EQUALIZATION TRANSFERS AND CONVERGENCE BETWEEN FEDERAL AND UNITARY SYSTEMS: A CONTRIBUTION TO THEIR HISTORICAL ANALYSIS

Giorgio Brosio, Università di Torino

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Keywords: evolution of intergovernmental relations, equalization transfers, political institutions
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GIORGIO BROSIO

Abstract

Equalization transfers, or grants, are a crucial component of modern federal and unitary countries. They also shape the evolution of different political systems promoting convergence in their effective working. The literature does not provide studies with a long-term and comparative perspective despite the relevance of this approach to the study of intergovernmental relations. The paper provides a contribution aimed at filling this void.

It considers a small set of countries, including two unitary systems, Italy and the UK with a focus on English local government and three federal countries, Australia, Canada, and the United States. Federal systems are paying now more attention than initially to uniformity of policies and equality of access to the benefits of public policies, while unitary systems show now much more attention than in the past to reaching equality of access and benefits from policies through local autonomy and use of transparent intergovernmental grants, rather than with hierarchical command. Another way of illustrating this process is stressing the growing recognition of common citizenship in both federal and unitary states.

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Dipartimento Economia e Statistica Cognetti de Martiis, Università’ di Torino
giorgio.brosio@unito.it
Introduction

Equalization transfers, or grants, are a crucial component of modern federal and unitary systems. Their aim is to allow citizens in similar income and personal conditions to have access, wherever they reside in the country, to exactly the same quantity/quality mix of services and pay the same amount of taxes. They serve the implementation of the principle of inter-jurisdictional equity that says that residence should not be determinant for securing access to local services and for bearing their cost. Characteristics and production methods can vary locally to satisfy local autonomy (as a matter of fact no strings are attached to the use of equalization grants), but citizen needs for local services are satisfied on equal terms across the whole country.

Their use in industrial countries is now almost universal (among the OECD countries only the US does not have them) and is also rapidly growing in emerging and, even, in poor countries. Their appearance and their present pervasive role show the amount of convergence that has taken place in the working of federal and unitary systems. As we will see, federal systems are paying now more attention than initially to uniformity of policies and equality of access to the benefits of public policies, while unitary systems show now much more attention than in the past to reaching equality of access and benefits from policies through local autonomy and use of transparent intergovernmental grants, rather than with hierarchical command.

This view is controversial in the literature and, according to some authors (Petchey and Walsh, 1993), it even does not make much sense to compare equalization grants in federal and unitary countries in view of their completely different targets. Federal countries may need to compensate their constituents units from the disadvantages their suffering from federalization and do not consider equality of access across the whole country as top priority, while unitary countries have almost opposite priorities.

General grants with compensatory purposes have been paid, as a matter of fact, in federations since their beginning, but equalization transfers targeted to the principle of inter-jurisdictional equity began in a unitary state, the United Kingdom and more specifically in England in 1929 with the introduction a system of grants initially of modest entity based on a formula that included needs and revenue. Canada and Australia started their now widely popular systems only after World War II, a long time after the inception of the two countries. By contrast modern federations, such as those of German and Austria, have equalization transfers enshrined in their constitution. Unitary countries lagged behind the UK but most of them, such as the Scandinavian countries, Korea, Japan, France, Italy and many others have today similar systems.

Equalization transfers occupy a large place in the literature on intergovernmental relations including a few comparative studies of present systems and historical analyses of individual countries. There is, according to Authors’ knowledge, no historical comparative analysis of equalization transfers despite its relevance for understanding the evolution of federal and otherwise decentralized systems. The paper intends to fill this void. In view of the complexity of the task requiring a lengthy observation of intergovernmental relations it considers a small set of countries, including two unitary systems, Italy and the UK with a focus on English local government (extending the analysis to the UK implies tackling four distinct cases) and three federal countries, Australia, Canada, and the United States. The smallness of the sample assigns to the paper an exploratory character. Italy and the United Kingdom represent two polar examples of unitary systems. Italy has the typical Napoleon-originated structure with all

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1 A concise illustration of the principle and of the structure of the transfers is provided in Annex 1.

2 Wheare (1963) provides a landmark contribution on the beginning and evolution of transfers in federations, while Boadway (2015) explores in deep the equity and efficiency properties of equalization systems. Political economy approaches are also a permanent component of the literature (Grossman, 1994; Dixit and Londregan, 1998; Khemani, 2003, for India and Diaz Cayeros, 2006, for Mexico).
its subnational units operating within the same legal framework and no difference in governance between urban and rural areas. England, at least until late 1880s, represents the opposite system where there is no national uniform discipline and where local government is specialized with municipal governments operating on their initiative only in the urban areas, and the counties operating in the rural ones. Australia and Canada provide elaborated, but distinct systems of equalization transfers, while the U.S is a notable case because of the absence of these grants. Each case follows a common pattern starting with the illustration of the subnational government system. It continues with the analysis of the national policies and their interactions with subnational government focusing on finance and then more in depth on transfers. Despite the search for homogeneity, the analysis still varies in depth showing the exploratory character of the paper and reflecting the varying availability and accessibility of information.

The paper starts with in the first section an illustration of the initial conditions of each country and of the basics of equalization grants. The following five sections illustrate the individual country cases.

1 The initial context

Table 1 presents a small set of socio-political indicators depicting the initial socio-economic conditions and the institutional context of our small set of countries. For England we start from the 1830s, when crucial political and institutional reforms set up the nucleus of the modern system of local government.

Most indicators show the similarities, but also the difference between the five countries under study. Two indicators, personal and regional inequality, may be considered as potential catalyzers of equalization transfers when high values of them are reached.

Similarities refer to the structure of public finance. The sampled countries had, at their beginning and with the partial exception of Italy, a small government. The national government was mostly busy with war and defense. Only local and state governments whose expenditure was relatively more important than the central one, provided services to the population. Personal inequality was high in all countries, creating a demand for redistribution also at the local level, but political resistance by the rich classes was also strong. The five countries were also characterized, particularly Australia, by a relatively low degree of regional inequality as represented by GDP that somewhat reduced the need of equalizing transfers. This does not obscure the fact that socio-economic, cultural and institutional differences between the regions of the same country were very deep not only in recently created federal systems, but also in unitary ones.

Table 1 The initial socio-economic and institution context of the five countries

<table>
<thead>
<tr>
<th></th>
<th>GDP per capita</th>
<th>Democracy Index</th>
<th>Personal inequality Gini</th>
<th>Regional inequality</th>
<th>Urbanization rate</th>
<th>% Subnational exp/GDP</th>
<th>% National exp/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>1830</td>
<td>0.74</td>
<td>2.</td>
<td>-0.5</td>
<td>50</td>
<td>0.57</td>
<td>27.5</td>
</tr>
<tr>
<td>Italy</td>
<td>1860</td>
<td>59</td>
<td>4.0</td>
<td>51*</td>
<td>#</td>
<td>27.5</td>
<td>23.0</td>
</tr>
<tr>
<td>Austra lia 1900</td>
<td>59</td>
<td>4.0</td>
<td>51*</td>
<td>#</td>
<td>27.5</td>
<td>23.0</td>
<td>3.6</td>
</tr>
<tr>
<td>Canada 1860</td>
<td>51</td>
<td>1.4</td>
<td>4.0</td>
<td>*</td>
<td>44***</td>
<td>0.27</td>
<td>48</td>
</tr>
<tr>
<td>USA</td>
<td>1820</td>
<td>61</td>
<td>1.3</td>
<td>9.0</td>
<td>57</td>
<td>#</td>
<td>0.86#</td>
</tr>
</tbody>
</table>

Regional inequality is calculated on the basis of the difference in GDP between the richest and the poorest region standardized by the regional mean (Range). When the richest is equal to the poorer, the value of Range is zero.

Urbanization rate: is the percentage of population living in cities > 5000 inhabitants.

Differences in urbanization rates were substantial with the UK, Italy and Australia (this latter country is, however, observed at a later time) showing that urbanization had already started originating a demand for typical urban local services. However, with the extension of the franchise starting to take place, the five countries presented the potential of a rising demand for public services of which the local governments were the main providers. Finally, political conditions varied, with the bottom line represented by the existence in every country of constitutional regimes with elected government although with a substantial portion of the population still disenfranchised (especially in Italy, the UK and the US).

2. England and the UK

The inception of local government

The story, as recounted here, starts from the early 1830s, when three crucial reform acts laid down the building blocks of the edifice. No national general legislation on local government existed before these reforms and boroughs and local units had to take the initiative for self-governing, submitting their statute and requests for powers to the Westminster parliament. Agreement was given with a Private Act valid only for the requesting unit, becoming a chartered borough. Public Acts introduced national legislation applying *erga omnes*. Municipal corporations governed chartered boroughs and towns. Councils of freemen who paid the rates, a property tax, and had the right to vote ruled them. Municipal corporations operated to the exclusive benefit of their members, providing a very limited and business-promotion targeted range of services.

Counties were the territorial divisions of the central government and were administered by the Justices of Peace, appointed by the central authorities. Counties were in charge of justice and public order and extended their activity to the implementation of national laws, hence entering in other fields. Counties had also some power of soliciting the provision of some services from lower governments, such as towns and parishes.

Parishes operated almost exclusively in the rural areas and had been created for the administration of the Poor Law, i.e. for the provision of social protection. Most local governments had no paid employees. Voluntary work had to be provided by the ruling propriety classes, and by laborers. The map of local government mirrored a leopard skin. Colors of spots and their size reflected the diversity in assignments and in arrangements. Quality of government was very variable and generally considered as low; ‘what they (local bodies) do, they do unspeakably ill’.

The three reform Acts of the early 1830s reshaped the system of local government. They were the *Poor Law Reform Act* of 1834; the Municipal Corporations Act of 1835, both proceeded by the Representation of the People Act of 1832.

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3 Main sources used are: Foster, Jackman and and Perlman (1980), Redlich and Hirst (1903), Chandler (2007) and Waller (1983).

4 Parishes evolved as a unit of civil government after the Reformation, when they were transferred to the authority of the State Church.

5 John Stuart Mill (1883, p. 497), quoted by Porter (1997, p. 115.)
Poor Law Reform Act mandated the amalgamation of parishes into Poor Law Unions under the control of elected representatives of ratepayers. Also importantly the Poor Law Reform introduced for the first time central government oversight and control on local government through the institution of a three persons Poor Law Board.

