG articulates such rule into two separate principles. The first one is the “principle of separation”. On the one hand, the Federation and the *Länder* separately finance the expenditures resulting from the discharge of their respective responsibilities (art. 104a.1 GG.). This means that *Länder* must bear the costs of their own activities. On the other hand, the discharge of the constitutionally assigned responsibilities prescribes that *Länder* be attributed an appropriate amount of funds<sup>35</sup>.

But the German Basic Law sets an additional principle – the *principle of connection* – which imposes a stringent correspondence between revenue, competences and expenditure responsibilities related to the latter<sup>36</sup>. An application of such principle can be found in art. 104a.2 GG: when *Länder* act on federal command, the Federation will finance the resulting expenditures<sup>37</sup>.

Not only the principle of connection does not match the “prescriptive grammar” of the correspondence rule, but it also triggers a severe deadlock breaking between the legal and the economic analysis of financial relations, since it does not correspond to “*revenue follow functions*” principle, which has been developed by U.S. economists in the second half of the twentieth century<sup>38</sup>.

In this regard, the GG sets so many exceptions to the correspondence rule,<sup>39</sup> that this is not capable to ensure the equivalence between spending powers and revenues ones, since the latter are allocated at

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<sup>33</sup> See art. 104a GG; § 2 F-VG; art. 47.2 of the Swiss Constitution; s 92(2) of the *Constitution Act, 1867* of Canada; schedule VII to the Constitution of India). The rule is set forth in regional constitutions as well, such as the Spanish and the Italian ones (articles 156.1 and 119.3 respectively)

<sup>34</sup> See H. H. von Armin, *Finanzzuständigkeit*, in J. Isensee, P. Kirchhof (ed.), *Handbuch des Staatsrecht der Bundesrepublik Deutschland*, vol. VI – Bundesstaat, 3rd edition, C.F. Müller, Heidelberg, 2008, 843-74; U. Häde, *Finanzausgleich*, Mohr Siebeck, Tübingen, 1996, 48-62; C. Pielke, *Das Konnexitätsprinzip in der deutschen Finanzverfassung*, Dr. Kovac, Hamburg, 2010.

<sup>35</sup> Among them, see BVerGE 72, 330.

<sup>36</sup> The expression is the translation of the German *Konnextität von Aufgaben und Ausgabenverantwortung*. See Hans-Uwe Erichsen, *Die Konnextität von Aufgaben und Finanzierungs-kompetenz im Bundes-Länder-Verhältnis* (Bad Hamburg, Berlin Zürich, 1968).

<sup>37</sup> See J. Hellermann “Artikel 104a,” in H. von Mangoldt, F. Klein and Ch. Starck (eds.), *Kommentar zum Grundgesetz, Band 3: Artikel 83 bis 146* (Verlag Franz Valen: München, 2010): 1117 et seq.

<sup>38</sup> See M. Olson Jr, “The Principle of ‘Fiscal Equivalence’: The Division of Responsibilities among Different Levels of Government,” 59 *Papers and Proceedings of the Eighty-first Annual Meeting of the American Economic Association* (May, 1969), 479-487.

<sup>39</sup> The exceptions enshrined in the GG do interrupt the correspondence between revenue raising powers and responsibilities (Art. 104a.2 GG sets the first exception: the correspondence rule applies to both legislative responsibilities and administrative inter-delegation (*Auftragverwaltung*) or deprive *Länder* of their dfiscal responsibility which is totally allocated at the federal power. The second exception is embedded in Art. 104a.3 GG: a federal law attributing money grants (*Geldleistungsgesetze*) can impose *Länder* to bear the costs deriving from the implementation of federal legislation. The third exception is set forth in Art. 104a.4 GG: federal laws can oblige the *Länder* to provide grants, benefits or comparable services to third persons; *Länder* executes the tasks. Finally, Art. 104b GG foresees the fourth exception. Conditional federal grants (*Finanzhilfen*) can be assigned to *Länder* provided that: 1) they avert a disturbance of the overall economic equilibrium; 2) they equalize differing economic capacities within the federal territory; 3) they promote economic growth On these exceptions see Johannes Hellermann “Artikel 104a,” 1132 et seq.; Id., “Artikel 104b,” in Hermann v. Mangoldt, Friedrich Klein and Christian Starck (eds.), *Kommentar zum Grundgesetz, Band 3: Artikel 83 bis 146* (Verlag Franz Valen: München, 2010): 1187 et seq.

different levels of government.<sup>40</sup> In legal terms, the correspondence does not match the economic principle of fiscal equivalence: due to the above-mentioned lack of limitation in the spending powers, the taxing power is therefore given for raising money for the exclusive disposition of the legislature and according to the discretionary public choice of the political branches.

The same assumption is held in Austria. Under the F-VG, *Länder* do not have any form of fiscal responsibility, as the federal legislative branch distributes finance powers: “*the federal parliament has to assign each tax ... and thus decides who is responsible for legislation and execution*”<sup>41</sup> thereover. Furthermore, “*federal law must assign taxes within an abstract constitutional framework of various types of shared or exclusive tax allocation*”: exclusive federal taxes, taxes divided between federal level and municipalities, exclusive state taxes and exclusive municipal taxes<sup>42</sup>. *Länder* can only participate in the periodical renewal of the “Fiscal Equalization Act” (*Finanzausgleichgesetz*), which is the sole cooperative mechanism through which *Länder* can influence the federal decision-making process over the distribution of finance: “*it is remarkable that the second chamber of the Austrian federal parliament, the federal council, has in these essential matters for Länder only a suspensive veto*”<sup>43</sup>.

