

Federations

What's new in federalism worldwide

Vol. 3, No. 1 / February-March 2003

Elections and federalism



Austria:

Big win for Schüssel



India:

Kashmiri dynasty falls



Pakistan:

Religious parties rise

Plus:

- U.S. states lose revenues
- Canada's cities seek charter status
- Brazil faces taxing problems

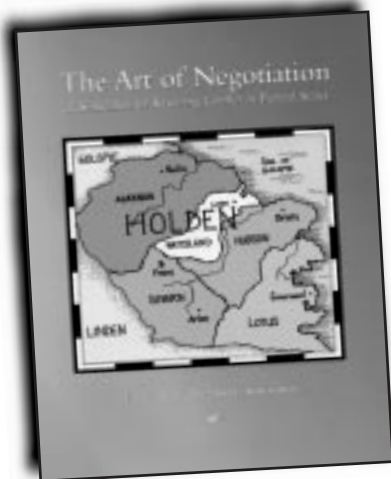


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COVER PHOTOS:

Austria: Austrian Chancellor Wolfgang Schüssel of the centre-right Austrian People's Party celebrates victory on election night after gaining seats from the Freedom Party. Photo: Bernhard J. Holzner, HOPI-MEDIA, Austria

India: The newly elected Kashmiri Chief Minister Mufti Mohammed Sayeed (right) shakes hands with State Governor Girish Chandra Saxena as Ghulam Nabi Azad looks on. Photo: REUTERS

Pakistan: Religious party leaders Qazi Hussain Ahmed (left) and Maulana Shah Ahmed Noorani (right) meet the press after their alliance, the MMA, won 60 seats in the Pakistan's National Assembly. Photo: Online International News Network, Pakistan



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This publication is also available in French under the title *Fédérations – Le fédéralisme de par le monde, quoi de neuf.*



From the Editors

On January 21, 2003, *The New York Times* carried a front-page story about the trial on federal drug charges of Ed Rosenthal of Oakland, California. In California, Rosenthal is – to use *The Times'* phrase – a “marijuana celebrity”. He has written a number of cannabis self-help books and has a magazine column of “advice for potheads”. More importantly, for a number of years he has run a business growing and selling marijuana for medicinal purposes. In a 1996 referendum, California voters approved Proposition 215, an initiative that made marijuana legal for medical uses.

Despite that, the federal Drug Enforcement Administration (DEA) considers Rosenthal a criminal. The DEA's position is that marijuana is illegal “regardless of the intended use”.

California sees it differently. As the spokesman of the Attorney General of California put it: “This is huge conflict. State law legalizes medical marijuana and federal law makes marijuana illegal. Period.”

We don't have an article on marijuana in this issue of *Federations*. We're sharing the story of Mr. Rosenthal to underline the point that federalism engenders lively debate in the United States. The world's news media may focus on the big issues of war and peace, terrorism and security. The President, the Secretary of State and the Secretary of Defense may take centre stage. But in the daily lives of Americans, it is the state governments that often count the most.

Current economic conditions and post-9/11 security needs have pushed most of those state governments into serious financial difficulty.

In this issue of *Federations* William Fox deals with one aspect of the states' economic difficulties: the corporate income tax system. States' income from this source has declined drastically in recent years and Fox analyzes the reasons for this – reasons that go beyond the current economic situation and touch on the way the American system of fiscal federalism is organized.

Among other issues on the *Federations'* agenda this time: elections in Austria, Kashmir and Pakistan and the continued

struggle of Canadian towns and cities for more powers and resources. Our practitioner this issue is Godelieve Van Den Bergh, an ambassador with Belgium's unit for relations with the communities and regions.

In the last issue we had a report on the peace process in Sri Lanka. There have been great advances on that front since then. The Government of Sri Lanka and the Liberation Tigers of Tamil Ealam (LTTE) agreed in December 2002 to pursue some version of federalism for the war-ravaged country. Forum advisors, including former Premier of the Canadian province of Ontario Bob Rae and David Cameron, former senior official in the Ontario and Canadian governments, have been advising both sides on matters related to federalism. The Forum will continue to be deeply involved in this process over the coming months. ☺

* * *

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We will also post letters to the editor of this publication there. We welcome any and all comments.