The Municipal Corporations Act (also known as the Municipal Reform Act) of 1835, reformed government in the chartered boroughs, by establishing a uniform system of municipal boroughs governed by town councils elected by ratepayers. The Act reformed 178 boroughs. The Act did not extend to the City of London that remained a *sui generis* authority.

The Act allowed unincorporated towns to petition for incorporation. In the decades that followed a quantity of new boroughs were created, most of them in the newly developed urban areas. By 1888 the number of boroughs had increased to 280 and to 313 in 1901, with in the last of the two years 34 boroughs had a population of 100,000 and more, compared with only 3 in 1835 (Waller, p.243 and 1901 Census).

The Act clarified the functions assigned to all corporate boroughs without however expanding them, implying that boroughs had to petition the assignment of new tasks. It also re-ordered the system for raising local revenue centering it on the rates, *i.e.* the property tax.

The Representation of the People Act of 1832, known informally also as the Great Reform Act, reformed the franchise making the payment of rates as the main criterion for qualifying voters and reducing membership of trade corporations and other peculiar criteria. Also the law ensured correspondence between the national and the local franchise.

**National policies toward local government**

Finance contributed to shape the construction of English local government. The perspective of having to pay more rates for the new services and of being dispossessed of their power to govern scared rich landowners, while the newly emerging commercial and industrial class being interested in the provision of the new services to its own benefit played a more active role (Chandler 2007, page 50). The creation of single purpose, or mono-functional governments placed under the responsibility of local governments (the Commissions) provided an acceptable compromise, bringing separation of finance but with access to the rates.

Assignment of local responsibilities followed a cyclical trend with an expansion of local duties taking place since the 1830s and lasting until the outbreak of first World War, followed by a retrenchment until the 1998s with the Thatcher governments and then a upswing until the present day.

Following the industrial revolution and the municipal and political reform of the 1830s cities experienced a period of extraordinary economic and population growth, fostered by huge programs of infrastructure. Manchester, Bradford, Leeds, Sheffield, York, Durham, Birmingham, Stafford and Glasgow in Scotland to quote the main rivaled in growth and even exceeded London (Waller, 1983; Hennock, 1963).

In turn, growth fueled own revenues of cities allowing rapid expansion of their expenditure. Municipal socialism and the massive slums clearance represent the apogee of British cities growth (Gibbons, 2001). Until the fist decade of the 20th century local governments provided virtually all public goods and services consumed by the British citizens. Jackman and Perlman (1980) show that in 1905 out of the 114 million pounds

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6 The Burgh Reform Act of 1833 had already carried similar reforms in Scotland. Similar legislation would not be introduced in Ireland until the Municipal Reform Act of 1840.

7 A very good example is provided by the Health of Towns Act of 1847 motivated by the outbreak of epidemics. The Act created the Local Health Boards, as combinations of parishes and boroughs under control of Municipal Councils and instituted the General Board of Health at the national level to supervise their creation and to set the standards.
spent by the central government, 77 percent was absorbed by defense, overseas services and the national debt. Most of the remaining 23 percent was spent for the upkeep of the national parliament, the civil service and the judiciary. Local government expenditure was higher than the central one.

The Local Government Act of 1888 set up elected councils for the counties. Direct election strengthened the counties, but their role was reduced by the creation of County boroughs leading to a continuous carving up of the area of the Counties and, much more importantly, of their tax base. Counties increasingly asked for additional tax sources, or in alternative for equalizing grants. County Boroughs merged municipal functions with county functions, originating a differentiated system of local government. In areas under jurisdiction of County boroughs only one level of government existed. Outside these areas, two levels of government operated.

Spatial growth, however, was not fully inclusive: rural areas and cities that were not able to take off industrially were left behind. Entering the 20th century and especially after World War I the incipient decline of the more traditional industrial sectors affected many cities.

Structural reform resumed after World War II with the restructuring of London. In 1963 the Greater London Council took responsibility for strategic planning transport, fire services and education standards, while the provision of services was assigned to a tier of 51 boroughs. This structure is still basically the same today.

Local public expenditure and hence importance of local government reached a peak in 1975, with 36.0 percent of total public expenditure and started a declining trend thereafter. This trend parallels a process of trimming of local responsibilities that started after WW II with, first, the electricity and gas nationalization in 1947/48. It continued with the transfer to centrally appointed regional water authorities of competence of water, sewerage and related activities. Also the creation of the National Health Service (1946-48) confirmed a centralization trend that was accelerated during the Thatcher’s era with shrinking local role in housing, in education. The centralizing trend has not been completely entrenched, however, as we can observe contrary moves, such as the transfer in 1993 to County Councils and from the Ministry for Social Affairs of the responsibility for the provision of welfare service to the old and the disabled. Local expenditure represents 30 per cent in 2014/15 of total public expenditure, a still considerably high share. Education, welfare services the old people and housing are still the biggest local responsibilities (Government of England, 2015).

Financing local government

Many of the previous features of the evolution of local government can be explained by the financing system. Revenue was provided to all levels and categories of local government only by access to the rates, a tax paid by the occupier of immovable property. Increases in the rates were strongly resisted by the propertied classes, since occupancy coincided predominantly with ownership. Fees, tariffs and charges and trading profits also supplemented rates. Trading profits provided substantial revenue when local government entered successfully new areas of activities. When expenditure needs exceeded revenue from rates and tariffs the gap was filled by loans, originating problems for their service when the proceeds were not used for income generating activities.
Table 2 Income and recurrent expenditure of various Local Authorities in England and Wales, 1897-1908.

(Pounds per 100 units of population)

<table>
<thead>
<tr>
<th></th>
<th>County boroughs</th>
<th>Ratio to urban districts</th>
<th>London</th>
<th>Ratio to urban districts</th>
<th>Non-county boroughs</th>
<th>Ratio to urban districts</th>
<th>Urban district councils</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditure 1897/8</td>
<td>156</td>
<td>2.1</td>
<td>232</td>
<td>3.2</td>
<td>104</td>
<td>1.4</td>
<td>73</td>
</tr>
<tr>
<td>Expenditure 1907/8</td>
<td>272</td>
<td>2.2</td>
<td>435</td>
<td>3.5</td>
<td>178</td>
<td>1.4</td>
<td>125</td>
</tr>
<tr>
<td>Rateable value 1897/8</td>
<td>395</td>
<td>1.1</td>
<td>804</td>
<td>2.3</td>
<td>311</td>
<td>0.9</td>
<td>347</td>
</tr>
<tr>
<td>Rateable value 1907/8</td>
<td>476</td>
<td>0.9</td>
<td>804</td>
<td>1.6</td>
<td>439</td>
<td>0.9</td>
<td>497</td>
</tr>
</tbody>
</table>


No wonder that with exclusive reliance on rates and trading profits, whose importance was dependent in the level of income and wealth of individual local governments, disparities in the level of expenditure developed, as observable in Table 2 that reports the average per capita (or better per a hundred capita) level of expenditure in the various categories of urban governments in 1897/8 and 1907/8.

The level of per capita expenditure was correlated to the size of the municipality, as expected, implying that the range of services provided expanded with size of local units. The differences were huge with London, for example, spending in per capita terms more than three times than the smallest units, i.e. the urban districts. Disparities also expanded over the years and were due to the size of the tax base, the rateable value, but also and increasingly to the access by the richest local units to others sources of revenue, as shown in the table by the stability of ratio of the rateable value of the largest units to that of the urban districts.

The first transfers, grants as they were called, allocated to a whole class of local authorities were introduced as early as 1835. They referred to prisons and costs of tribunals, providing funds for two typical national functions mandated to local governments. Grants for salaries of poor law medical personnel and teachers were paid in 1846. Another category of transfers was paid under the Police Act of 1856 as a quarter of pay and cost of cloth. Grants paid to schools under the revised education code of 1861 were based on attendance and success of students; contributions under the public health act of 1872 amounted to half the salary of medical personnel, while contributions of half the cost of maintaining main roads were started in 1862.

Grants came to play a substantive role only after 1890. According to the Fowler’s Report on Local taxation (1893. Appendix C. Table 1, p. 94) considered as the only source for that period of data referred to all local governments, in 1868 Treasury grants amounted to 951,000 pounds out of total local revenue of 24,744,000 amounting to a mere 4% of the latter.

Fragmentation of transfers was deep and it continued to grow over time despite to the introduction of shared revenue to which we will come in the next paragraph. Just to mention a single number, there were 57 specific grants just for education by 1918 (Foster, Jackman and Perlman 1980, page 173).

The concession of transfers helped the enforcement of national standards and their allocation reflected differences in intensity of national interest towards local goods provision. As a matter of fact, many of the services locally provided had few characteristics of truly local goods and services, but being devoid of local branches the central government was practically unable to provide services at the territorial level. Devolution of tasks also relieved the central government of the burden of taxation (Peden, 2002; Harris, 1983; Inness, 2009).
Most grants were determined as a percentage of the expenditure made by beneficiary governments. The higher the national content of the policy, the higher the percentage of co-financing. This favored the richest local units. Only the grant for education had an equalization component, being paid in part also on the basis of tax capacity. However, this component was very small (0.5% of total education grant in 1891 reaching a share of 25% of whole elementary school grant only in 1911 (Foster, Jackman and Perlman, 1980, pp.174-5).

Starting from John Stuart Mill’s (On Liberty, 1959 and Considerations on Representative Government, 1861) famous analysis on spheres of government, an animated discussion of national versus local interest developed. It had deep roots into the sharing of the cost of policies. National functions were to be charged to the national Treasury (the taxpayers), local functions were to charged to local revenue (the rate payers).

A step towards equalization grants was taken by the Local Government Act of 1888, supplemented by a further Act of 1890, that assigned local governments with a share of the proceeds of certain specified taxes, more precisely the additional beer and spirit duties, the estate duty and the excise license duties.

This shared revenue came to replace most of the specific transfers related to the implementation of the Poor Law, and provided a modest additional fiscal space that depended on the trend in collections but not on discretionary decisions. The introduction of shared revenue signaled an innovation in policy, although it was partly allocated according to the origin principle (where tax revenue was generated) and partly on the basis of the previous grants, and hence with no equalizing content. No constraints were imposed on use of shared revenue and debate was started on the method of allocation.

In the fiscal year 1890/91 all grants and share revenues totaled 7,198,000 pounds out of total revenues of 50,662,000 (amounting to 15per cent of expenditure).