Relevant exceptions to the correspondence rule Constitutional exceptions are then detected in regional countries (Italy and Spain), and in federal countries, which are the outcome of a federalizing devolutionary process (Belgium). Although the Constitutions of Italy, Spain and Belgium and South Africa vest constituent units with taxing and expenditures powers, these provisions require implementation through state legislation<sup>44</sup>. This is particularly clear in South Africa, where the Constitution assigns to provinces limited revenue-raising powers: “*allowing provinces to choose applicable tax rates and tax bases could result in tax competition [...] thus reinforcing economic disparities*”<sup>45</sup>. In order to avoid imbalances in resources allocation, “*competing jurisdictions [...] reach mutual agreements on the rules of the game and a coordination strategy*”<sup>46</sup>. Thus, section 220 of the South African Constitution sets a Financial and Fiscal Commission, which has to be consulted, for example, for approving the national legislation over “*the equitable division of revenue raised nationally among the national, provincial and local spheres of government [...] the determination of each province’s equitable share of the provincial share of that revenue: and any other allocations to provinces, local government or municipalities from the national government’s share of that revenue, and any conditions on which those allocations may be made*”<sup>47</sup>. This upholds the idea of the mismatch between the legal and the economic fiscal between the revenue and the expenditure side, and therefore the possibility of applying an economic-oriented concept of the correspondence rule.

Finally, exceptions to the correspondence rule originate from executive federalism, which indeed derogates to the dual-federalist principle, since the distribution of finance does not reflect the allocation of legislative functions.

In federal and regional countries the administration of substantial portion of federal legislation is now constitutionally assigned to the government of the constituent units, such as in Switzerland, Austria, Germany, India and Malaysia<sup>48</sup>. Hence, the functioning of the correspondence rule shifts from legislative responsibilities to the administrative powers: these powers must be fully financed in order to fully discharge the functions related thereto<sup>49</sup>. If we consider that taxes shall be levied or collected under the authority of law, the shift from legislative responsibilities to the administrative powers can be

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<sup>40</sup> See Johannes Hellermann “Artikel 104a,” 1117.

<sup>41</sup> For further references see Manfred Stelzer, *The Constitution of the Republic of Austria*, 159.

<sup>42</sup> Peter Bußjäger, “Reforms on Fiscal Federalism in Austria”, 59.

<sup>43</sup> Peter Bußjäger, “Reforms on Fiscal Federalism in Austria”, 60.

<sup>44</sup>Articles 175–177 of the Belgian Constitution require an entrenched federal law for the implementation of the constitutional provisions over finances The Italian national Parliament shall have recourse to an ordinary act at the legislative level (art. 119.2); the Spanish national Parliament does the same approving the LOFCA – i.e., an organic law passed by a the majority of votes cast in the Lower Chamber in the final vote on the bill as a whole (art. 81.2).

<sup>45</sup> Bongani Khumalo and Renosi Mokate “Republic of South Africa,” in Anwar Shah and John Kincaid (eds.), *The practice of Fiscal federalism: Comparative Perspectives* (McGill-Queen’s University Press, Montreal et al., 2007): 263-285, 265.

<sup>46</sup> Anwar Shah, “Introduction: Principles of Fiscal Federalism”, 38.

<sup>47</sup> Bongani Khumalo and Renosi Mokate “Republic of South Africa,” 277-278. See also Heinz Klug, *The Constitution of South Africa*, 254.

<sup>48</sup> See, for example, s 83 of the Constitution of India.

<sup>49</sup> See Ronald L. Watts, *Comparing Federal Systems*, 100.

considered both as an outcome of Pound's "the discrepancy between doctrine in books and empirical data about law",<sup>50</sup> and as an acquisition of the practice of comparative law as a subversive discipline.

4. The subversive character of comparative legal studies discloses another fallacy in the traditional researches related to financial relations. This fallacy does not concern the variety and heterogeneity of forms such relations takes under federal constitutions; it regards the idea that there is "at the least a global legal language" capable of expressing such variety – and that "global legal language [is necessarily] based on economic models."<sup>51</sup>

We have already noticed that concepts and issues related to the distribution of raising powers are explained through the language of economics: first, the fragmentation of forms in which constitutions allocate revenue powers are usually termed as the "tax-assignment problem"; second, the assumption that the correspondence rule partly rests on the economic model of fiscal equivalence. Such a global, economic-oriented language does not only characterize concepts, models, and the criteria for classifying financial relations. It also denotes the expressions scholars employ in order to label the mechanisms presiding the allocation of financial powers.

These classifications give raise to significant problems. Scholars designate financial relations by resorting to a widespread selection of terms: 'distribution of finance', 'financial (or fiscal) relations', 'financial (or fiscal) arrangements', 'fiscal federalism', 'fiscal' or 'financial constitution', and so on<sup>52</sup>. The meanings of the expressions at stake depend on whether financial relations are examined either through the lenses of economics or from a legal perspective.

This is evident in the case of the expression 'fiscal federalism'. Albeit it is very common among political scientists and jurists<sup>53</sup>, its use is very contentious. 'Fiscal federalism' pertains is a "*subfield of public finance*", and therefore denotes "*which functions and instruments are best centralized and which are best placed in the sphere of decentralized levels of governments*". Moreover, "*the traditional theory of fiscal federalism lays out a general normative framework for the assignment of functions to different levels of governments and the appropriate fiscal instruments for carrying out these functions*"<sup>54</sup>.

