

## Reviving Federalism: Canadian Reflections on an American Dream

Richard Janda<sup>†</sup>

### I. INTRODUCTION

For a Canadian, there is some irony in learning that rediscovering the American dream may turn decisively on resuscitating federalism and clarifying the division of powers between the central government and the federated units, as Dr. Alice Rivlin suggests in *Reviving the American Dream*.<sup>1</sup> After all, Canadians have spent all too much time in this century worrying about an optimal division of powers between the orders of government. If there were an export market for proposals detailing alternate forms of federal organization, Canada would have few, if any, trade rivals. More often than not, Canadians are embarrassed by this preoccupation, believing that they are diverting attention from concrete matters of policy. Instead of worrying so much about who ought to exercise power over various policy domains, why not pay more attention to what the policy ought to be? In that sense, Rivlin's suggestion that rethinking federalism may increase living standards comes as a tremendous relief. Maybe Canadians haven't been wasting their time after all.

Nevertheless, I find myself skeptical about the decentralization scheme Rivlin proposes. My concerns are four-fold and linked in different ways to the Canadian and European experiences. First, the principle by which Rivlin would reallocate jurisdiction is unclear and possibly unsound. Second, the competitive federalism resulting from this jurisdictional reallocation may produce a race to the bottom rather than a race to the top. Third, shifting federal responsibilities to the states without providing guaranteed tax revenue will simply transfer the federal debt burden to the states and exacerbate inequalities among states. Fourth, the Canadian experience suggests that a more decentralized federation is not necessarily better at managing its debt problem.

---

<sup>†</sup> Director, Centre for the Study of Regulated Industries; Assistant Professor, Institute of Comparative Law, Faculty of Law, McGill University; LL.M. 1987, Columbia Law School; B.C.L. and LL.B. 1985, McGill University; B.A. 1981, University of Toronto. I am grateful to Jutta Brunnée, Robert Howse, Rod Macdonald, and Robert Wolfe for their helpful comments.

1. ALICE RIVLIN, *REVIVING THE AMERICAN DREAM: THE ECONOMY, THE STATES & THE FEDERAL GOVERNMENT* (1992).

These comments are not meant as a broadside against efforts to recast and modernize federalism. Rivlin is right that central governments have a significant burden to marshal their fiscal and administrative resources and to identify those functions that they can best fulfill. This paper concludes, therefore, with some praise for the virtues of federalism and support for efforts to reinvigorate it.

## II. ALLOCATING JURISDICTION

Under Rivlin's recipe for "dividing the job" between the federal government and the states, the federal government would shrink and the state and local sectors would expand.<sup>2</sup> However, the federal government would take on one new job: implementing a national health financing system. New areas of state responsibility would center on a "productivity agenda" for revitalizing the economy and raising incomes: education, skills training, child care, housing, infrastructure, and economic development.<sup>3</sup>

By what principle is jurisdiction being divided under this scheme? This question may seem unfair, as Rivlin does not intend to present a comprehensive blueprint for the devolution of federal jurisdiction or to propose sweeping constitutional change or any court-enforced realignment of government responsibilities. She seeks instead to outline a general policy framework. If a coherent principle of jurisdictional allocation cannot be gleaned from the general contours of this proposal, however, one is entitled to wonder how closely it withstands scrutiny.

The jurisdictional reallocation may be based on an implicit principle of subsidiarity, for Rivlin seems to assume that jurisdiction should not be allocated to the federal government unless there is a compelling reason to do so. Subsidiarity has been a governing principle for the European Community, most explicitly since the Single European Act.<sup>4</sup> This principle was inspired by an encyclical of Pope Pius XI that linked subsidiarity to justice and human prosperity:

[I]t is an injustice and at the same time a grave evil and disturbance [*sic*] of right order to assign to a greater and higher organization what lesser and subordinate organizations can do. . . . Therefore, those in power should be sure that the more perfectly a graduated order is kept among the various associations, in observance of the principle of "subsidiary function," the stronger social authority and effectiveness will be[,] the happier and more prosperous the condition of the state.<sup>5</sup>

---

2. *Id.* at 116-25.

3. *Id.* at 118.