With the start of the 20th century regional inequalities expanded considerably with the decline of coal producing and old industrial areas (distance between the richest and the poorest region increased considerably (the range increased to 0.88 in 1911 against 0.57 in 1871) impacting also on the capacity of local governments to provide not too dissimilar levels of services. With the start also of the Great Depression the British government initiated a regional policy aimed at fostering the economic activity in the most depressed areas through subsidies to firms and later infrastructure building (see, for an account, Howarth, 1983). The policy varied in intensity in the following decade and was also accompanied with the introduction of constraints on firms’ creation in the London area. Regional policy operated to a limited extent as a substitute to equalization grant to local governments. As a matter of fact regional policy operates at a higher territorial level than that accessible to local governments.

The inception of equalization grants

The earliest, in their history, concept equalization grants system was developed in 1901 by the Royal Commission on Local Taxation chaired by Lord Balfour (see Sanger 1901). The minority Chapter drafted by Edward Hamilton and George Murray (Hamilton and Murray, 1901) represents, I believe, the first system of equalization grants aimed at implementing the interjurisdictional equity principle ever elaborated. The model proposed took in consideration differences both in expenditure needs and in fiscal capacity; although it was finally rejected, it created the reference point for the later introduction of equalization grants in the UK. Hamilton and Murray did not present a formula, but they elaborated a table (reported in the Annex as Table A1) whose clarity would deserve its inclusion in a modern textbook on local public finance. The model based the grant on the difference between standardized expenditure and standardized revenue. More precisely, standardized expenditure was determined in a rather simple way by taking the lowest per capita expenditure observed in a local unit. Standardized revenue was determined with a greater sophistication allowed by the availability of
information on the tax base. In particular, the national average tax rate on the property tax was applied to per capita base (*rateable value*) of the same tax, determining the fiscal capacity of each local government. *i.e.* what it should have collected by asking to its taxpayers the national average tax effort. The grant was finally determined by the difference between standardized expenditure and standardized revenue. In addition the excess of actual on standardized expenditure was partially financed with an extraordinary grant covering one fourth of this excess.

The 1929 Local Government Act started equalization grants with the introduction of a block grant consolidating a myriad of grants that made only 20 percent of the revenues distributed by the central government. The grants for education, police and housing that were still the most important in terms of size remained separate. The Act also reduced ("derated") by a factor of 75% the burden of the rates on agriculture and industry depriving the local governments of a most important source of revenue (Carlson, 1947).

The block grant was allocated according to a relatively simple formula that included both expenditure needs and revenue capacity. Needs were taken into account by distributing the grant according to population weighed according to three criteria of need, the number of children under 5 years of age, unemployment and sparsity of population. These criteria were targeted, although quite imperfectly (see Foster, Jackman and Perlman, 1980), to single out poverty conditions of local governments. As for revenue capacity the government units with a rateable value, the property tax base, below the national average, had their weighed population increased by the distance of their rateable value from the national average. Since the block grant covered only a small fraction of local expenditure it was only partially able to ensure uniformity of service provision.8

The 1948 Local Government Act brought an expanded version of equalization grant, but it reversed the focus of equalization, targeting the grant to fill the gap of revenue capacity, by bringing per capita revenue from rates of every local government to the national average level.9 Some weight to population remained, children under 15 and sparsity, ("new grants systems nearly always contain vestigial remains of the old ones", Foster, Jackman and Perlman, 1980, page 188) maintaining consideration of expenditure needs in the allocation formula.

Continuous change has characterized the evolution of equalization transfers. In 1959 expenditure for education was incorporated into the grant and a few years later also expenditure for roads. In 2006, however, education was taken away and financed with an earmarked grant. More consideration has also been given to expenditure needs and, finally, also revenue from commercial and industrial revenue has been included in the formula.

Basically the fundamental traits of the system have remained the same despite incessant change. Presently grants, both for equalization and specific purposes, account for the largest share of total local government revenue (net of loans). As of 2016-1710 their share was 57% down from a peak of 65% two years earlier. Specific grants are the biggest component accounting for three/fourths of total grants, implying that equalization grants cover 15 per of total revenue. As a matter of fact their target is bring equality only in the share of expenditure that is not financed with specific grants.

The most interesting remark refers to the grant for education ("Dedicated Schools Grant"). It is by far the largest specific grant representing more than 70 percent of them. Education is left to local government, but it reflects a crucial national interest leading to the allocation of a specific grant that covers most of the expenditure of the sector. This is

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8 A good illustration is provided by Carlson (1947).
9 The individual amount of the grant was determined by taking the difference between the national per capita rateable value (assessed property value) and the per capita rateable value of the beneficiary government and by multiplying it for the population.
a pattern that we will find also, although somewhat attenuated in the Australian and Canadian federations.

Regional government and equalization

From May 1998 the UK has an asymmetric system of regional government. Scotland and Wales have each a legislative Assembly, and an executive.

Scottish authorities have been assigned with substantial powers in the fields of education, social services, housing and the police. Also the entire issues of tiers, size function and financing of local government are a Scottish responsibility. Welsh Authorities have more limited powers especially towards local government. Scottish authorities have also fiscal powers in the field of personal income taxation, although they have not used it.

Finance for the devolved functions is provided by a block grant that gives the devolved administrations a proportionate share of spending on ‘comparable’ functions in England, given their populations compared to England’s. The block grant is revalued each year according to the so-called Barnett formula that takes into consideration the change in the UK expenditure in the devolved areas, - for example if the British government decides to increase expenditure in housing by a given percentage the same increase will be granted to Scotland and Wales – a comparative factor (for example, the Treasury decided in the 2007 Comprehensive Spending Review to exclude all spending on the 2012 London Olympics from allocations to Scotland and Wales, on the ground that it was for the benefit of the UK as a whole) and the change in population. As a result of the actual working of the formula both Scotland and Wales have a public spending per head higher than that of England that reflects higher expenditure needs and costs. Interjurisdictional equity is and has been fully implemented since the beginning.11 As in federal states threats of secession contribute to shape financial relations between central government and the regions.

2 Italy

The beginning of the country

Italy started officially in 1861 with the military annexation to the former Kingdom of Savoy of the states governing the rest of the Italian peninsula. Building on the Italian longstanding tradition of autonomy, especially in the Center-Northern part of the country, each pre-unitary state had created its own system of taxation and of local government. Also political and cultural differences were extremely wide. It suffices to say that in 1861 less than 2 % of the population was able to speak the national language, Italian.

Italy, being at that time a mostly underdeveloped country, was characterized by relatively small regional differences in income12. However, Center and Northern states had a level of national and local taxation much higher than those in the South. Municipal revenue was about three times higher in the North than in the South (see Table 3). Given the equality of per capita GDP, revenue gaps reflected differences in the expenditure assignments prior to the annexation. It is also worth mentioning that the differences in

11 House of Commons, The Barnett formula, Briefing Paper, Number 7386, 13 April 2016
www.parliament.uk/commons-library | intranet.parliament.uk/commons-library | papers@parliament.uk | @commonslibrary.

12 “income inequality in pre-industrial countries today is not very different from inequality in distant pre-industrial times”, Lindert and Williamson. 2011, page 268.
revenue between the rural and the urban areas were higher with per capita amounts four times higher in the latter.

A law of 1861 divided the national territory in 59 provinces headed by a prefect appointed by the King, while a law of 1865\textsuperscript{13} introduced a national uniform system of municipal government. The existing municipalities (7,720 units at the time of the creation of the country in 1861) were maintained, but their expenditure responsibilities and revenue sources were unified across all Italy. Municipalities had wide responsibilities ranging from the typical urban services to protection of the poor. Provinces, as the French departments from which they took inspiration, had a narrow range of responsibilities, primarily roads, school construction and maintenance and assistance to the mentally ill. The King initially appointed mayors, but gradually popular election, with limited franchise, started in 1888 in the large municipalities and was afterwards extended to all. Local government was started.

National policies towards local government

Uniformity of expenditure and revenue assignments across the whole country put the Southern municipalities and provinces in a situation of deep initial disadvantage. To keep with their obligations Southern governments had to proceed to a massive increase of their taxes. Distribution of transfers from the centre was not even considered by the government. In addition the custom tariffs of the Kingdom of Savoy were extended to the all of Italy lowering the level of protection firms located in the South had enjoyed. This led to disappearance of most of Southern industry. Instead of paying compensation, the burden of national and local taxes was quickly and abruptly increased in the South, giving rise to violent protests and local revolts that were officially labeled as brigandage\textsuperscript{14}. From 1860 to 1899, local taxes per capita increased in the South by almost five times, while in North the increase was just above two times. The gap in revenue between the two areas reached its minimum in 1889 and began to widen very fast thereafter, when Italy started its industrialization process.

Until the creation of regional governments in 1970 no fundamental change in structure of local government took place. Additional and also expensive responsibilities were assigned to municipalities, as in the case of education, with no corresponding increase in tax handles. Competition for revenue with the central government became more acute. Urbanization and industrialization fostered demand for local services, while huge programs of national infrastructure exacerbated the need of revenue at the central level, by the colonial expansion, and later on by the (re) conquest of the Northeastern provinces still being part of the Austro-Hungarian Empire.

The assignment of primary education to municipalities, one of the first decisions taken by the new state, increased local government duties and financing problems. Under the new system, primary education had to be offered by the municipalities’ free of charge and “proportionally to the (municipalities’) spending capacity and according to their people’s need”. Uniform and strict standards were mandated for the provision together with obligations for families to ensure the enrollment of their children.

This was a typical national government policy of unitary of the epoch. The focus of the Italian policy was on ensuring that every local government implemented the national mandates, hence making service provision uniform. In the Italian narrative, the country “had still to be unified”, and locally provided services, being a main component of government policies, had to give their contribution. However, uniformity of service provision was far from achieved also in education. A government inquiry for 1865\textsuperscript{15} showed the presence of remarkable regional disparities in enrolment: only the Northwestern provinces of Italy had gross enrolment ratios substantially larger than 50%.

\textsuperscript{13} Law n° 2248 of March 20, 1865.
\textsuperscript{14} See Dal Lago (2014).
\textsuperscript{15} Reported by Cappelli (2013).
in 1863. The political influence of the clergy, which saw the expansion of public schools as a dangerous factor of secularization, was also a constraint on schooling along with poverty and low living standards especially in the rural areas.

Since no finance was provided, the poor municipalities were simply unable to stick to the mandates. A compromise was found in the dilution of standards. For example, while the law mandated separate classes for boys and girls, the government was forced to accept mixed schools in the poor and rural municipalities.