Fiscal economists consider "*state and local finance as a field of research*"<sup>55</sup> for the allocation of revenue and expenditure powers, and address the following questions: "*which taxes are best suited for use at the different levels of government?*"; "*placed in a context of a federalist government, should distribution be a national or a local responsibility?*"<sup>56</sup>.

It is apparent that these questions denote fields of research that are very different from those characterizing comparative federal studies. Public finance indeed as a normative approach – and therefore 'fiscal federalism' is an expression entailing a non-legal definition of financial relations. The expression does not consider the legal features – in particular, the constitutional ones – related to the allocation of financial powers. Fiscal federal studies aim at maximizing the efficiency of public policies and services by setting an appropriate distribution of revenue powers.

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<sup>50</sup> J.-L. Halpérin, "Law in Books and Law in Action: the Problem of Legal Change," 46.

<sup>51</sup> G H. Muir Watt, *Further terrains for subversive comparison: the field of global governance and the public/private divide*, 272.

<sup>52</sup> Ronald L. Watts, *Comparing Federal Systems*, 95 has recourse to the expression 'distribution of finance'; Peter W. Hogg, *Constitutional Law of Canada*, 6-1 term them 'financial arrangements'; Heinz Klug, *The Constitution of South Africa. A Contextual Analysis* [Hart Publishing: Oxford and Portland (OR), 2010]: 216 uses 'fiscal constitution'; Anwar.

<sup>53</sup> Among others, see Anwar Shah (ed.), *The Practice of Fiscal Federalism: Comparative Perspectives* (McGill-Queen's University Press, Montreal et al., 2007); Ronald L. Watts, *Comparing Federal Systems*, 95; Ronald L. Watts and John Kincaid, "Introduction", in Ronald L. Watts and Rupak Chattopadhyay (eds.), *Emerging Issues in Fiscal Federalism* (Viva Books, New Delhi, 2008), xi et seq.; Ehtisham Ahmad and Giorgio Brosio, *Handbook of Fiscal Federalism* (Edgar Elgar, Cheltenham-Northampton, 2006); Robin Boadway and Anwar Shah (eds.), *Fiscal Federalism: Principles and Practice of Multiorder Governance* (Cambridge University Press, Cambridge, 2009).

<sup>54</sup> Wallace E. Oates, "An Essay on Fiscal Federalism," 1120-1121. The expression was first used in Richard A. Musgrave's *The Theory of Public Finance* (New York, McGraw-Hill, 1959) and then in subsequent studies. See Richard A. Musgrave, "Economics of Fiscal federalism", 10(4) *Nebraska Journal of Economics and Business* (Autumn 1971), 3-13; Wallace E. Oates, *Fiscal Federalism* (New York, Harcourt Brace Jovanovich, 1972). See also Gisela Färber, "Was ist Finanzföderalismus?", in Peter Bußjäger (eds.), *Perspektiven des Finanzföderalismus in Österreich* (Innsbruck et al.: Studienverlag, 2013): 11-38.

<sup>55</sup> Richard A. Musgrave, "Economics of Fiscal federalism", 3.

<sup>56</sup> See Wallace E. Oates, "An Essay on Fiscal Federalism", 1125, and Richard A. Musgrave, "Devolution, Grants, and Fiscal Competition" 11(4) *The Journal of Economic Perspectives* (Autumn 1997), 67. See also Richard M. Bird and François Vaillancourt (eds.), *Perspectives on Fiscal Federalism* (World Bank Institute, Washington, 2006).

On the contrary, comparative studies have a different approach to financial relations. ‘Legal’ fiscal federalism analyses the constitutional foundations of financial powers and the mechanisms through which national and subnational levels appropriate funds in order to finance their constitutional responsibilities. It also examines revenue raising and revenue distribution, as well as equalization and the scope of expenditure powers. Financial autonomy, solidarity and spending powers are the most relevant fields of research in ‘legal’ fiscal federalism<sup>57</sup>.

In this regard, the expression fiscal federalism seems a mere projection of the above-mentioned principle of fiscal equivalence, and underpins the idea that legal financial relations must be governed by budgetary policies – and therefore by economic theories. Through fiscal equivalence, public finance expresses an efficiency rule, the necessity of optimising the allocation of proceeds, as well as fiscal responsibility. But legal fiscal federalism does not uphold the idea that the budgetary position of federal and regional states should be balanced or in surplus. This normative character of regional budgetary policies does not match the ‘legal’ correspondence rule. We have already noticed that, on the expenditure side, there is a lack of limitation in the spending powers, whereas in the revenue side, taxing powers are in the hands of the political branches the effective amount of raising money depends on the economic situation.

To put it differently, the legal relevance of the economic principle of balanced budgets in financial relations depends on whether it is applied under federal and regional constitutions. In the United States of America, state constitutions require that state’s expenditures match revenues. This is considered as the ‘golden’ budgetary rule: furthermore, surplus of revenues in “*good economic times*” are accumulated as “*rainy day’ funds that can cover what would otherwise be fiscal deficits in bad economic times*”<sup>58</sup>. The same occurs in Brazil, where the Fiscal responsibility Act 2000 introduced mechanisms for enforcing constituent units’ fiscal discipline<sup>59</sup>. In Switzerland, the budget must to be balanced both at the federal level (art. 126 of the Constitution)<sup>60</sup>, and at the cantonal one. Cantonal constitutions of St Gall, Solothurn, Grison, and Appenzell Outer-Rhodes prescribe governments to “*accumulate savings in order to equalize revenue fluctuations over the business cycle [and] to build up reserves in good times and to eliminate structural deficits*”<sup>61</sup>.