Just drop us a line at:

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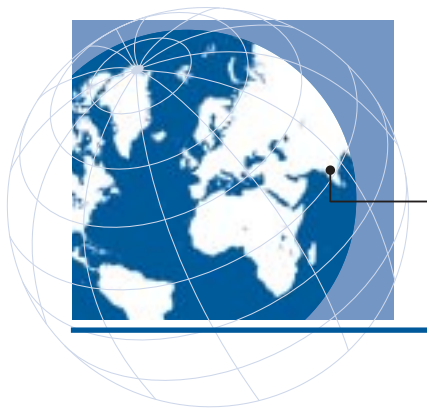
The LTTE delegation (L.) discusses federal options with the Forum's advisory team (R.) on the margins of the Sri Lankan peace negotiations, January 2003.

Erratum

The first box accompanying the article “A new peace initiative in Sri Lanka” in the November 2002 issue of *Federations* (Vol. 2, No. 5) erroneously stated that “In 2002 at time of cease-fire, an estimated 20,000 have died in the on-again, off-again civil war”.

The correct total is difficult to determine, but certainly is much larger. The estimates most often quoted are:

- **70,000 deaths** – Source: *Conflict and Aid: Enhancing the Peacebuilding Impact ...* by Jonathan Goodhand with Philippa Atkinson, (London: International Alert, 2001)
- **64,000 deaths** – Source: “Tense round of Sri Lanka peace talks kicks off”, *Reuters*, by Scott McDonald, January 6, 2003



Elections may herald a new opening in Kashmir

Can a coalition led by a new political party bring peace?

BY RUPAK CHATTOPADHYAY

In a mountainous region where Indian and Pakistani troops have faced each other across a shifting border since partition in 1947, the Indian state of Jammu and Kashmir recently elected its ninth government. The election, with staggered dates in different regions in response to the threat of violence, took place in September and October 2002. This was the state's most closely contested election in more than a decade and resulted in a massive defeat for the ruling Jammu and Kashmir National Conference, which has dominated state politics for nearly fifty years.

The new government of the state is a coalition of the newly formed People's Democratic Party (which won 16 seats), the Indian National Congress Party, (which won 20 seats) and independent members.

At the northernmost tip of India, the Indian state of Jammu and Kashmir is about the size of Belgium and is known worldwide as the place where cashmere wool originated and as the home of K2, the second-highest mountain in the world. What happens there could mean peace or war in South Asia. The new state government could generate movement towards the settlement of boundaries in the region, where Pakistan and China occupy areas in the north and east of the pre-partition Jammu and Kashmir and where movements for independence, autonomy and union with Pakistan have often flared into violence.

"A political earthquake"

The election of the new government in the state is a turning point. The Kashmir Times described the ouster of the National Conference as "a political earthquake". The election left no party with a clear majority in the 87-seat state assembly. The National Conference, which had previously held 57 seats in the assembly, was reduced to just 28 seats.

The Indian National Congress increased its position from seven to 20 seats, while the People's Democratic Party, or PDP, formed only three years ago, gained 16 seats.

Politically, the biggest winner is the People's Democratic Party led by veteran politician and one-time Union Home Minister Mufti Mohammad Sayeed. The PDP not only wrested the traditional constituencies of the National Conference in the Kashmir Valley

The election left no party with a clear majority in the 87-seat state assembly.

Language and religion

Religion divides this northern state. Of the 10 million inhabitants of Jammu and Kashmir in 2001, the vast majority were Muslim. The Indian Census of 1981 – the last for which figures on religion are available – showed 64 per cent were Muslims, 32 per cent Hindus, 2 per cent Sikhs and 1 per cent Buddhists. Despite the overall Muslim majority, the three regions within the state each have different majorities. Ladakh, in the east, is split between Buddhists and Muslims; the Kashmir Valley in the north is overwhelmingly Muslim; and the plains of Jammu in the South are majority Hindu. And yet, even though Pakistan has long insisted on a plebiscite to determine the fate of the divided province, it is not certain that a majority in Jammu and Kashmir would vote for Pakistan.