Two subsequent landmark acts illustrate very appropriately the national government policy towards the municipalities (see Giarda, 2014). The first one was the Roads Act of 1868 calling municipalities to extend and to improve their road network. The law also mandated that the huge financial cost necessitated by its implementation had to be covered with surcharges on local taxes, tolls on new roads, contributions from the landowners of the affected estates, loans and, finally, with central government support that turned out to be very modest. The second law, called the Health Reform Act, was passed in 1888 and referred specifically to water, sanitation and local (family) doctors. Again, a high financial burden was imposed on municipalities, while the central government contribution was kept at minimal level.

Table 3 Regional disparities in gross domestic product and local revenues: secular trends in Italy

<table>
<thead>
<tr>
<th></th>
<th>1860</th>
<th>1870</th>
<th>1876</th>
<th>1889</th>
<th>1912</th>
<th>1925</th>
<th>1936</th>
<th>1951</th>
<th>1971</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Center-North</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Per capita GDP as % of national average</td>
<td>1.06*</td>
<td>1.06*</td>
<td>1.06*</td>
<td>1.08*</td>
<td><strong>1.10</strong></td>
<td>1.12^</td>
<td>1.16^^</td>
<td>1.23</td>
<td>1.14</td>
</tr>
<tr>
<td>Per capita local taxes</td>
<td>5.75</td>
<td>7.99</td>
<td>9.08</td>
<td>12.21</td>
<td>17.36</td>
<td>94.70</td>
<td>112.81</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Incidence of local taxes on GDP</td>
<td>1.04</td>
<td>1.32</td>
<td>1.34</td>
<td>1.69</td>
<td>1.63</td>
<td>1.53</td>
<td>2.35</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>South</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Per capita GDP as % of national average</td>
<td>0.9*</td>
<td>0.9*</td>
<td>0.9*</td>
<td>0.89*</td>
<td><strong>0.84</strong></td>
<td>0.77^</td>
<td>0.71^^</td>
<td>0.61</td>
<td>0.73</td>
</tr>
<tr>
<td>Per capita local taxes</td>
<td>1.88</td>
<td>4.61</td>
<td>5.87</td>
<td>8.96</td>
<td>9.24</td>
<td>45.30</td>
<td>56.73</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Incidence of local taxes on GDP</td>
<td>0.38</td>
<td>0.90</td>
<td>1.02</td>
<td>1.51</td>
<td>1.13</td>
<td>0.82</td>
<td>1.18</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Country total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Per capita local taxes</td>
<td>4.03</td>
<td>6.56</td>
<td>8.03</td>
<td>10.93</td>
<td>14.22</td>
<td>76.36</td>
<td>n.</td>
<td>a.</td>
<td></td>
</tr>
</tbody>
</table>

* 1861, **1871, ***1891, ^1911, ^^1931, ^^^1938

The fascist period, 1922-45, saw some centralizing moves the most important of which was the appointment of the mayors and heads of provinces by the government.

The biggest change in intergovernmental relation took place in 1970 with the creation of the regional governments. It implied the devolution of important tasks, such as primarily health care, to the regions.

The revenue

A fiery competition on access to tax revenue sources characterized the long-term evolution of intergovernmental relations in Italy, but with no fundamental changes of the main traits of the system. Local budgets have had to rely on surcharges on national taxes with a frequent repealing of their assignment and sub-sequent re-assignment depending on the political orientation of the national government of the time and the situation of the public finances. Also, the introduction of a local income tax as early as in 1868 did not
represent an exception to this pattern, as the tax was repealed and re-introduced until its final elimination with the national tax reform of 1970.

Grants were used very parsimoniously starting with education. To reduce disparities and to alleviate the burden on municipalities, the central government intervened repeatedly to support the payment of teachers' salaries. Initially, in 1876 (with the Coppino Act) it contributed to the direct payment of the statutory salary increases; then in 1886 it intervened with the payment of a specific grant to finance the cost of a new statutory salary increase. Finally, in 1904 the national government took on itself the payment of the entire salary of teachers. There was no redistribution intent in those three interventions. Rich municipalities were able to hire more teachers and to get a larger help from the national government.16

When some municipalities, especially in the South, got in deep trouble the central government preferred to play substitute to them, acting on a case by case basis with the so-called Special laws, such as those for Naples, Sicily, Calabria and Rome, where the national government intervened directly through the provision of infrastructure rather than the payment of subsidies. The approach was typically centralistic, based on the assumption that it was more efficient to foster directly the local economy and through it the tax base, rather than to provide direct financial support to local governments. Financial assistance to them was confined to loan guaranties and to the granting of some soft loans.

In the last decades of the 19th century a limited amount of financial support was extended to a growing number of municipalities by relieving them of a share of the service of debt raised for public works.17 The program took strength along the South-North direction, starting with the Sicilian municipalities, and, finally, extending its reach to the whole country.

The draft of a revised law of 1930 on local government presented mentioned the need of introducing equalization transfers to municipalities. The government rejected the idea of allocating transfers based on indicators of need and revenue. The reason was that the introduction of “complicated automatic allocation criteria based on population of tax capacity” would have impacted negatively on “the possibility of controlling the dynamics of these funds”.18 The government relied on selective grants to cover approved deficits.

The inception of equalization grants

Regional inequality peaked in 1951. To correct it the government a massive program transfers with spatial equalization purposes. During World War II the government introduced a fund for paying contributions filling the deficit of the municipalities most affected by the war. Individual transfers, consisting in the permission to raise loans whose service would be at the end taken by the central government, were negotiated between the central government and the concerned municipalities. The program was renovated and extended until the tax reform of 1970.

Also the government introduced in 1949 a program of allocation of capital grants to all municipalities. Three years later, 1952, a general transfer fund fed with a share of the proceeds from the turnover tax was created. The key for the distribution was population.

Equalization transfers started with the tax reform of 1970 with that brought the elimination of practically all-local taxes. Also no taxes were assigned to ordinary regions that were created in the same year.

16 Battilani (1997) details on this point showing that the areas with the highest revenue were granted the highest government subsidies. Hence, the distribution of subsidies led to the widening of regional gaps.

17 Technically relief was given through allowing access by local government to postal saving via

A system of revenue sharing whereby the central government guaranteed the revenue from the lost taxes with some adjustment to inflation funded local governments and regions. This adjustment was then slightly increased for the Southern municipalities. At the same time, the old habit of transferring municipal debt to the central government was strengthened, again in very discretionary basis. In 1980 a small equalization fund whose allocation was based on the distance from the national average of per capita expenditure of the recipient municipality.

Local tax autonomy was reintroduced gradually through a local property tax and a surcharge on the personal income tax levied by the central government.\textsuperscript{19} In 2014 own tax revenues accounts for 58\% of total revenue of municipalities and for 49\% for provinces, recreating inequality of per capita revenue.

Local taxation has been the object of frequent interventions by the national government and has responded to short-term fiscal or political motivations with little regard for local autonomy and with detrimental effects on the capacity of both the local governments to plan and budget. This has been especially the case with the municipal property tax, repeatedly modified in recent years as regards its coverage, rate structure, and relation with the above-mentioned taxes to finance local services. Between 2011 and 2014 there have been some 10 modifications of municipal property taxation. Per capita municipal tax revenues in 2014 averaged 652 Euros, but with substantial variance, ranging from 443 to 931 Euros. The lowest values were recorded in municipalities located in the special-statute regions and in the South, reflecting a mixture of lower revenue-raising capacity and efforts. Correspondingly, the degree of dependence from transfers from higher levels of government also varied significantly among municipalities.

An epochal change in the transfer system took place with the constitutional review of 2001 that mandated the elimination (sic!) of all conditional transfers to all subnational governments and their replacement with, possibly, the most ambitious system of equalization transfers ever tried.

The system distinguishes between “fundamental” and “non-fundamental” local/regional functions. For the municipalities, fundamental functions would include general administration, local police, education, local transport, management of the territory and of the environment, and social assistance, altogether accounting for about 70\% of municipal current non-interest spending. For the Provinces, they would include the functions defined as fundamental by the Delrio law.

Article 117 of the constitution assigns to the exclusive responsibility of the central government the definition of standards called „essential levels of service provision” for a set of basic services that are considered „necessary to guarantee equality of basic individual and social entitlements across the whole nation”. These services include for regions health, education and social protection, plus a still undefined set of services provided by municipalities and provinces. These services will account for at least 70 \% of subnational expenditure. Transfers are determined on the basis of the difference between the standard costs of provision of these essential levels and the revenue derived from levying at a standardized rate, the local (own) taxes. Hence full equalization should be ensured for these services.

Because of the complexity of the system its implementation has been delayed until very recently and it is being introduced gradually.

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\textsuperscript{19} The illustration here is based on Piperno (2013).
Creation of regional government in Italy took two steps. The first one, just after WWII, was to create an asymmetric system as in the UK with the creation of five autonomous regions, two of which on the main islands, the remaining three situated at the Northern border of the country and with ethnic and/or linguistic minorities. The regions have an elected assembly and an executive, enjoy constitutional protection and have a wide range of responsibilities. A very generous system of shared national revenues provided finance. Sharing rates reach 90 percent for all major national taxes in the three Regions, Sicily, Valle d’Aosta and Alto Adige (South Tyrol) that presented major secessionist threats. In addition, autonomous regions have access to all central transfers. This is a situation of privilege widely resented in the rest of the country, since ordinary Regions, created in 1970, have lesser responsibilities and much lesser revenue. Health care is the preponderant task.

Financing of ordinary regions has followed since the beginning a marked equalizing approach. Revenue derives, in varying proportions over the years, from own taxes, specific grants and equalization grants. The main source is by far the health fund. Per capita revenue is everywhere aligned to the national average with only two extremely rich outliers, the tiny, rich but autonomous regions of South Tyrol and Valle d’Aosta, still banking on their legacy. Regionalization implied a gradual reduction of regional policies implemented through Cassa del Mezzogiorno. Equalization of revenue appears to be a substitute of regional convergence policy.

4 Equalization transfers in Canada

The inception of the federation

Canada was created by the constitution of 1867 with a structural vertical fiscal imbalance. On the eve of Confederation the expenditure of the colonies was extremely modest: Provinces and their municipalities were spending less than five percent of GDP (it corresponds with the total of federal and provincial share reported in Table 1). Most of expenditure was for debt service, in turn originated by the building of infrastructure for roads and railways. Expenditure for education and public welfare was negligible, while defense having been taken over by the Imperial authorities left no heavy burden on the colonies (Rowell-Sirois Report, Book 1, Chapter 1).