But public finance principles cannot be construed as “new universals” in comparative legal studies. This, however, implies an additional effort in the practice of subversive comparison: scholars should highlight that the applications of public finance budgetary principles are the offshots of economic-oriented representations of law, which instrumentalise the global economic legal language ‘spoken’ by international financial actors. The assumption is held when we consider how, during the course the international financial crisis, several EU member states amended their constitutions and introduced therein the principle of balance between revenue and expenditure. This occurred in quite all EU federal and regional countries, such as Austria, Germany, Spain, and Italy<sup>62</sup>. Thus, limitations to subnational financial powers are the outcome of the entrenchment of economic budgetary policies, since the above-mentioned constitutional reforms assure that the budgetary position of the member states is balanced or in surplus according to article 136 TFEU and to the ‘Treaty on Stability, Coordination and Governance in the economic and monetary union’ (TSCG) signed in Brussels on February 2, 2010. In this respect, the EU constraints over budgetary rules deriving from the TSCG can be conceived as part of the federal-like integration process resting upon economic principles, which progressively deprive member states of their constitutional *Kompetenz-Kompetenz*. The subversion is indeed represented by the deletion of constructs purporting one of the main core values upon which constitutionalism was

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<sup>57</sup> See Ronald L. Watts and John Kincaid, “Introduction”, ix et seq.

<sup>58</sup> Mark Tushnet, “The Constitution of the United States,” 161.

<sup>59</sup> See Fernando Rezende, “Federal Republic of Brazil”, 82-84.

<sup>60</sup> Thomas Stauffer, “Art. 126”, in B. Ehrenzeller, P. Mastronardi, R.J. Schweizer, K. A. Vallender (eds.), *Die schweizerische Bundesverfassung* (Dike-Schulthess: Zürich/St. Gallen-Basel/Genf, 2008), 1944-1957.

<sup>61</sup> Gerhard Kirchgässner, “Swiss Confederation,” in Anwar Shah and John Kincaid (eds.), *The practice of Fiscal federalism: Comparative Perspectives* (McGill-Queen’s University Press, Montreal et al., 2007): 318-343, 328. See also Gerhard Kirchgässner, “Finanzföderalismus in der Schweiz”, in Peter Bußjäger (eds.), *Perspektiven des Finanzföderalismus in Österreich* (Innsbruck et al.: Studienverlag, 2013): 39-70, 46 et seq.

<sup>62</sup> For Austria, see art. 13.2 B-VG, as inserted by the 2008 constitutional reform (BGBl. I 1/1008). For Germany, see articles 109 and 110 GG, as amended by the 2009 constitutional reform. For Spain, see art. 135 of the Constitution, amended in 2011. For Italy, see articles 81 and 119.1 of the Constitution, as amended the *constitutional (amendment) act no. 1/2012*. See Tania Groppi, “The Impact of the Financial Crisis on the Italian Written Constitution,” 4 *Italian Journal of Public Law* (January 2012): 1-14.; David Delgado Ramos, “La reciente constitucionalización de la estabilidad presupuestaria ¿Una reforma necesaria?” 87 *Revista de Derecho Político* (2013): 317-352.

erected, that is, the idea of the supremacy of the same constitutions: “*The stability treaty not only requires ... constitutional changes in each of the signatory states, but also raises significant questions about its relationship with EU law and the extent of the discretion left to member states to make fundamental decisions about taxation and spending*”<sup>63</sup>.

5. The comparative method does not have the solely analytical aim of categorizing problems, but also practical implications: the analyses of comparative legal studies are useful for the study of constitutional contexts. This is what Horatia Muir Watt terms as the practice of comparative law “used in an essentially domestic context by legal scholars”<sup>64</sup>.

Focussing on *legal* ‘fiscal federalism’, this paper – and the comparative method that underpins it – will examine some of the constitutive features of financial fiscal relations in specific constitutional contexts, and therefore propose a renovated taxonomy of the same features.

When addressing domestic contexts, such subversive practice of comparative law is apparent as far as the correspondence rule is concerned. We have already noticed that German correspondence does not only entail equivalence between the two sides of financial relations – the revenue side and the expenditure one –; by contrast, it establishes a close relation between expenditures and constitutional responsibilities.

Both versions of the correspondence rule originally reflected the competitive rule applied in dual-federalist systems. Domestic use of comparative law that highlights the trends and the evolution of financial relations. Further, the comparative method discloses that intergovernmental financial relations are the outcome of a history of constitutional adaptation to changing circumstances, which also affected the correspondence rule – and the principle has indeed undergone tremendous modifications under the advent of the cooperative financial relations and the welfare state.