4. Single European Act of February 17, 1986, 1987 O.J. (L. 169) 7. For a discussion of subsidiarity, see Joel P. Trachtman, *L'Etat, C'est Nous: Sovereignty, Economic Integration and Subsidiarity*, 33 HARV. INT'L L.J. 459 (1992).

5. Pope Pius XI, Encyclical Letter *Quadragesimo Anno* §§ 79-80 (1931), translated in 3 PAPAL ENCYCLICALS 1903-1939, at 415, 428 (Claudia Carlen ed., 1990); see also Ludger Kühnhardt, *Federalism and Subsidiarity*, 91 TELOS 77 (1992).

However, the principle of subsidiarity is of little use in allocating jurisdiction. It begs the central question: what tasks can be accomplished fully by smaller communities? These smaller communities need not be states. In Germany, for example, voluntary associations, not just *Länder*, play an integral role in federal social assistance legislation.<sup>6</sup> European subsidiarity has given rise to a "new regionalism" that supersedes national governments.<sup>7</sup>

To enhance economic stability, Tommaso Padoa-Schioppa explains:

The principle of subsidiarity means that the production of public goods should be assigned to the level of government that has jurisdiction over the area in which that good is public. . . . Only indivisibilities, economies of scale, externalities and strategic requirements are accepted as efficiency arguments in favour of allocating powers to higher levels of government.<sup>8</sup>

Does Rivlin's jurisdictional allocation fit such a framework of subsidiarity? Arguably yes, yet there are certain ambiguities that are discussed below.

#### A. *Assigning Tasks to the Federal Government*

Defense, resolution of international disputes, international trade, and international environmental matters clearly meet the national public good test; they are thus appropriate subjects of federal jurisdiction, perhaps even of supranational jurisdiction. Rivlin also places funding for scientific research and promotion of technological development in federal hands on the ground that individual states are unlikely to support them adequately on their own.<sup>9</sup> This is at best a cryptic rationale. The very purpose of transferring these responsibilities would be to allow competition among the states to determine the "adequacy" of funding. If jurisdictional allocation were based on an assessment of which level of government could provide the most adequate funding, Rivlin's project of transferring jurisdiction to the states would collapse. There will always be pressure for additional "adequate" funding from the federal government.

Health financing by the federal government, as Rivlin proposes, does not meet the national public good test well. Local priorities must be considered

---

6. Dirk Jarré, *Subsidiarity in Social Services Provision in Germany*, 25 SOC. POL'Y & ADMIN. 211 (1991); see also Robert Howse, *Is Federalism the Future?: A Critical View*, Paper Presented at the Conference on Federalism and the Nation-State, University of Toronto 20 (June 4-6, 1992) (unpublished paper, on file with author) (supporting funding of programs designed by community groups).

7. See Jacques Pelkmans, *Governing European Union: From Prefederal to Federal Economic Integration?*, Paper Presented at the Conference on Federalism and the Nation-State, University of Toronto 35-36 (June 4-6, 1992) (as revised Jan. 1993) (unpublished paper, on file with author).

8. Tommaso Padoa-Schioppa, *Economic Federalism and the EC*, Keynote Address at the Conference on Federalism and the Nation-State, University of Toronto 3 (June 4-6, 1992) (transcript on file with author). Given the actual range of public expenditure, this approach to subsidiarity would have to be expanded to cover the provision of what might be called "quasi-private" goods. See ROBIN BOADWAY, *THE CONSTITUTIONAL DIVISION OF POWERS: AN ECONOMIC PERSPECTIVE* 35 (1992).

9. RIVLIN, *supra* note 1, at 153. Rivlin adds that states are unlikely to support "basic scientific research" because benefits would spill over state lines. *Id.* at 12.

in health care. Although the Canada Health Act sets out the framework of the national health care system,<sup>10</sup> over seventy percent of health care funds are earmarked for the provinces.<sup>11</sup> Provinces negotiate fee schedules with local medical associations and approve budgets of individual hospitals. To be sure, Rivlin does not rule out some combination of federal and state roles in health care reform, but once we contemplate joint or overlapping functions, we need a more sophisticated categorization of tasks.