The new constitution transferred to the Dominion (the federal government) the responsibilities for defense and development infrastructure; it also transferred to the Dominion the service of provincial debt. To fund these responsibilities, the constitution assigned to the Dominion indirect taxes, at that time the most dynamic source of revenue. Direct taxes were left to the Provinces (Sections 91 and 92 of the Constitution) and consisted mostly of the municipal property tax. Ownership of natural resources above and below ground went to the Provinces (Section 109) as well as access to any revenue (at that time almost irrelevant) extracted from them.

Revenue assigned to Provinces was not enough to finance their expenditure responsibilities. An agreement provided gap-filling grants (subsidies) to the provinces for

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20 Alto Adige/South Tyrol has a German phone majority. Valle d’Aosta has a Francophone tradition that the Fascist regime tried to erase. Friuli Venezia Giulia has a small Slovenophone minority.

21 As the famous Rowell Sirois Report made clear: “The financial settlement at Confederation had left the provincial governments almost entirely dependent upon federal subsidies and the revenues from licenses, fees and the public domain” (Book 1, page 62).

22 In 1866 the tax revenue of the three Provinces that gave birth to the Dominion (Federation) of Canada, 59% of tax revenue derived from indirect taxes, 25 from property and other, while the remaining 16% came from fees, licenses and revenue from public domain. Rowell-Sirois Report, Chapter 1, page 44.
a ten-year period on the basis of the difference between the national average of per capita expenditure and the revenue. The reference to the national average lead to an estimate of a per capita grant of 80 cents that favored the province of Canada (split little afterwards in Ontario and Quebec), but put immediately at a disadvantage the two remaining provinces of Nova Scotia and New Brunswick that had a much higher deficit. The agreement assumed that equity was reached with the allocation to every province of the same per capita amount, without consideration of differences in actual expenditure needs and revenue.

The federal had since 1869 to increase the grant to Nova Scotia. It also paid subsidies to each of the new members of the Dominion, particularly to Manitoba and Saskatchewan.

Despite the federal government resistance, assistance to provinces provided continued to grow over the years. It consisted of four general non-conditional grants: a) the debt allowance grant; b) the equal per-capita subsidy; c) the special grant to Nova Scotia and New Brunswick and d) an additional equal per-capita subsidy for support to legislature and administration.

Specific/conditional subsidies had a late and slow start. The first conditional grant to Provinces started in 1913 and was paid for agricultural education. After the First World War a set of new joint Federal/Provincial projects were started in the areas of vocational training, highway construction and, more importantly since 1929, old age pensions and unemployment relief. Fifty per cent of the cost of these projects was covered by the federal government subject to the meeting a varying stringent standards. As in other federal countries, specific grants allowed the national government to enter in areas that were assigned to the provincial responsibility and to attain its own goals. In Canada focus was on interpersonal equity, i.e. achieving equality of cost of access to public services across the whole country.

Table 4. Canada: current revenue of provinces and expenditure for education in 1937. (Canadian Dollars per capita)

<table>
<thead>
<tr>
<th>Province</th>
<th>Prince Edward Island</th>
<th>Nova Scotia</th>
<th>New Brunswick</th>
<th>Quebec</th>
<th>Ontario</th>
<th>Manitoba</th>
<th>Saskatchewan</th>
<th>Alberta</th>
<th>British Columbia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own revenue</td>
<td>15.07</td>
<td>31.98</td>
<td>28.55</td>
<td>44.2</td>
<td>56.54</td>
<td>45.83</td>
<td>34.69</td>
<td>45.57</td>
<td>66.99</td>
</tr>
<tr>
<td>Transfers</td>
<td>7.06</td>
<td>3.6</td>
<td>3.56</td>
<td>0.83</td>
<td>0.79</td>
<td>3.42</td>
<td>5.98</td>
<td>2.68</td>
<td>2.16</td>
</tr>
<tr>
<td>Total</td>
<td>22.13</td>
<td>35.58</td>
<td>32.11</td>
<td>45.03</td>
<td>57.33</td>
<td>49.25</td>
<td>40.61</td>
<td>48.25</td>
<td>69.15</td>
</tr>
<tr>
<td>Transfers as % of revenue</td>
<td>31.90</td>
<td>10.12</td>
<td>11.09</td>
<td>1.84</td>
<td>1.38</td>
<td>6.94</td>
<td>14.73</td>
<td>5.55</td>
<td>3.12</td>
</tr>
<tr>
<td>Own rev as % of GDP</td>
<td>7.92</td>
<td>11.10</td>
<td>11.74</td>
<td>14.65</td>
<td>13.18</td>
<td>12.85</td>
<td>16.68</td>
<td>14.64</td>
<td>15.58</td>
</tr>
<tr>
<td>Per capita expenditure for education</td>
<td>5.9</td>
<td>7.78</td>
<td>6.08</td>
<td>7.24</td>
<td>12.01</td>
<td>9.03</td>
<td>8.72</td>
<td>12.14</td>
<td>12.47</td>
</tr>
<tr>
<td>As % of GDP</td>
<td>3.1</td>
<td>2.7</td>
<td>2.5</td>
<td>2.4</td>
<td>2.8</td>
<td>2.7</td>
<td>4.2</td>
<td>3.9</td>
<td>2.9</td>
</tr>
<tr>
<td>Per capita GDP</td>
<td>190.32</td>
<td>288.15</td>
<td>243.20</td>
<td>301.67</td>
<td>428.93</td>
<td>356.67</td>
<td>207.62</td>
<td>311.28</td>
<td>430.00</td>
</tr>
</tbody>
</table>

Source: Author’s elaborations on data from Rowell-Sirois Report, Book I, Chapter 8, various tables.

However, federal assistance was not able to ensure equality of total revenue among Provinces. Observed in 1937, the incidence of both general and conditional transfers on

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23 Main sources are in addition to the Rowell-Sirois Report the study prepared by Eggleston and Kraft (1939) for the Report and the very accurate history of intergovernmental financial relations in Canada written by Perry (1997).
provincial revenue was inversely correlated to provincial per capita GDP, as reported in Table 4. For example, the poorest province, Prince Edwards Island, had per capita revenue of 22.1 dollars against 69.1 dollars for British Columbia or 57.3 dollars for Ontario. These differences in fiscal capacity were translated into disparities in expenditure, as shown again in the table with reference to education, a crucial policy area. The share of education on provincial GDP was reasonably uniform over the Provinces, showing a remarkable effort by the poorest Provinces, but its per capita amount varied significantly and inversely to the GDP, from 5.9 dollars in New Brunswick to 12.5 dollars in British Columbia. Clearly, uniformity of service provision, and consequently of opportunities for the young population, was not attained.

The slow introduction of equalization transfers

Balancing provincial budgets became more difficult during the Great Depression, inducing the federal government to establish a Royal Commission on Dominion-Provincial Relations (the Rowell-Sirois Commission). In its 1940 Report, the Commission concluded that Provinces did not have sufficient taxing power to meet the constitutional responsibilities for which they were responsible. The Report considered a wide range of alternatives rejecting any option that would have reduced the policy responsibilities of the Provinces, or alternatively given Provinces greater fiscal capacity. Instead, the Commission recommended the centralization of taxation powers with the federal government with the guarantee of federally paid National Adjustment Grants to the Provinces and territories “enable(ing) a (each) Province to provide adequate services (at the average Canadian standard) without excessive taxation (on the average Canadian basis)” with full discretion on their spending 34 The Dominion, however, did not accept the recommendations of the Commission.

The World War II Wartime Tax Agreements represent ex post a crucial step towards the introduction of equalization grants. With the Tax Agreements the federal government occupied the tax fields of personal and corporate income, and of succession duties in return for the payment of a rental fee to the Provinces that voluntarily vacated those fields. The rental fee was determined according to the collections with small corrections following individual negotiation and originated a system of revenue sharing making the Provinces more dependent on the Dominion government. After their formal expiration at the war the Tax Agreements were transformed in 1947 into the Tax Rental Agreements, the main difference being the adoption of a per capita equal sum as the main criterion for allocation. This criterion disadvantaged Ontario hat joined the Agreements only in 1952 after receiving some specific compensation, while Quebec remained outside.

Always agitated by secessionist aspirations, Quebec instituted its own personal income tax (PIT) system in 1954 (Brydeen, 2014, 2007). Since the Provinces had the constitutional right to levy direct taxes, the federal government feared that the move would trigger the creation of series of separate provincial income taxes. Therefore, in 1957, the federal government decided to transfer a share of each of the three so-called standard taxes to the provinces — 10 percent of the PIT, 9 percent of the corporate income tax (CIT) and 50 percent of succession duties. These transfers were paid according to the derivation principle, meaning larger per capita transfers for the richer provinces.

To correct this revenue inequality the federal government launched in the same year, 1957, the Equalization Program, which, in its initial version, guaranteed that for all Provinces the revenue from these shared taxes would be brought up to the per capita level of the average of the richest two Provinces (Courchène, 2007). Spatial differences in revenue started to have no impact on the access by citizens to provincial services.
It has to be noted that around the time of the launch of equalization transfers regional inequality in Canada that had peaked during the Great Depression had reached a low that never be maintained afterwards (see Table 4).

A number of changes have afterwards affected the Equalization Program extending, on the one hand its coverage, meaning the range of revenue sources that are subject to equalization, and, on the other, reducing its equalization content by calculating the standard of equalization with reference to a larger number of Provinces, or by excluding from equalization the revenues from natural resources when peaks in oil prices made the cost of equalization unbearable for the federal finances (Stevenson, 2006).

In 1982 the Federal responsibility to make equalization payments “to ensure that Provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation” was enshrined in the constitution. We have to remark the almost perfect similarity with the principle for equalization recommended by the Rowell-Sirois Commission.

Also in 1957 the federal government began to subsidize provincial programs of universal hospital insurance through a sector grant that became eventually the largest single grant to subnational governments in Canada. The health grant required provincial compliance to five principles or national standards. Initially, the grant was allocated fifty/fifty according to the cost of service provision and population (same per capita amount). In 1967 the federal government began to pay a sector grant to the provinces for post-secondary education. The grant replaced a previous grant allocated directly to the colleges and universities.

Starting from 1962 the federal government started programs of regional development assistance, targeted initially to the rural and mining depressed areas and expanded then to “special areas” (Perry, 1997, pp. 199-204). Programs include a variety of interventions going from industrial parks to training facilities. Despite targeting and intensity, regional disparities remained substantial.