The equation between legislative powers, finance and discharge of responsibilities that was typical of the dual-federalist approach governed the initial distribution of finance set forth in the U.S. Constitution. The principle was applied in all mature federations, such as Australia and Canada, and it is still the operational rule in Switzerland. Furthermore, the evolution of financial relations is intertwined with the advent of the Welfare State and policies, which exhibited difficult relations with federalism, in general, and financial relations, in particular. This is particularly evident in Canada, Australia and in the United States of America: “*it is true that the framers of the Constitution could hardly have foreseen the rise of the welfare state with its enormous growth in [subnational] responsibilities*”<sup>65</sup>. The trend toward centralization was originally due to the First and the Second World Wars, when the Federal level of government approved financial measures in order to face the war expenditures. In Canada, such measures “*were regarded as temporary [...], because it was generally agreed then that the field of direct taxation should be left to the provinces; and indeed federal rates were substantially reduced in the period between the First and the Second World Wars*”<sup>66</sup>. During the Second World War, the federal government and the provinces started entering into tax rental agreements: “*the provinces abandoned their personal income taxes, corporate income taxes and inheritance taxes. In return, the provinces were to receive unconditional payments to compensate them for the lost revenue*”<sup>67</sup>. At the end of the war, however, the system of tax rental agreements was maintained, and the States were compensated with annual payments, which corresponded to their average annual income tax collections in the recent past.<sup>68</sup>

This led to modifications in intergovernmental financial relations – as well as to a flaw between the black-letter and the living constitution –, and therefore conferred a new role to the Federation: the federal government now levies taxes throughout the federal and state territories, and transfers part of the total amount to the subnational (and local) levels of government.

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<sup>63</sup> Steve Peers, “The Stability Treaty: Permanent Austerity or Gesture Politics?” 8(3) *European Constitutional Law Review* (October 2012): 404-441, 404.

<sup>64</sup> G. H. Muir Watt, *Further terrains for subversive comparison: the field of global governance and the public/private divide*, 270.

<sup>65</sup> Peter W. Hogg, *Constitutional Law of Canada*, 6-18.

<sup>66</sup> Peter W. Hogg, *Constitutional Law of Canada*, 6-3.

<sup>67</sup> Peter W. Hogg, *Constitutional Law of Canada*, 6-4.

<sup>68</sup> The same occurred in Australia: “*Following the bombing of Darwin during the Second world war, uniform income taxation legislation was enacted by the federal government, beginning on 1 July 1942, to enable the Commonwealth to meet expenditure needs during the war. The intention was that the Commonwealth would continue collecting income tax until one year after the end of the war*” Alan Morris, “Commonwealth of Australia”, in Anwar Shah and John Kincaid (eds.), *The practice of Fiscal federalism: Comparative Perspectives* (McGill-Queen’s University Press, Montreal et al., 2007): 71 note 2

Such centralising trends have become even more concentrated in regional and devolved regional and federal states: “control of revenues has been much more concentrated in the federal governments of more recent emergent federations than in mature ones”<sup>69</sup>, as in the case of Spain, Belgium, South Africa, Italy, India, Nigeria and Malaysia. This is also evident in Brazil. The 1988 Constitution inaugurated a dual fiscal regime: states and municipalities set and levy their own taxes and share federal revenues (article 155 and 156); the federation exercises its taxing powers in order to “finance pensions and free access to health care and social services for every Brazilian citizens regardless of previous contribution to the social security system” (articles 153 and 154)<sup>70</sup>. By the time, this led to a federal dominance, which eroded subnational autonomy.

The centralizing trend in financial relations led to a new redistributive role of the Federal government – i.e., “the role of government as a vehicle for social protection” in the form of minimum standards of social services<sup>71</sup>. This is particularly true if we consider that one of the major outcomes of the Welfare state is represented by the role played by the Federation in distributing and transferring funds in order to avoid imbalances, to promote equalization, and to assure homogeneity of economic and social conditions to all citizen throughout the country. And these centralising trends are considered as unavoidable mechanisms granting all citizens the possibility of enjoying comparable services without having to be submitted to excessively different tax rates<sup>72</sup>.

This also determines a continuation of highly centralized fiscal arrangements. This is evident in several federal countries, such as India, Australia, and Canada. In particular, the ‘Canada Health Transfer’ and the ‘Canada Social Transfer’ Programmes set down shared-cost mechanisms, where tax abatements do not provide full federal contributions. This is due to the necessity of “continuing federal influence over health and social assistance, because it is the power to withhold all or part of the grant which is the sanction against non-compliance by a province with federal conditions”<sup>73</sup>. Anyway, shared costs assure a high minimum level of some important social services.

But competition has undergone relevant alterations, too. With the advent of social federalism and Welfare, they have exhibited a high degree of resilience. In most cases, the constitutional systems have recourse to a ‘mixed rule’, where competition, solidarity and cooperation merge. The 2004 Swiss constitutional reform merges competition and solidarity: the three pillars of the ‘new’ Swiss competitive rule rest on a stringent distribution on taxing powers between federation and Cantons (article 127 et seq.), on a strict application of fiscal responsibility and correspondence (art. 47.2), on mechanisms of equalization, which aim at correcting the competition among Cantons (art. 135)<sup>74</sup>.

6. The subversive character of the comparative method discloses that intergovernmental financial relations not only refers to federal and subnational levels of government, but also to the regulation of local financial powers under federal and regional constitutions. This is evident in both aggregative federations – where the constitutions sets several mechanisms for federal intervention in member states-municipalities financial relations – and in those federations and in regional states, where constitutions entrench the sphere of guaranteed autonomy attributed to local authorities and set down an exhaustive regulation, which national and subnational legislation has to subsequently enforce, such as under section 214 and 226 or the South African Constitution.

Thus, the economic ‘fiscal federalism’ does not adequately outline the role attributed to the different tiers of government in the distribution of finance. This ‘economic’ approach only focuses on the ‘efficiency rule’ for the best allocation of functions between the central and the decentralized levels of governments, but it does not legally define *which* are the decentralized levels of government concerned.