Subsidiarity is in fact entirely consistent with a system of central policy directives and local implementation. This is the principal model in European integration.<sup>12</sup> For instance, German federalism is based largely on a combination of federal legislation and *Länder* administration.<sup>13</sup> Rivlin, on the contrary, is anxious to eliminate state-administered federal mandates, because she believes they add to public confusion about which level of government is truly responsible.<sup>14</sup> Yet citizens may well choose to have national standards coexist with state responsiveness to local needs. Combined federal and state roles may better respond to popular will, as long as citizens are aware which level of government is responsible for which task.

#### B. *Tasks Assigned to State Governments*

In some respects, the prosperity agenda to be assigned to the states can also, in some respects, become an interstate trade barrier and weaken economic union. Canadians have devoted considerable attention to this aspect of skills training.<sup>15</sup> One purpose of retraining is to encourage labor mobility throughout the country, yet as Professor Howse has argued,

[t]he provincial perspective on training and adjustment is likely to focus on the needs of the province's own economy, and not to be oriented to preparing workers to take employment elsewhere in the country. Taxpayers in a given province are unlikely to want to invest in another province's labour force.<sup>16</sup>

---

10. Canada Health Act, R.S.C., ch. C-6. (1985) (Can.).

11. The provincial share has grown, from a 66% share in 1978 to a 72% share in 1988. ISABELLA D. HERRY & MICHAEL A. WALKER, GOVERNMENT SPENDING FACTS app. 10-5 (1991).

12. See Renaud Dehousse, *Integration v. Regulation? On the Dynamics of Regulation in the European Community*, 30 J. COMMON MKT. STUD. 383 (1992); M. Rainer Lepsius, *Beyond the Nation-State: The Multinational State as the Model for the European Community*, 91 TELOS 57 (1992); Andrew McGee & Stephen Weatherill, *The Evolution of the Single Market — Harmonisation or Liberalisation*, 53 MOD. L. REV. 578 (1990).

13. GG art. 83; see also DONALD P. KOMMERS, THE CONSTITUTIONAL JURISPRUDENCE OF THE FEDERAL REPUBLIC OF GERMANY 107 (1989).

14. RIVLIN, *supra* note 1, at 30-31, 109.

15. ROBERT HOWSE, ECONOMIC UNION, SOCIAL JUSTICE, AND CONSTITUTIONAL REFORM: TOWARDS A HIGH BUT LEVEL PLAYING FIELD 106-08 (1992). See generally James B. Davies, *Training and Skill Development*, in ADAPTING TO CHANGE: LABOUR MARKET ADJUSTMENT IN CANADA 163 (W. Craig Riddell ed., 1985); MINISTRY OF SUPPLY AND SERVICES OF CANADA, 3 REPORT OF THE ROYAL COMMISSION ON THE ECONOMIC UNION AND DEVELOPMENT PROSPECTS FOR CANADA 170 (1985).

16. HOWSE, *supra* note 15, at 106.

The federal government therefore has an essential role in skills training. Similarly, varying child care benefits, such as public-supported day-care or parental leave, can cause disruptions in labor mobility, as can impediments to transferring benefits like pension plans from one jurisdiction to another. In addition, local economic development programs are notoriously prone to "beggar-thy-neighbor" strategies. In the European context, the Treaty of Rome<sup>17</sup> supplements its principle of subsidiarity with a prohibition against "state aids" that would distort competition by favoring local undertakings.<sup>18</sup>

This analysis by no means amounts to an argument for exclusive federal jurisdiction over training, child care, or economic development. It does, however, suggest that Rivlin's quest for "a cleaner distinction . . . between the responsibilities of the federal government and those of the states" may be quixotic.<sup>19</sup> Canada, for example, has recently attempted to streamline the division of powers, in an effort to rid itself of a legal thicket of concurrency, "double aspect," delegation, paramountcy, and "minimal impairment."<sup>20</sup>

In the October 1992 constitutional referendum, Canadian voters rejected a proposal providing, among other things, for greater freedom to negotiate limitations to federal jurisdiction. Partial or complete federal withdrawal from labor market development and training, combined with compensation to the province, was a central and controversial feature of the proposal. Yet even this "decentralizing" proposal would have maintained crucial features of national jurisdiction: the federal government would have been able to negotiate a continued presence in the field, and the federal government, together with the provinces, would have been required to establish national objectives in relation to national aspects of labor market development programs and activities, which would "tak[e] into account the different needs and circumstances of the provinces."<sup>21</sup> Furthermore, federal jurisdiction to make expenditures on job creation programs would have been preserved.<sup>22</sup> Some continued jurisdictional overlap not only would have been endemic to the scheme — it would have been a desirable feature of it.