Many languages are also spoken in the state, and linguistic preferences are often associated with religion. Kashmiri, Dogri, Urdu, Hindi and Ladakhi are spoken in Jammu and Kashmir. The Kashmiri language also has many dialects. In the Pakistani-held areas, Punjabi is also spoken. Ladakhi speakers are likely to be Buddhists; Urdu speakers are likely to be Muslims; Hindi speakers are likely to be Hindus; and Kashmiri and Dogri speakers could be either Hindus or Muslims.

but also obtained Congress support in leading the new coalition government. The most lasting image from these elections is the loss of the Abdullah family's traditional legislative seat in Ganderbal from where the legendary Sheikh Abdullah and his political machine had successfully contested elections for decades.

The PDP campaigned on a platform to heal the "physical, psychological and emotional wounds" of the Kashmiri people, to consult all segments of opinion – including secessionists – without preconditions, and to relax the pressure on the general public from the security forces. Analysts attributed the increased voter turnout – 46 per cent as opposed to 32 per cent in 1999 – to PDP campaign promises. Most significantly, high voter figures were recorded in a number of Muslim-majority districts along the "Line of Control"; these include Karnah at 71 per cent, Gurez at 77 per cent and Uri at 67 per cent. For many

Kashmiris, these elections represent a watershed. As journalist Shujaat Bukhari observed, "Many do believe that this has been one of the fairest elections in Kashmiri history."

Political prisoners?

The chief minister immediately began to implement his promises by releasing from prison several prominent secessionists whom he characterized as "political prisoners". But a resurgence of terrorist attacks against government targets since early December has forced the new government to tread more carefully. The previous National Conference government of Farooq Abdullah had repeatedly promised to turn the state into "heaven on earth once

Rupak Chattopadhyay is a program officer with the Forum of Federations.



again" by wiping out insurgency and negotiating with Kashmiri secessionists in order to draw them into the national mainstream. The PDP is in an even more difficult position because the electorate expects more from them. Not surprisingly, Mufti Mohammad Sayeed is more circumspect than his predecessor, conceding that the challenge ahead "scares" him.

Mufti's accession during the global "war against terrorism" is probably fortuitous. Farooq's government had to contend with the Karhmiri insurgency's most savage phase. Mufti, on the other hand, assumes the chief ministership at a time when Pakistan is under intense diplomatic pressure to reduce the infiltration into Jammu and Kashmir of armed fighters (or *jihadis*). Consequently, the insurgency is weaker today than even a year ago and its immediate prospects appear uncertain. The Indian government's mobilization after the terrorist attack on parliament of December 2001 has also made operations difficult for *jihadis* in Jammu and Kashmir. This combination of military and political changes may at last have opened the political space for a settlement.

Mufti has proved more dynamic than his predecessor in boldly attempting to reposition the PDP as *the* political vehicle for pro-independence, or *azadi*, Kashmiri opinion. Kashmiri academic Amitabh Dubey suggests that this historic step carries potential costs and benefits for India. The main benefit that might accrue is that the PDP might displace the separatist Hurriyat Conference as the repository of Kashmiri nationalism and help integrate it into the national mainstream. This would be likely if the ruling coalition is able to deliver on its promises of improved welfare and increased economic development. Public pressure might encourage the Hizbul Mujahideen, the only significant indigenous insurgent group, to experiment with a second ceasefire offer, especially since Pakistan would find it harder to sabotage a peace effort this time.