On the contrary, comparative federal studies do differentiate between federal, state and local governments. In this respect, the origins – aggregative or devolutionary – and the basic features of federal and regional constitutions assign different institutional responsibilities to constituent units and

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<sup>69</sup> See Ronald L. Watts, *Comparing Federal Systems*, 97.

<sup>70</sup> Fernando Rezende, “Federal Republic of Brazil”, 76-77.

<sup>71</sup> Robin Boadway, “Canada,” in Anwar Shah and John Kincaid (eds.), *The practice of Fiscal federalism: Comparative Perspectives* (McGill-Queen’s University Press, Montreal et al., 2007): 99-124, 106.

<sup>72</sup> See Ronald L. Watts, *Comparing Federal Systems*, 108, Alan Morris, “Commonwealth of Australia,” 55.

<sup>73</sup> Peter W. Hogg, *Constitutional Law of Canada*, 6-7 and 6-11 et seq.

<sup>74</sup> See also Gerhard Kirchgässner, “Finanzföderalismus in der Schweiz”, 56 et seq.

local authorities. In aggregative federations, member states have exclusive jurisdiction over municipal institutions: “*the idea of federal intervention into municipal ... affairs seems inconsistent with the conception of municipalities as creatures of the state of which they are political subdivisions*”<sup>75</sup>. In Latin American federations and devolved ones, constitutions expressly entrench the local autonomy and constrain the legislative powers of constituent units thereover<sup>76</sup>. In some cases – as in Italy and South Africa – the central state has the major legislative power, and constituent units have a limited jurisdiction over local government<sup>77</sup>.

The outcome is an intricate concurrency between national and subnational jurisdictions, and therefore legislative powers over local government frequently overlap. This complexity affects financial relations as well: federal and regional constitutions expressly regulate the financial relations between national and local governments. In the United States of America, the federal order of government has recourse to several instruments – such as conditional and unconditional grants, tax agreements, etc. – in order to bypass state level and allocate funds at the local one, thus ‘influencing’ state-local relations<sup>78</sup>. In Germany, the proceeds of local governments are part of the total amount of money the *Bund* transfer to each *Land* as a share of total revenue from joint taxes (article 106.7 of the Basic law; hereinafter: GG). As a consequence, revenues and expenditures of municipalities are deemed to be revenues and expenditures of the *Länder* (article 106.9 GG).

In most cases, however, financial relations originate a “*three-layered-federalism*”<sup>79</sup>, such as in Belgium, Italy, Spain, South Africa, Russia, Brazil, and Austria. In Austria, art. 3 FAG allows the *Bund* to have recourse to grants in order to transfer money to municipalities for specific purposes. The same occurs in Spain: article 142 of the Constitution and the law No 39/1998 over local fiscal management impose State and Autonomous regions to provide local governments with the adequate amount of funds in order to fully finance their responsibilities.

Both federal and regional constitutions allow local authorities to levy taxes. In Canada, “*municipalities levied taxes before any provincial tax was enacted*”<sup>80</sup>. In the United States of America, local authorities have been imposing property taxes in order to generate their own revenues from the inception of the Federation<sup>81</sup>. Under art. 106.6 GG, revenues from taxes on real property and trades, from local taxes on consumption shall accrue to the municipalities.

Furthermore, the ways local authorities participate in financial mechanisms vary from state to state. Local authorities levy taxes, impose fees, have recourse to public debt, and receive financial transfers from national and subnational governments. These mechanisms grant local entities the appropriate amount of resources in order to address the needs of their communities.

Questions arise, however, when we try to define the basic features – established by either constitutional or legislative provisions – of local taxing powers.

The first point at issue is represented by the fact that local taxing policies require the intervention of the central or subnational legislative branch. Indeed, the principles of “*no taxation without representation*” and of legality prescribe that a legislative act allows municipalities to appropriate funds by taxation and to raise proceeds. Hence, the Constitutions of Australia, India, and Malaysia expressly stipulate that tax shall be levied or collected under the authority of law (ss 83, 265 and 96 respectively). The intervention

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<sup>75</sup> Clayton P. Gillette, “Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy” 79(1) *The University of Chicago Law Review* (Winter 2012): 281-330, 298. The idea that local authorities are ‘creatures’ of the constituent units can be traced back to X Amendment (1791) to the US Constitution, to s 92(8) *Constitution Act, 1867* of Canada, to article 50(1) of the Swiss Constitution, to articles 28 and 104a GG; to article 115(2) B-VG.

<sup>76</sup> Articles 115 and 115-I of the Mexican Constitution; article 123 of the Argentinian Constitution; articles 1, 18, 29, 30, 35 of the Brazilian Constitution; articles 243 and 243Q of the Constitution of India; articles 137, 101, 141, 149(1)(18) of the Constitution of Spain; article 162 of the Constitution of Belgium, as implemented by the ‘special’ law 13 July 2001, which enables Regions to set the basic organizational features of Belgian local government.

<sup>77</sup> See articles 117(2)(p), 118(1)(2) and 123(4) of the Italian Constitution; s 40 of the *Constitution of the Republic of South Africa, 1996*. It should be recalled that the five Italian ‘autonomous’ regions (Trentino-Alto Adige/*Südtirol*, Friuli-Venezia Giulia, Aosta Valley/*Vallée d’Aoste*, Sicily and Sardinia: art. 116.1 Const.) have exclusive jurisdiction over local authorities situated within their boundaries. See Francesco Palermo, “Asymmetric ‘Quasi-Federal’ Regionalism and the Protection of Minorities: the case of Italy”, in Alan Tarr, Robert F. Williams, Josef Marko (eds.) *Federalism, Subnational Constitutions, and Minority Rights*, (Westport, CT, Praeger, 2005) 109.