To summarize, rethinking federalism, as Rivlin advocates, will require more attention to the details of jurisdiction and to the kinds of jurisdictional overlap that ought to be maintained. In Canadian constitutional law, the old doctrine of jurisdictional "watertight compartments" in the ship of state has become an anachronism. It cannot cope with the growing complexity of agreements and arrangements among orders of government, to say nothing of government agreements with private citizens and groups. The task, therefore,

---

17. Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11.

18. See Conor Quigley, *The Notion of State Aid in the EEC*, 13 EUR. L. REV. 242 (1988).

19. RIVLIN, *supra* note 1, at 7.

20. See PETER W. HOGG, *CONSTITUTIONAL LAW OF CANADA* 371-434 (3d ed. 1992).

21. Charlottetown Accord, Aug. 28, 1992, § 11 (draft legal text on file with author) [hereinafter Charlottetown Accord] (proposed addition to Constitution Act, 1867 as § 93C(2)).

22. *Id.* (proposed addition to Constitution Act, 1867 as § 93B(4)).

is not so much to find a new set of separate compartments as it is to identify appropriate principles by which relations among levels of government can be managed.

### III. RACE TO THE BOTTOM VS. RACE TO THE TOP

To the extent that authority is decentralized, the question is whether rivalry among states will produce a race to the top or a race to the bottom: will states attempt to attract business by taking steps to improve services or by subsidizing businesses and relaxing, for example, environmental regulations?<sup>23</sup> Rivlin posits that decentralization will produce a race to the top: "Once clearly in charge, the states would compete vigorously with each other to improve services and attract business by offering high-quality education, infrastructure, and other services."<sup>24</sup> D.K. Tarullo's comments on the European Community provide a rejoinder to this view:

Such competition is desirable where regions vie to offer better schools or transport systems, or otherwise to enhance economic growth. But other forms of competition among regions to attract private investment can erode social standards — competitive tax abatements, wasteful subsidies or weakened environmental, health, or employment regulation opposed by business interests.<sup>25</sup>

Canada has been plagued by race-to-the-bottom problems associated with tax abatements and subsidies,<sup>26</sup> a race that now includes competition among provinces and jurisdictions south of the border.

Rivlin's confidence that her scheme would produce a race to the top seems to be based on three factors. First, she assumes that the sort of jurisdiction she would assign to the states would create considerable private demand for high levels of performance, particularly in education and transport. This assumption, however, applies less well to other areas of jurisdiction. Rivlin would assign to the states child care, economic development, and training. Without national minimal standards, state programs in these areas could be caught in a race to the bottom. Yet, if the federal government is to impose such standards legitimately, it may well have to share in the cost of the programs. Because such programs can be forms of business subsidy, the federal government must maintain at least some residual role to prevent subsidies that distort interstate trade. In Canada, the recent devolution proposal was in part designed to strengthen the economic union by bolstering

---

23. See Joel P. Trachtman, *International Regulatory Competition, Externalization, and Jurisdiction*, 34 HARV. INT'L L.J. 47 (1993).