In 1977 the federal grants in aid of health insurance and post-secondary education were replaced by a rather complex system, the Established Programs Financing (EPF), consisting of tax abatements and cash grants in roughly equal proportions. Federal income and corporation taxes were reduced to create space for taxation by provinces. In addition, the provinces would receive annual cash grants ensuring that the per capita combination of the tax abatement and the grant would be the same for each province. This implied that the poorer provinces collecting less from the abatement would receive larger per capita cash payments than the richer provinces.

The further evolution of sector transfers shows a growing combination of separate grants into more inclusive block grants. Presently, there are only two and there are allocated with the same criterion, i.e. same amount per capita. They are the Canada Health Transfer, a block grant provided to the provinces to help finance healthcare costs, with payments contingent upon compliance with the five provisions of the Canada Health Act. and the Canada Social Transfer, another block grant that provides financial support to the provinces to help finance social welfare programs and other social programs and services. This transfer is provided on a “no strings attached” basis, and there are no cost-sharing provisions, as was the case for transfers related to social programs prior to the

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25 More specifically, the Range (difference in GDP between the richest and the poorest provinces divided i.e. normalized by the national mean) reached a value of 1.09 in 1929 and fell to 0.9 in 1956 according to my calculation from Green (1969).

26 They are the following: a) universality, requiring that public provision of public health care insurance to all Canadians; b) comprehensiveness, implying coverage by public health care insurance of medically necessary hospital and doctor services; c) accessibility, meaning that health services are available to all Canadians when they need them; d) portability, ensuring that all Canadians when travelling inside or outside Canada are covered under public health care insurance and, e) finally public administration requiring that provincial and territorial health care insurance plans to be managed by a public agency on a not-for-profit basis.
reforms of the 1990s.\textsuperscript{27}

Equalization grants are presently relatively small-sized in Canada when compared with specific transfers. For the most grants-dependent province, Prince Edward Island, the equalization grants cover 20 percent of total revenue (see Table 5) while sectors grants are almost the double. Paradoxically since sector grants are distributed on the basis of same per capita amount (1,311 Canadian dollars for FY 2015-16), they are more redistributive than equalization grants, since the standard of the latter is not the richest province but a set of rich provinces.\textsuperscript{28}

Table 6. Canada. Major Federal Transfers by Province, 2015/16

<table>
<thead>
<tr>
<th>Province</th>
<th>Health and social programs (Can. $ per capita)</th>
<th>Equalization (Can. $ per capita)</th>
<th>As a share of revenue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Columbia</td>
<td>1,311</td>
<td>0</td>
<td>13.1</td>
</tr>
<tr>
<td>Alberta</td>
<td>1,310</td>
<td>0</td>
<td>12.6</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>1,311</td>
<td>0</td>
<td>10.6</td>
</tr>
<tr>
<td>Manitoba</td>
<td>1,310</td>
<td>1,344</td>
<td>22.9</td>
</tr>
<tr>
<td>Ontario</td>
<td>1,310</td>
<td>171</td>
<td>16.4</td>
</tr>
<tr>
<td>Quebec</td>
<td>1,311</td>
<td>1,512</td>
<td>20.3</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>1,312</td>
<td>2,214</td>
<td>32.0</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>1,312</td>
<td>1,792</td>
<td>30.7</td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>1,311</td>
<td>2,465</td>
<td>33.5</td>
</tr>
<tr>
<td>Newfoundland &amp; Labrador</td>
<td>1,313</td>
<td>0</td>
<td>9.9</td>
</tr>
</tbody>
</table>

Sources: Statistics Canada, 2015a; calculations by the author.

Provincial transfers to local governments

The equalization of Provinces readies the ground for ensuring uniform treatment of citizens across the country, but full equalization requires also equalization at the local level. Canadian local government consists of a variety of municipal governments plus the school boards. Local government accounts, together with school boards, for about one sixth of total public expenditure. Historically, Canadian municipal governments have relied for their financing on own taxes (above all the property tax) and fees with the support of specific transfers from the Provinces. With the rapid urbanization process taking place the 1960s and 1970s poor municipalities would have been forced to increase taxation to hardly bearable levels to ensure continuity of service provision, prompting intervention from Provinces. Presently almost four/fifths of revenue come from owns sources and the remaining one/fifth coming from transfers, while the reverse percentages apply to school boards that have been made mostly dependent on transfers to ensure equality of access to schools (Garcea and Munroe, 2014). Provincial-municipal transfers are largely, 85% on average, conditional, with small difference among Provinces. The

\textsuperscript{27} Department of Finance, Federal Support to Provinces and Territories. https://www.fin.gc.ca/access/fedprov-eng.asp

\textsuperscript{28} To understand this point, one has to keep in mind that, since equalization grants make up for differences in fiscal capacity, the combination of the grants plus tax collections would lead to an equal per capita sum for all provinces only if the standard for equalization is the fiscal capacity of the richest province.
prevalence of conditional Provinces to Municipalities transfers is designed to implement provincial priorities, giving Provinces control over the expenditure and taxing decisions through setting and enforcement of standards, hence replicating the pattern of unitary states.

Many Provinces to Municipalities transfers are of the matching type, with frequent high matching rates. In seven Canadian provinces, the provincial government provides equalization grants to municipalities. In two provinces (Nova Scotia and New Brunswick) the equalization grant formula recognizes expenditure needs as well as fiscal capacity; the other Provinces only take into account fiscal capacity. The equalizing impact of the transfers depends only from the allocation formula, and also more importantly from the total amount that is allocated. In the case of Nova Scotia for example, only half of the municipal expenditure is considered for equalization. The total pool is determined independently of the total value of the entitlements with the consequence that municipalities are only partially equalized (Slack, 2015, p. 2967). In Ontario equalization transfers are selective, meaning that they are paid only to the northern and rural municipalities and are aimed to fill gaps in fiscal capacity and not in expenditure needs. Urban municipalities do not benefit from these grants, but have access to the conditional grants.

Equalization is also a policy goal especially with reference to education. During the last decades most Provinces have eliminated the power of school boards to set the property tax rates, hence introducing provincial uniformity with also lower rates (Garcea and Munroe, 2014). Compensation has been provided through an increase of transfers that now represent more than 80 per cent of total revenue and are allocated mostly on an equal per pupil base. Before centralization of tax rates, the poor Provinces had to levy high tax rates to keep their expenditure up to the level of the richest ones, the reform has brought, through the combination of equal tax rates and equal per pupil transfers, an increase in equality of spending for education inside the Provinces.

5. Equalization transfers in Australia

The creation of the Commonwealth

Australia is our latecomer, the Commonwealth being created in 1901. All the social-political and economic indicators referred to Australia in Table 1 show a country with a more mature stage of development than the other ones. Australian per capita GDP of 1901 corresponds to that of a today medium-income country, and public expenditure absorbed a sizeable share of GDP. Fully democratic political institutions and very low personal and particularly regional inequalities complete the representation. (Sawer, 1963; Petchey and Walsh, 1993; Smith, 1993; Commonwealth Grants Commission, 2008).

The Commonwealth paid compensatory grants to States from its very beginning. The vertical fiscal imbalance was even higher than that in Canada. Taxes on exports and excises which represented the bulk (more than 75%) of the revenue of the Colonies were transferred to the Commonwealth, while the most expensive of policy areas were left to the responsibility of the States. The distribution of federal revenues back to the States became a hot debating point among the framers of the Constitution. While the poor States asked for an equal for all per capita allocation, the rich ones demanded the return of revenues to the place where they were generated. A compromise was found with Section 87 of the Constitution that mandated the federal government to return three fourths of its tax revenues to the States of origin for a period of ten years. This favored the rich States. In addition, Section 96 of the Constitution allowed the federal government to pay conditional grants to the States. Although the reasons for payment were not made explicit, the rationale was to allow the needy States to face the transitional period after federation, allowing them to adjust to the loss of customs revenue and custom protection.
and excise duties. Interestingly also the introduction in 1909 of nationally funded Old Age Pensions implied an implicit support to the needy States because of equality of pensions, with higher financing coming from richer States.

The Surplus Act of 1910 started a system of equal per capita payments from the Commonwealth to the States. Special grants were also paid to Western Australia (from 1910-11) and Tasmania (from 1912-13). This new system endured until 1927, when the Commonwealth took over State debts and contributed to debt servicing in return for ending per capita payments.

The introduction of a highly progressive income tax by the Commonwealth during World War I worked along lines similar to the Old Age Pensions allowing more implicit redistribution through the expenditure/revenue nexus. In response to the increased pressure from the three poorest states, Western Australia, South Australia and Tasmania to receive financial assistance from the Commonwealth, an autonomous commission – the Commonwealth Grants Commission – was operating since 1933 advising the federal government on the distribution of grants. A strong secessionist movement had developed in Western Australia in the 1920’s. To quench secessionist aspirations a Royal Commission of the Finances of Western Australia was created in 1924. In 1933 a referendum on secession was held in this State\(^{29}\), generating worries about the unity of the whole country.

In the fiscal year 1942/43 the federal government took over from the States the income tax. States were given ‘tax reimbursement grants’ based on their average income tax collections in 1939-40 and 1940-41. Each State grant in subsequent years was made on the base amount increased by the percentage increase in the Australian population and half the percentage increase in Australian average wages per person employed. Slowly a grants system with a clear equalizing aim was being introduced. The equalizing content of the grants would progressively increase since 1957-58 with each State’s share made dependent on specific criteria of need, i.e. population adjusted for density and the number of children aged 5 – 15 years of age.

**Table 10 Australia: structure of federal grants to the States, 1934-35 to the present day.**

<table>
<thead>
<tr>
<th>Years</th>
<th>Block/ equalization grants</th>
<th>Specific purposes grants</th>
<th>Total grants</th>
<th>Specific purposes grants as % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1934-35 to 1941-42</td>
<td>0</td>
<td>29.4</td>
<td>29.4</td>
<td>100</td>
</tr>
<tr>
<td>1942-43 to 1945-46</td>
<td>68.7</td>
<td>27.8</td>
<td>96.5</td>
<td>28.8</td>
</tr>
<tr>
<td>1946-47 to 1958-59</td>
<td>470.4</td>
<td>196.1</td>
<td>666.5</td>
<td>29.4</td>
</tr>
<tr>
<td>1959-60 to 1964-65</td>
<td>594.7</td>
<td>216.4</td>
<td>811.1</td>
<td>26.7</td>
</tr>
<tr>
<td>1965-66 to 1971-72</td>
<td>1,090, 0</td>
<td>453</td>
<td>1,543</td>
<td>29.4</td>
</tr>
<tr>
<td>1972-73 to 1982-83(c)</td>
<td>4,327, 7</td>
<td>3898.4</td>
<td>8225.6</td>
<td>47.4</td>
</tr>
<tr>
<td>2015/2016</td>
<td>58,236</td>
<td>49,958</td>
<td>108,195</td>
<td>46.2</td>
</tr>
</tbody>
</table>

Source: for years up to 1982/83: History of the Commonwealth Grants Commission –

\(^{29}\) The secession referendum was held on 8 April 1933 on the proposal that the state withdraw from the Australian Federation. The proposal won a majority of the votes and a petition to give effect to the decision was subsequently sent to the British Parliament, where a parliamentary joint select committee ruled it invalid.