<sup>78</sup> See William F. Fox, “The United States of America,” 364.

<sup>79</sup> Peter Bußjäger, “Reforms on Fiscal Federalism in Austria”, in Gerhard Robbers (ed.), *Reforming Federalism - Foreign Experiences for a Reform in Germany* (Peter Lang, Frankfurt am Main et al., 2005): 59-67, 61.

<sup>80</sup> Peter W. Hogg, *Constitutional Law of Canada*, 6-2.

<sup>81</sup> See William F. Fox, “The United States of America,” 354.

of the legislative assemblies limit local financial autonomy: indeed, local government may levy, collect, appropriate taxes and determine additional rates in accordance to the principles set forth by federal, central and state law (article 106 GG, articles 7.5 and 8.5 F-VG; s 243H of the Constitution of India; articles 117 and 119 of the Italian Constitution).

The second point at stake is related to the regulation of local financial powers under federal and regional constitutions. To this extent, the constitutions sets highly differentiated rules regarding local financial responsibility and accountability. In aggregative federations, the constitutions only set the basic features of local financial powers, and then confer upon subnational legislatures the duty of specifying which powers are actually assigned to local authorities. The GG establishes the principle of local financial autonomy (article 28); it sets several mechanisms for federal intervention in *Länder*-municipalities financial relations (articles 106, 107 GG)<sup>82</sup>; it provides that a share of the revenue from the income tax shall directly accrue to the municipalities (Art. 106.5 GG). The implementation of this constitutional provision is then committed to paras 6(1), 7(1)(2), 8, 9(3), 13 and 17 of the *Gesetz über den Finanzausgleich zwischen Bund und Ländern* (*Finanzausgleichsgesetz* – hereinafter: FAG) – i.e. the federal law on equalization.

In several federations and in regional states, the constitutions do not only entrench the sphere of guaranteed autonomy attributed to local authorities; they also set down an exhaustive regulation, which national and subnational legislation has to subsequently enforce (see ss 40 and 220 of South African Constitution, articles 156 and 159, § 3 of the Brazilian Constitution; s 243H of Indian Constitution for *Panchayats*)<sup>83</sup>.

Such imbrications in intergovernmental financial relations are apparent in South Africa, where the Constitutional court expressly acknowledged local financial powers. In *Certification of the Constitution of the Republic of South Africa, 1996*<sup>84</sup>, the Court ruled: “*Subsection 40(1) of the Constitution entrenches the institutions of local government as a sphere of government and pronounces all spheres of government to be distinctive, interdependent and interrelated*”. Thus, national and provincial governments cannot impede the exercise of powers and functions of municipalities. Municipalities have the right to govern their own affairs and communities. However, duties, powers and rights of municipalities have to be exercised subject to national or provincial legislation as provided for in the Constitution. The same occurs as for local financial powers. In *Liebenberg NO and Others v Bergrivier Municipality*<sup>85</sup>, the Court states, “*A municipality’s authority to impose rates and levies is derived from section 229 of the Constitution. The purpose of a municipality’s revenue-raising powers is to finance a municipality’s performance of its constitutional and statutory objects and duties as set out in sections 152(1) and 153 of the Constitution. These include the provision of services to communities in a sustainable manner, promoting social and economic development and providing for the basic needs of the community. These objects are integral in the task of constructing society in the functional areas of local government*”<sup>86</sup>.

7. But, like the overlapping tiles of a roof, the correspondence rule, the advent of the welfare state, mechanisms of equalization, as well as an even more complex distribution of powers over local authorities seems to uphold a huge transfiguration of the same rationale of financial relations.

This transfiguration is vigorously triggered by the financial crisis – and the outcome is a paradox: the efficiency rule and the economic models – not the social federalism – are now causing centralization in financial relation.

This is the last acquisition of the practice of subversive comparison: the applications of public finance budgetary principles, an economic-oriented representation of the law, which instrumentalises the global

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<sup>82</sup> See Peter J. Tettinger and Kyrill-A. Schwarz, “Artikel 28,” in Hermann v. Mangoldt, Friedrich Klein and Christian Starck (eds.), *Kommentar zum Grundgesetz, Band 2: Artikel 20 bis 82* (Verlag Franz Vahlen: München, 2010): 567-641, 629 et seq.

<sup>83</sup> As for Brazil, see Fernando Rezende, “Federal Republic of Brazil”, in Anwar Shah and John Kincaid (eds.), *The practice of Fiscal federalism: Comparative Perspectives* (McGill-Queen’s University Press, Montreal et al., 2007): 74-97, 80. Under the seventy-third and the seventy-fourth constitutional amendments (1992), “*each of the [Indian] state governments has devolved powers to levy certain taxes and fees to the local bodies*”: Govinda Rao, “Republic of India”, in Anwar Shah and John Kincaid (eds.), *The practice of Fiscal federalism: Comparative Perspectives* (McGill-Queen’s University Press, Montreal et al., 2007): 152-177, 156.

<sup>84</sup> (CCT 23/96) [1996] ZACC 26; 1996 (4) SA 744 (CC); 1996 (10) BCLR 1253 (CC) (6 September 1996).