24. RIVLIN, *supra* note 1, at 118.

25. Daniel K. Tarullo, *Can the European "Social Market" Survive 1992?*, 5 AM. PROSPECT 61, 63 (1991).

26. See generally HOWSE, *supra* note 15, at 102-04.

constitutional protection for the free movement of persons, capital, goods, and services.<sup>27</sup>

A second factor explaining Rivlin's confidence in the race to the top, even absent national standards and prohibition of trade distorting subsidies, might be that federal withdrawal from certain areas would be purely voluntary under her scheme and not constitutionally mandated. In other words, states would compete in a market for the provision of services that could be contested by federal reassertion of jurisdiction.<sup>28</sup> The mere threat of federal entry might be sufficient to discipline anti-competitive state behavior. However, state governments may prefer federal entry so as to have a scapegoat upon which to blame their own failure to provide a subsidy or other favor. Moreover, if competition depends upon the absence of barriers to entry, the high transaction costs of the legislative process must be considered. Finally, a credible threat of federal entry would require a stable pattern of constitutional interpretation after federal withdrawal from a field of activity, for there is a risk that the judiciary would not permit the reassertion of federal jurisdiction.<sup>29</sup>

The third and most important factor explaining Rivlin's confidence in a race to the top is that a new tax structure would put all states on a substantially equal fiscal footing. Because Rivlin recognizes the race-to-the-bottom dangers inherent in interstate competition to keep taxes low,<sup>30</sup> she proposes a system of common shared taxes to minimize this sort of danger. Competition to keep taxes low, however, is only one aspect of the race-to-the-bottom problem. Indirect forms of subsidy, such as competition to lower pollution standards, would not be addressed by a common tax scheme.<sup>31</sup>

---

27. Charlottetown Accord, *supra* note 21, § 31 (proposed addition to Constitution Act, 1982, R.S.C., app. II, no. 44 (1985) (Can.), as § 36.1(3)(a)). However, the new "Social and Economic Union" only enshrined "policy objectives" that were to be monitored according to a mechanism to be specified at a future date. *Id.*

28. Here, I am making an analogy to the "contestable market" hypothesis of Baumol, Panzar, and Willig. They posit that the welfare problems posed by monopolistic anti-competitive behavior can be solved as long as competitive pressure is exerted by potential entrants having no barriers to entry into the market. Such a barrier-free market is contestable. *See generally* WILLIAM J. BAUMOL ET AL., *CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE* (1982). It should be noted that central governments can be also guilty of imposing differential costs on various constituencies and playing them off against each other. *See, e.g.,* Pete du Pont, *Federalism in the Twenty-First Century: Will States Exist?*, 16 HARV. J.L. & PUB. POL'Y 137, 144-45 (1993).

29. Rivlin does not discuss the role of the judiciary in the expansion of federal jurisdiction, which is somewhat surprising given her focus on recasting the division of powers. For a somewhat partisan account of the judiciary's role in this context, see Lino A. Graglia, *From Federal Union to National Monolith: Mileposts in the Demise of American Federalism*, 16 HARV. J.L. & PUB. POL'Y 129 (1993).

30. Rivlin's analysis derives from Tiebout's work on local spending. *See* Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956). Rivlin, however, expresses doubts about whether individual mobility across state lines is heavily influenced by local tax rates. RIVLIN, *supra* note 1, at 137-38.

31. However, Rivlin would maintain some responsibility for transborder pollution control at the federal level and thereby restrict the capacity of states to give indirect pollution subsidies. RIVLIN, *supra* note 1, at 12.

Rivlin's book canvasses various methods for achieving a common tax, but one point in particular merits discussion. A guaranteed common fiscal framework must be the linchpin to Rivlin's broad devolution proposal. Thus it is in this context that she mentions, for the first and only time, the possibility of constitutional amendment. She writes: "Drastic as such a suggestion might seem, enshrining the common shared tax fund in a constitutional amendment might be necessary to ensure its survival and immunity from congressional tinkering."<sup>32</sup> Yet, recognizing the unlikelihood of a constitutional amendment, she is still prepared to proceed with devolution.

The model for Rivlin's proposed constitutional amendment is the German Basic Law. Chapter X of the Basic Law identifies with considerable precision which level of government has access to which sources and which shares of tax revenue. It also gives the Bundesrat, a body composed of representatives of the *Länder* governments, a significant role in the oversight of federal taxation.<sup>33</sup> One important function of the German system is to equalize the revenue base of rich and poor *Länder*. The system is currently under review because of the growing disparities that came with unification.