It took, however, a while before the introduction of a fully-fledged equalization system, whose need became less acute if we stick to indicators of inequality. Regional disparity had expanded substantially after the creation of the Commonwealth and reached a peak in the 1930s subsiding thereafter, while personal inequality did not move substantially from the inception of the country until 1970s. (It has taken on an increasing trend in the most recent decades). The crucial step towards equalization transfers was the Personal Income Tax Sharing Amendment Act of 1978 that was the outcome of the Commonwealth’s ‘new federalism policy’ started in 1976 within which the Commonwealth and the States agreed that a proportion of personal income tax revenue would form a pool to be shared among the States in a way that equalized their financial capacities.

More specifically, the Act required the Commission to take into account the differences in the capacities of the States to raise revenue and the differences in the amounts required to be expended by the States in providing comparable government services. Australian equalization transfers represent today one of the most accomplished systems, serving both territorial and personal equity making residence almost irrelevant concerning access to services provided by the States.

Local government equalization

With expenditure representing a mere 8 per cent of total national spending, local government plays a modest role in Australia. Local governments rely mostly on their own sources, taxes and fees for the financing with transfers, most of them coming from their State, representing less than a third. Local government is not mentioned in the Australian Constitution and is a legislative creation of the States. Commonwealth’s involvement in local government has been relatively minor until late in the twentieth century. Despite the political interest of national politicians to create support at the local level, the Commonwealth financial support to localities started only in the 1920 and had to be provided indirectly through the States (Megarrity, 2011). To make the Commonwealth–local government relationship constitutionally unambiguous, in 1974 the federal government put to the voters a referendum proposal which asked for permission to alter the constitution to allow the Commonwealth to ‘borrow money for, and grant financial assistance to, local government’. The proposal was rejected.

However, starting from 1976-77 the federal government began to distribute to local government a share (initially 1.52%) of the collections of the personal income tax. The allocation had to be made by newly created local government Grants Commissions established by the States. The system combined the federal desire to provide assistance to local government with the preservation of States’ power vis a vis their local governments. The allocation among the States is made, after 1989/90, on the basis of population exclusively.

The Local Government (Financial Assistance) of 1995 shifted some power towards the federal government by establishing that the allocation of general purposes grants has to be subject to a few federally dictated criteria aimed at ensuring, basically, that each local government body has to be able to function with a reasonable tax effort to provide a

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30 The Act of 1978 stated explicitly that: ...payments to which the States are entitled ... should enable each State to provide, without imposing taxes and charges at levels appreciably different from the levels of the taxes and charges imposed by other States, government services at standards not appreciably different from the standards of government services provided by the other States.
level of services not lower than the average standard of other local government in the same state or territory.

It has also to be mentioned that the Commonwealth pays, exploiting the vagueness of the constitutional discipline, current and capital specific purpose payments, such as for the provision of residential and community-care services for the frail aged and services for people with disabilities, directly to local governments in the area of health and education. Examples of current payments are funds (Webb, 2001).

This system in combination with Commonwealth equalization in favor of the States eliminates most of the disparities in level of municipal service provision across the whole of Australia (see the conclusions).

6 Ephemeral equalization transfers: the United States of America

Early history

The absence of general equalization grants makes the American federal system almost unique, making *de rigueur* its inclusion in this paper. General unconditional transfers with an equalization purpose, labeled as Revenue Sharing, were experimented for a sixteen-year period, from 1971 to 1986, but were repealed.

The Constitution of 1788 replaced the *Articles of Confederation* of 1791 and transformed the United States into the first federal system in history. Under the *Articles* the national government had no taxing power and had to rely completely on contributions paid by the States and/or on debt to finance its expenditure. The new Constitution assigned to the federal government exclusive control on custom tariffs and concurrent jurisdiction with the States on practically all fields of taxation. The Constitution also retained the from the *Articles* the provision giving the Congress the power to levy direct taxes, but only by apportioning the revenue among the States “according to their numbers”, i.e. population. This last provision transformed the levy into a grant from the States to the federation and was strongly opposed by the States with low income and wealth. As a matter of fact, the instrument was used only a couple of times.

Intergovernmental grants to the States had an almost immediate start, as the first move by the Federal government was to assume the State debts, relieving the finances of the latter and strengthening, in perspective, the taxing power of the federal government. The assumption of debt amounted to the allocation of a grant equal to the discounted value of future interest and repayment of principal. There was no equalization content, or intent, in the grant, and States were totally free in how to spend it.

During the initial decades Congress provided grants in kind to the new States through the divestment of federal land with a clear compensatory aim to facilitate their joining the Union, or to States facing financial stringency in some of their activity.31

*“Congressional Research Service 2015.”* For example, in 1823 Ohio received a federal land grant of 60,000 acres along the Maumee Road to raise revenue to improve that road. In 1827, Ohio received another federal land grant of 31,596 acres to raise revenue for the Columbus and Sandusky Turnpike. In 1841, nine states (Ohio, Indiana, Illinois, Alabama, Missouri, Mississippi, Louisiana, Arkansas, and Michigan), and, with three exceptions, all subsequent newly admitted states were designated land grant states and guaranteed at least 500,000 acres of federal land to be auctioned to support transportation projects, including roads, railroads, bridges, canals, and improvement of water courses, that expedited the transportation of the United States mail and military personnel and munition. By 1900, over 3.2 million acres of federal land were donated to these states to support wagon road construction. Congress also authorized the donation of another 4.5 million acres of federal land to Illinois, Indiana, Michigan, Ohio, and Wisconsin to raise
As the federal government started to build its taxing powers mainly in the excise area and as its responsibilities remained concentrated on war and defense, the federal Treasury started to generate budget surpluses, giving way to a vertical fiscal imbalance, as in Australia and Canada. Its correction lead in 1837 to the allocation of the first and substantial cash grants to the States in proportion to their respective representation in the House and Senate (in turn representing weighed population, since for the house seats were apportioned according to the population of each state where in turn free men accounted for one while slaves for three fifths each). Again, there were no restrictions placed on use of funds by the States. Unfortunately for the latter, the banking crisis and the fall into recession led to a stop of payments.

The starting point of a ceaseless process of continuative grants support to state and local governments was the allocation in 1879, a century after the constitution, of teaching materials for the blind based on the state’s share of the total number of pupils enrolled in public schools. The Hatch Act of 1887 authorized the second federal cash grant. It provided each State with an annual lump-sum cash grant of $15,000 to establish agricultural experiment stations. In 1888, an annual grant of $25,000 was appropriated for the care of disabled veterans in State hospitals. States were provided $100 per disabled veteran.

At the turn of the last century there were only five grants programs to State and local governments. The number of federal grants increased at an incredibly rapid rate in the following years, reaching in the fiscal year 2014 the astonishingly high number of 1099. (The number of grants from the states to local government is even higher). Practically all of these grants are categorical with narrow sector constrains and stringent limitations on their use. Only twenty-one are block grants implying the absence of constraints on their use inside the area for which they are paid, such as education.

Revenue sharing

The only general purpose grants program with an explicit equalization content ever paid in the US was the Federal Revenue Sharing program started in 1972 and terminated in 1980 as regard to the States and in 1986 as regard to local governments. The introduction of the program was fiercely debated. The idea was advanced in 1956 and it took 14 months to pass the final bill through the Congress. However, the two chambers were unable to agree on a single formula for the allocation, leading to the use of two formulas. The Senate formula included population, relative income and tax effort, while the House formula made allocations dependent on population, urban population, per capita income, state income tax collections and tax effort. Each state received the maximum deriving from the application of the two formulas. Despite of hot political discussion Revenue Sharing allocations remained modest (about 80 millions of US $ in 16 years) amounting to a tiny share of about 2 per cent of state and local expenditure. The relatively small weight assigned to redistribution parameters in the formula and above all the paucity of total allocations made the equalization impact of the program modest. To

revenue for canal construction and 2.225 million acres to Alabama, Iowa, and Wisconsin to improve river navigation. In addition, states were provided 37.8 million acres for railroad improvements and 64 million acres for flood control.35 States were provided wide latitude in project selection and federal oversight and administrative regulations were minimal."35 Dilger, 2015.

32 Transfers to cover the cost of militias were paid in belligerent years but have to considered more as reimbursement of a federal mandate than allocation of grants.

33 The Three-Fifths Compromise, is found in Article 1, Section 2, Paragraph 3 of the United States Constitution,
make just a few examples of extremes, in 1973-74, Connecticut, with a 1973 per capita income of $5,889, received a per capita revenue sharing allocation $24.39 or $4.15 per $1,000 of personal income, while Mississippi, with per capita income of $3,448, received $44.12 per capita of $12.70 per $1,000 of personal income.34

Fiscal stringency in the federal finances may explain why the revenue sharing program was terminated. But much more interesting is to understand why a similar program has never since been resumed, if only in the political debate, while the allocation of specific grants continues unabated. Explanations provided by the small literature available on this topic (Kenyon Daphne and John, 1996; Stark, 2009; Beland and Lecours, 2014) refer to the role of bureaucracy, of nationally shared social values and of political institutions.

Starting from the first type of explanation, the building up of massive specific grants system did engender a close co-operative relationship between federal, state and local bureaucrats whose mutual benefit from specific grants program would be clearly endangered by the lack of conditionality in revenue sharing program. It was also perceived that the reaching of mutually agreed sector goals and priorities could be achieved much more economically with sector specific grants, rather than with unconditional grants. Concerning nationally shared social values Kenyon Daphne and John Kincaid (1996), and Beland and Lecours (2014) affirm that the idea of citizenship is directly related in the US to equality of opportunity rather than equality of outcomes” hence explaining resistance to programs of redistribution. As a matter of fact, revenue sharing is more consonant to the idea of equality of opportunity, since it provides states and local governments additional revenue that they can spend freely according to their preferences and vision of opportunity. Specific/categorical grants predominantly allocated by the American federal government are primarily directed at ensuring equality of outcomes in terms of public policies and specific services. If this view were correct, equalization transfers if ever implemented would have had to play a minor role. as in fact it has been the case with the revenue sharing program.