<sup>85</sup> (CCT 104/12) [2013] ZACC 16 (6 June 2013).

<sup>86</sup> (CCT 104/12) [2013] ZACC 16 (6 June 2013).

legal language and requires highly centralised and efficient decision-making processes as regards to fiscal powers.

Such trend has been accentuated by the steady rise of the differential that upset the European Union, in general, and Spain and Italy, in particular in the last years. These two countries are the sole EU member states with a regional frame of government. The rise of the differential between their bonds and those issued by Germany entailed the growth of the interests to be paid for refinancing the public debt. This led to the approval of extraordinary measures undermining Italian and Spanish regional financial powers. Indeed, the necessity of holding down the raise of the public debt produced the adoption of severe cuts on the amount of the grants transferred to regions, provinces and municipalities, thus limiting regional – and local – expenditure powers<sup>87</sup>.

Needless to say, the raise of the interest rates had severe backlashes over the European economic and monetary union<sup>88</sup> – and the EU adopted several measures, which give a legal relevance to the budgetary policies we have examined above.

This implies a change in the meaning of financial relations. First, there is a shift between a centralisation, which seems to reflect the anxiety towards the creation of a global legal language and common regulation of financial relations in decentralised countries and markets. Second, there is an even more remarkable shift toward the efficiency rule, whose application requires that funds and proceeds be definitively allocated at the central/national level of government, which is financially responsible *vis à vis* financial markets and international investors – to put it differently, the national government is accountable as far the global economic governance is concerned. Third, this financial global dominance causes a shift from the political to the economic sphere: and the discretionary powers of political branches in levying taxes and appropriating of funds rest on a new form of “confidence” between the political power and the sovereign financial market, where the “distressed sovereign debt can be sold on private equity markets and the debtor [is] subjected to the harsh economics of private law.”<sup>89</sup>

It follows that there has been a complete overturn in the political debate and meaning of accountability, responsibility and capability of appropriating funds in federal states. The current financial crisis is thus undermining the same concepts of intergovernmental financial relations, as well as the same presuppositions of the federal-like EU integration process. In this regard, the crisis gives rise to issues that are related to global economic governance. Hence, international financial actors such as the World Bank and the International Monetary Fund,<sup>90</sup> as well as private-sector investors, endorse the transformation of the legal and economic premises of financial relations. In particular, international financial actors suggest the adoption of a model capable of supporting a capitalist socioeconomic model, but that totally departs from the model of *Soziale Marktwirtschaft* (i.e., social market economy) enshrined in Article 3 TEU.<sup>91</sup> This is caused by international investment law, which “shifts power and authority from states to investors, tribunals and other decision-makers”, and “[t]hese shifts produce outcomes that only partially support global policies”, as well as the transfer of power and authority to decision-makers who are not democratically accountable.<sup>92</sup>

As the comparative legal studies reveal, the principle of correspondence has both an economic-oriented significance and a new, subversive meaning, which crosses the public/private divide – and subsequently

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<sup>87</sup> See Francesco Palermo and Alice Valdesalici, “Italy: Autonomism, Decentralization, Federalism, or What Else?,” in Jaime LLuch (ed.) *Constitutionalism and the Accommodation in Multinational Democracies* (Oxford: Palgrave MacMillan, 2014): 180-199.

<sup>88</sup> See Aart Loubert, “Sovereign Debt Threatens the Union: The Genesis of a Federation”, 8.3 *European Constitutional Law Review* (October 2012): 442-455; Vestert Borger, “How the Debt Crisis Exposes the Development of Solidarity in the Euro Area”, 9.1 *European Constitutional Law Review* (February 2013): 7-36.

<sup>89</sup> G. H. Muir Watt, *Further terrains for subversive comparison: the field of global governance and the public/private divide*, 286.

<sup>90</sup> It is “remarkable” that the institutions of the World Bank Group “have reached their present status as the premier source of both development finance and economic research and information without introducing any major change in their constituent charters”. See Shihata, I.F.I., Tschofen, F. and Parra, A.R. (Eds.), *The World Bank in a Changing World. Selected Essays* (Dordrecht, Martinus Nijhoff Publishers 1991), p. 15.

<sup>91</sup> On the negation of the *Soziale Marktwirtschaft* model in Germany, the country where the model was invented, see Ruffert, M., “Public Law and the Economy: A comparative view from the German perspective,” 11 *International Journal of Constitutional Law* (no. 4, 2013), pp. 925-939.

<sup>92</sup> Cheng, T.-C., “Power, Authority and International Investment Law,” 20 *American University International Law Review* (no. 3, 2005), pp. 465-520, 469.

enforced under private law mechanisms. In this respect, the centralizing trends must now cope two necessities in economic-oriented systems of financial relations. On the one hand, the ‘correspondence rule’ requires the application of the efficiency rule to the equation taxing powers–responsibilities and to the necessity of ensuring the homogeneity of economic and social conditions. On the other hand, such rule must cope a new ‘legal’ budgetary policy – budgetary positions must be balanced or in surplus –, which percolates the whole federal constitutional design.

This entails a reconfiguration of federal and regional financial relations: and the correspondence rule rests now on the sustainability of what we may term as “financial equivalence” that can be traded on global equity markets. Further, this imposes a severe connection between the powers of levying taxes, of imposing fees, and the equalization mechanisms, in order to allow constituent units to fully discharge their constitutional responsibilities under the budgetary guardianship of an ever more invasive central level of government.