Unlike Germany, Canada lacks a constitutional basis for fiscal harmonization. It therefore exemplifies the pitfalls of proceeding to decentralization without such a basis.<sup>34</sup> To be sure, Canada does have a constitutional basis for the principle of equalization transfers from the federal to the provincial governments, so that it has a more solid framework than the United States for guaranteeing a large measure of fiscal equality.<sup>35</sup> Nevertheless, the problem of tax rate differentials identified by Rivlin remains considerable in Canada.

The Canadian version of a value-added tax, the Goods and Services Tax (GST), provides a cautionary tale. In enacting this highly unpopular tax, the federal government sought to combine two of the approaches Rivlin outlines for achieving a common shared tax. On the one hand, it created a uniform national sales tax. On the other hand, it sought provincial agreement to harmonize existing retail sales taxes with the federal tax. Just as Rivlin fears, holdout provinces scuttled harmonization. Canadians now have the accounting nightmare of administering two different forms of sales tax, one federal and

---

32. RIVLIN, *supra* note 1, at 149.

33. For a brief account, see RICHARD JANDA, RE-BALANCING THE FEDERATION THROUGH SENATE REFORM: ANOTHER LOOK AT THE BUNDESRAT 14-16 (1992).

34. In the last round of constitutional discussions, the federal government proposed the establishment of a Council of the Federation that would have the mandate "to vote on common guidelines for fiscal harmonization and coordination, and make decisions on improved processes for collaboration in this area." MINISTRY OF SUPPLY AND SERVICES OF CANADA, SHAPING CANADA'S FUTURE TOGETHER: PROPOSALS 42 (1991).

35. Boadway discusses why the existing scheme does not fully achieve fiscal equality. See BOADWAY, *supra* note 8, at 46.

the other provincial, together with variations among the provinces on the tax rates and tax base.<sup>36</sup>

Thus, although Rivlin recognizes the race-to-the-bottom problem, her partial solution to it, common shared taxes, will be difficult to achieve. Rivlin acknowledges this difficulty, but does not recognize the degree to which it renders her decentralization program tenuous. Canada offers mixed results on common shared taxes. Although Canadians benefitted from a significant equalization program even before adopting explicit constitutional guarantees, they have been unable to achieve tax harmonization.

#### IV. THE DANGERS OF OFF-LOADING THE FEDERAL DEFICIT

Dr. Rivlin is prepared to back decentralization even in the absence of fiscal guarantees to the states, because she believes, first, that the states will be better able to persuade voters of the need for tax increases<sup>37</sup> and, second, that harmonization can be achieved incrementally.<sup>38</sup> However, one should not underestimate the danger that the states will find the deficit simply transferred to them.

Canada provides an example of this problem. Beginning with the 1989 budget, the federal government sought to limit the size of transfers to the provinces.<sup>39</sup> First, the federal government capped the largest program of unconditional transfers, referred to as Established Programme Financing, which provides assistance for health care and post-secondary education. Next, the federal government unilaterally reduced funding for the Canada Assistance Plan (CAP), a program through which the federal government reimbursed the provinces for fifty percent of their "eligible expenditures" for assistance to persons in need. As a shared-cost program, CAP had operated under a federal-provincial agreement. Not surprisingly, the provinces protested the federal government's expenditure reduction of the program, and, in a recent landmark decision, the Supreme Court of Canada ruled that the federal government was unfettered in its power to break funding commitments.<sup>40</sup> The proposed constitutional amendment defeated in the 1992 referendum

---

36. For an account of GST harmonization, see Stanley L. Winer, *Taxation and Federalism in a Changing World*, in *TAXATION TO 2000 AND BEYOND*, CANADIAN TAX PAPER No. 93, at 343 (Richard M. Bird & Jack M. Mintz eds., 1992). See also Charles E. McLure, Jr., *What Can the United States Learn from the Canadian Sales Tax Debate*, in *CANADA-U.S. TAX COMPARISONS 295* (John B. Shoven & John Whalley eds., 1992).

37. RIVLIN, *supra* note 1, at 16 ("Perhaps taxpayers are clearer about their need for state and local services and are more willing to pay for them than for the more remote services of the federal government.").

38. *Id.* at 152. ("Cooperation on common taxes might start in a small way — say with catalog sales or professional services — and then spread to a larger portion of the tax base.").