The main political explanation lies, according to all the authors quoted, in the operation of the legislative power. More specifically, party discipline being almost inexistent, congressmen and senators are primarily interested in targeting funds to their constituencies which in turn is much easier with specific rather than with general unconditional grants. An additional reason, contrasting the US with the American and Canadian cases, is the absence since the mid of the nineteenth century of secessionist pressures in the US. In other words, there is no need of paying equalization grants to states to keep the country together.

A limited equalization impact among States derives from the allocation of sector specific grants. A part of these grants are allocated on a co-financing basis that per se favors the richest states. To counterbalance this effect about 20 percent of all grants including matching grants are allocated according to a formula including equalizing indicators.35

34 ACIR, 1974.
35 A telling example is provided by Medicaid is by far the largest program of federal grants to the states. Enacted in 1965 as part of Lyndon Johnson’s “Great Society,” Medicaid funds are allocated to the states in accordance with a formula that expressly incorporates a measure of fiscal capacity—i.e., relative per capita income. For example, a matching grant for dentist is allocated according to a formula that weight population with the inverse of per capita income. The program also requires that states contribute with one dollar for each dollar put by the federal government, discriminating among poor and rich states, because poor states tend to spend less on healthcare (Levitt and Poterba, 1994). An additional provision works against equalization. According to it, individual allocations are subject to a statutory floor of 50 percent, making also the richest states beneficiary of the program, and a ceiling of 83 percent limiting the support received by the poorest states. “As a result, the federal government’s most significant program of intergovernmental fiscal assistance has no equalizing effect”. (Stark page 41).
Overall U.S. federal grants do not seem to have an equalizing effect (Laurent and Vaillancourt 2002).

State transfers to local governments

US local governments are financed mainly by the property tax supplemented by tariffs and fees. Local tax autonomy combined with huge disparities in wealth income and needs inside the states, particularly between urban and rural areas, remote and central location, small and big cities makes pervasive and crucial the potential role of equalization. The 1971 California Supreme Court decision in Serrano v. Priest found that the system of financing of schools through the property tax in that state violated the state’s constitution and also the equal protection of the laws clause of the Fourteenth Amendment of the US constitution. Also in a famous ruling the Texas Supreme Court held that the system of financing schools, through the property tax, violated the state constitution requiring the state legislature to find appropriate substitute sources of funding. It also pointed out that “the wealthiest district has over 14,000,000 $ of property wealth per student, while the poorest has approximately $20,000, this reflects a 700 to 1 ratio” (quoted by Zimmerman 1992 p.179.).

At least, part of these inequalities is filled by grants totaling more than one third of local revenues. Most of these transfer come from state governments, while the federal government provides a tiny share. Aid to school districts accounts for more than half of all state government transfers to local governments and is allocated according to methods and criteria widely different from state to state. States’ educational grants are estimated to have reduced the large fiscal inequalities among school districts by between 19% to 34% (Evans, Murray, and Schwab,1997).

An indirect proof of the limited impact of educational grants is provided by educational expenditure per pupil). Data for 2013\textsuperscript{36} shows a huge variance. Expenditure ranges from 19,134 American dollars in Vermont to a low of 7,084 in Utah (with similar low levels observed for most of the poor states). This variation could also reflect differences in preferences in addition to differences in fiscal capacity. To the extent it is due to differences in revenue it reflects not only the absence of equalization at the state level, but also the lack of equalization transfers from the federal government to the states.

Conclusions

General, non-conditional transfers, called also compensatory transfers, have been paid in most federations since their very beginning. Sometimes, as in the US, they consisted of grants of land. These pristine transfers had very little in common with equalization transfers considered here. They were paid to selected States and their rationale was to address disparities of benefits and costs among the constituent entities that derived from the process federalization, such as adoption of a common tariff, disparities of wage costs and also in access to fiscal resources hence easing separatist threats through nation building.

There was almost no equivalent to these allocations in unitary states, although some countries, such as Italy (see later), presented similar disparities of treatment between the different regions. Filling disparities, and even less distancing secession, was for a long period not a major preoccupation of most unitary states. Force could be used. When not enough and when large regional gaps emerged, the main response by governments was to

\textsuperscript{36} Education Week, April 18, 2016. Map: How Per-Pupil Spending Compares Across U.S. School Districts.
intervene directly in the economy, through industry creation or protective tariffs, without resorting to transfers to their local governments.

Before industrialization and sustained growth public resources in both federal and unitary countries were scarce and, when available, were devoted to growth rather than equalization. Specific transfers were used, although parsimoniously, by unitary countries to help implementing national priorities and standards. Unitary countries could also pursue uniformity with orders and mandates and leaving use of specific transfers when hierarchy was not enough. Federal countries had, by necessity, a different less cogent approach to uniformity than unitary states, leaving more autonomy than the latter to their constituent units. This explains why specific grants became also popular, although later, in federal countries. They are extremely popular today, since the federal government having lesser cogent powers has, when pursuing it own objectives, to make more use of the financial incentives, such as primarily specific grants.

As economies grew grants to the social sectors, targeting personal disparities, become increasingly important in all systems. These grants accelerated with the inception of the Great Depression. When not completely discretionary, these grants were allocated on the basis of relevant indicators (pupils in schools, or unemployed people, for example) and co-financing, ending up in most cases with an unclear, when not negative, although non-intended impact of income distribution. For example, the rich regions could supplement the grants with their own larger revenue; also rich regions having more pupils in schools were able to benefit from larger grants than the poor regions.

The UK led the inception of fully-fledged intergovernmental equalization transfers during the Great Depression, long after regional and personal inequality had peaked, as reported in Table 11, although they had been already discussed before. The timing is, however, unique. The other countries came somewhat later and, before equalization transfers they handled regional and personal disparities with different instruments. The British model has been from the beginning quite articulated, aiming at correcting the impact of differences in needs and fiscal capacity. The same aims inform the structure of most equalization transfer systems today.

Table 11 Equalization grants and inequality

<table>
<thead>
<tr>
<th>Country</th>
<th>Inception of equalization transfers</th>
<th>Peak in personal inequality</th>
<th>Peak in regional inequality</th>
<th>Impact of equalization on subnational units revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gini</td>
<td>Range 2</td>
<td>GINI before</td>
<td>GINI after</td>
</tr>
<tr>
<td>UK</td>
<td>1929</td>
<td>1930</td>
<td>1921</td>
<td>Not available</td>
</tr>
<tr>
<td>Italy</td>
<td>1970</td>
<td>1930</td>
<td>1951</td>
<td>0,1</td>
</tr>
<tr>
<td>Australia</td>
<td>1978</td>
<td>1990</td>
<td>1932</td>
<td>0,06</td>
</tr>
<tr>
<td>Canada</td>
<td>1957</td>
<td>1930</td>
<td>1929</td>
<td>0,11</td>
</tr>
<tr>
<td>USA</td>
<td>1972</td>
<td>1930</td>
<td>1880</td>
<td>Does not apply</td>
</tr>
</tbody>
</table>

Source of data: for personal and regional inequality see Table 1. For the equalization impact of transfers: Bloechiger, (2014).

While for most of the past equalization transfers were paid in federations only to States and Provinces, nowadays they are also paid to local governments with a substantial further impact on equalization. Also with regionalization the UK and Italy have introduced very equalizing revenue systems for their regions (Scotland and Wales in the UK). In other words equalization transfers are paid to all levels of subnational government. As table 11 shows for tiny sample of countries here considered, inequality of subnational revenue after transfers is much lower than before and equalization is higher in federal than in unitary countries.
Both systems make extensive use of sector-specific grants intended to promote uniformity of access to services in areas of national priority. All this signals that a substantial amount of convergence has taken place as regards equality of fiscal treatment of citizens despite differences in residence and also as regards homogeneity of services. Another way of illustrating this process is the recognition of common citizenship in both federal and unitary states.

Although the literature makes frequent reference to the impact of macroeconomic conditions on the introduction of equalization grants, this may apply, in our sample, only to the UK. The Great Depression worked as an igniter of the welfare state everywhere. The state intervened with pensions, unemployment benefits, and transfers to poor individuals and families to combat across the whole country extended poverty and work deprivation with programs affecting a large part of the population. This opened the way to the inception of equalization transfers by recognizing the responsibility of the national government to reduce inequalities attributable to state and local government areas of responsibility. It took time, however, to take on effectively the responsibility.

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Annex 1 Interjurisdictional justice and equalization grants

A convenient way to present equalization grants is to stress that they are functional to the implementation of the principle of inter-jurisdictional equity. The strictest interpretation would mean that citizens in similar conditions should have access, wherever they reside, to exactly the same quantity/quality mix of services and pay the same amount of taxes. A convenient and very simplified way of defining the grants is to use the following simple formula that refers to a single local service and a single tax to finance it.

\[ T_n = \sum_{i=1}^{l} E_{c,d,e,f,j} - R_{wy} \]

The grant paid to local government \( n \), \( T_n \), is equal to the difference between the expenditure, \( E \), where \( c,d,e,f,j \) are a few parameters that standardize the expenditure, for example the number of pupils, number of pupils per class. These parameters are chosen and defined by the central government. A few parameters, \( w,y \), are also used to standardize the revenue, such the tax rate. We can better understand their inclusion, when we realize that the expenditure and revenue have to be defined, or better standardized by the government that pays the grant. If left to the local governments each of them would have an incentive to expand the expenditure or to reduce the revenue to increase the grant.

The full elimination of the impact of residence, required by inter-jurisdictional equity, demands that all local expenditure are included in the formula and all the revenues including specific sector grants are and the transfer is big enough to fill entirely the gap between expenditure and revenue.

Annex 2 Sources of data of Table 1.

Table A1. The prototype of equalization grants: the Royal Commission on Local Taxation of 1901.

<table>
<thead>
<tr>
<th>Local Gov</th>
<th>Population</th>
<th>Expenditure</th>
<th>Rateable value</th>
<th>Standardized revenue of rateable value (0.01666) (the national average tax rate)</th>
<th>Standardized expenditure (minimum observed)</th>
<th>Grant</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total amount</td>
<td>Per capita</td>
<td>Total amount</td>
<td>Per capita</td>
<td>Total amount</td>
<td>Per capita</td>
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<td>1.000</td>
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<td>30.000</td>
<td>3</td>
<td>500</td>
</tr>
</tbody>
</table>

Source: Hamilton and Murray (1901)