39. See DEPARTMENT OF FINANCE OF CANADA, BUDGET PAPERS 13 (1989).

40. Reference re: Canada Assistance Plan, 83 D.L.R. (4th) 297 (1991).

would have enshrined a general mechanism for rendering intergovernmental agreements enforceable.<sup>41</sup>

Taking into account transfers from the federal government, the provinces have received the largest share of revenue since the early 1960s.<sup>42</sup> By 1988, their share had levelled off at about sixty-five percent.<sup>43</sup> Such support enabled the provincial governments to operate on nearly balanced budgets through the late 1980s.<sup>44</sup> However, the imposition of federal caps on transfers in 1989 to the provinces has seriously worsened their fiscal position. By the end of the third quarter of 1992, the combined deficit of the ten provincial governments reached Can\$24.9 billion, nearly equivalent to that of the federal government, which stood at Can\$28.8 billion.<sup>45</sup> Provinces have been raising taxes and cutting expenditures, but voters are no more receptive to these provincial measures than they were to federal tax increases and spending cuts.

Rivlin would likely say that the key difference between the revenue position of the American states and that of the Canadian provinces is that most states are required by state constitutions to maintain balanced budgets, which is unheard of in Canada.<sup>46</sup> In other words, decentralization in the United States would have the virtue of transferring spending from a level of government that need not maintain a balanced budget to one that must. According to James Savage, the constitutions of forty-three states have balanced budget amendments.<sup>47</sup> Nevertheless, states have managed to generate significant state debts through off-budget spending or non-guaranteed borrowing by issuing state agency revenue bonds, borrowing through public corporations, delegating state operations to local governments and agencies, and using lease-purchase agreements.<sup>48</sup> James Bennett and Thomas DiLorenzo have documented the growing portion of state debt accounted for by non-guaranteed debt, a form of debt more expensive to finance than guaranteed debt.<sup>49</sup> They go so far as to argue that state balanced budget amendments

---

41. Charlottetown Accord, *supra* note 21, art. 26. Agreements would have had a maximum five year duration. *Id.*

42. See Winer, *supra* note 36, at 346 fig. 10.2.

43. *Id.*

44. See S. DAMUS, CANADA'S PUBLIC SECTOR: A GRAPHIC OVERVIEW 6 (1992) (charting federal, provincial, and local government budgetary surpluses and deficits).

45. ECONOMIST INTELLIGENCE UNIT OF CANADA, COUNTRY REPORT, No. 1, 1993, at 11.

46. See RIVLIN, *supra* note 1, at 14. ("Because, unlike the federal government, states and localities cannot normally borrow to cover operating expenses, they are forced to raise taxes and cut services as soon as their reserves are exhausted.")

47. See JAMES D. SAVAGE, BALANCED BUDGET AMENDMENTS & AMERICAN POLITICS 117 tbl. 14 (1988). These amendments usually contain the following requirements: "(1) a nominal debt was allowed to cover casual deficits; (2) beyond this, the consent of the people was required; and (3) the state might not endorse obligations of others." *Id.* at 118, *quoting* BENJAMIN U. RATCHFORD, AMERICAN STATE DEBTS 122 (1941).

48. *Id.* at 238.

49. JAMES T. BENNETT & THOMAS J. DILORENZO, UNDERGROUND GOVERNMENT: THE OFF-BUDGET PUBLIC SECTOR 92-94 tbl. 15 (1983) (noting total of over \$39 billion by 1977).

"have had very little impact on the expansion of the nonfederal public sector," because politicians "have managed to move large segments of the public sector 'off the books.'"<sup>50</sup> Furthermore, voters have frequently approved the issuance of state bonds rather than faced increased taxes, as the recent California experience illustrates.<sup>51</sup> Thus, it may be a mistake to rely upon constitutionally required balanced budgets as a fiscal basis for decentralization. Even given balanced budget amendments, devolving federal responsibilities to the states may simply transfer the federal government's fiscal crisis to the state level.

## V. DECENTRALIZATION AND DEBT CONTROL

The final problem with Rivlin's analysis is her conviction that decentralization will partially solve America's public debt problem as local efficiencies develop and taxpayers show greater willingness to pay for clearly justified state services.<sup>52</sup> Canada is a good test case for this proposition because decentralization along the lines suggested by Rivlin would lead to a structure similar to the Canadian model. However, decentralization has not been of substantial assistance in solving the debt problem in Canada.

In 1984, Canada's net public debt was 26.7% of its gross domestic product (GDP), while the U.S. net public debt was 24.9% of GDP. By 1991, the net public debt in Canada had grown to 49.2% of GDP, as compared to 34.7% in the United States.<sup>53</sup> By 1990, interest payments on the debt, as a percentage of total expenditures, were almost twice as high in Canada as in the United States.<sup>54</sup> As Canada's debt was rising disproportionately faster, interest payments were crowding out other expenditures to a higher degree.<sup>55</sup> By any measure, Canada's debt problem is worse than that of the United States. At the very least, one can conclude that decentralization has not been of substantial assistance in solving the Canadian debt problem.

## VI. CONCLUSION

Broadly speaking, Canada and the United States both developed the division of federal and local authority that the founders of the other country wanted. Conceived in the wake of the American Civil War, the British North America Act<sup>56</sup> reflected a will to produce a stronger central government than

---

50. William E. Simon, *Epilogue* to BENNETT & DiLORENZO, *supra* note 49, at 182.

51. See SAVAGE, *supra* note 47, at 239.

52. RIVLIN, *supra* note 1, at 16, 126, 179.

53. OECD ECONOMIC OUTLOOK, Dec. 1992, at 143 tbl. 41.

54. For a discussion of the dynamics of the debt problem see Christopher Green, *From "Tax State" to "Debt State,"* 3 J. EVOLUTIONARY ECON. 23 (1993).

55. For a review of the debt situation in Canada, see HERBERT G. GRUBEL ET AL., LIMITS TO GOVERNMENT: CONTROLLING DEFICITS AND DEBT IN CANADA (1992).

56. British North America Act, 1867, 30 & 31 Vict., ch. 3 (Eng.).

was provided for in the U.S. Constitution. For example, Canada's trade and commerce clause was deliberately drafted so that it would not be restricted to interprovincial or international commerce. Residual power in Canada was assigned to the federal government. Nevertheless, the realities of provincial diversity and the caution of Canadian and British courts produced an institutional structure more closely resembling what James Madison envisioned than does the current organization of the U.S. federal government.

Indeed, even Alexander Hamilton imagined that the United States would remain a largely decentralized polity. He wrote Federalist 17 in response to the anti-Federalist contention that the new Constitution would set in motion a process whereby the central government would tend to absorb the authority granted to the states:

The superiority of influence in favor of the particular governments would result partly from the diffusive construction of the national government, but chiefly from the nature of the objects to which the attention of the State administrations would be directed.

. . . Upon the same principle that a man is more attached to his family than to his neighborhood, to his neighborhood than to the community at large, the people of each State would be apt to feel a stronger bias toward their local governments than towards the government of the Union; unless the force of that principle should be destroyed by a much better administration of the latter.<sup>57</sup>

Perhaps in the United States, the force of that principle was destroyed by a much better administration of the central government, at least since the New Deal. Perhaps Rivlin is right. With the central government's administrative ability seriously in doubt, it might be appropriate to return to the original conception of American federalism and, in Hamilton's words, let government "come home to the feelings of the people."<sup>58</sup>

Yet there is something technocratic and unconvincing about basing federalism on specialists' predictions as to which level of government is the most efficient spender. Federalism, after all, has the virtue of allowing citizens to retain the plurality of their allegiances and providing multiple fora for democratic debate. Pluralism and accountability commend to us the idea of revitalizing federalism much more so than does a conviction that decentralization produces fiscal responsibility. To paraphrase a former Canadian premier, on a list of one hundred good reasons for federalism, debt control would surely be number one hundred and one. If decentralization occurs without an equalized and guaranteed fiscal base, it is likely to be a recipe for exacerbating existing inequalities and crippling local governments. If, on the other hand, Rivlin were to have her fondest wish — constitutionally entrenched fiscal re-balancing along the lines of the German model — the true virtues of federalism could flourish.

---

57. THE FEDERALIST No. 17, at 119 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

58. *Id.* at 120.