The Special Operations Group

On the other hand, a quasi-secessionist strategy could backfire in at least two ways. The first danger is that it could produce paralysis within the ruling coalition because the Congress Party, the larger coalition partner, is unlikely to tolerate separatist opinion. Unlike the previous government, the PDP's paltry 16 seats (in an assembly of 87) make it dependent on the Congress Party with 20 seats and on other allies for support. An incoherent political strategy would, in turn, invalidate the psychological gains produced by the most recent election and make it harder to woo Valley voters. The president of the National Conference, Omar Abdullah, has already indicated that his party will attempt to capture the pro-*azadi* vote by renewing its campaign for "autonomy", and stands ready to take advantage of any discord within the ruling coalition.

The second danger lies in the possible consequences of the government's policy toward a controversial police unit called the Special Operations Group. On January 7, 2003, Amnesty International condemned the Jammu and Kashmir government for not implementing a promise in its Common Minimum Program to investigate all earlier deaths of those in police custody and punish those found responsible for killings. If the government abolishes the controversial unit, or interferes too extensively in its operations, it could reduce the flow of intelligence to security forces. If the government does nothing, it risks condemnation for human rights abuses.

Political violence

Stories in India's press show the scale of the problem:

"More than 1,900 people have died in Jammu and Kashmir's terrorist violence this year, including 136 people in the first half of August

"Since the launch of counter-insurgency operations in Jammu and Kashmir in 1990, security forces have seized 24,426 AK rifles, 27,782 bombs and explosive devices, 6,642 kilograms of RDX explosives, 46,224 hand and rifle grenades, 5,691 mines and 4,135 rockets. More than 36,500 people have died in Jammu and Kashmir since the eruption of terrorist violence in 1989, and official sources say 30,600 of the victims were civilians and Muslim terrorists. Officials have also recorded a total of 7,213 incidents of firing across the Jammu and Kashmir border with Pakistan, 130 of them in the first half of August."

The Hindustan Times, 28 August, 2002

The Delhi-based Institute of Social Sciences reported that political violence and terror in Jammu and Kashmir did have an effect on the elections:

"The report by the Institute of Social Sciences, New Delhi, 'Fair Elections Under the Shadow of Fear', said while the election was fair it was "not necessarily free", with violence and terror being real factors affecting the election outcome. George Mathew of ISS said the election endorsed the importance of the democratic process, but cautioned against "taking this election as a plebiscite."

The Hindu, November 10, 2002

The PDP has begun to back away from its promise to close the police unit entirely. Indeed, the Common Minimum Program of the coalition makes no mention of the unit's future. Nonetheless, the fact that the PDP campaigned on an anti-Special Operations Group platform suggests that voters in the Kashmir Valley will carefully scrutinize the government's actions.

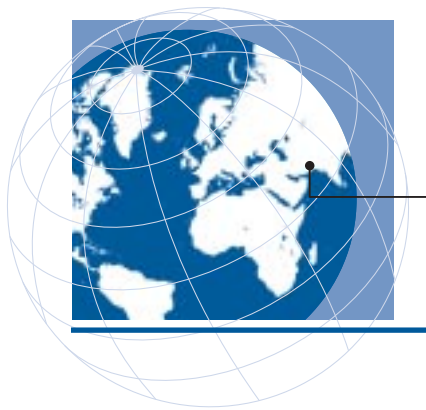
Regional support

Another significant challenge for the PDP government is the apparent over-concentration of its support in the Kashmir Valley. This part of Jammu and Kashmir is suffering the most from the insurgency but comprises only a third of the state's geographic area. The PDP has no political standing in largely Hindu Jammu and largely Buddhist Ladakh. Even though the

Indian National Congress, the PDP coalition partner, has representation in both Jammu and Ladakh the government must nevertheless take care to ensure that its Kashmir-centric policies do not alienate people in these areas.

It is entirely possible that the victory of the PDP-Congress coalition represents a real revival of the political process. The election campaign of 2002 witnessed greater participation from Valley Kashmiris than did the tepid campaign of 1996. The greatest challenge for Mufti is to walk the fine balance between having his platform hijacked by separatist elements while at the same time breaking the current political status quo. If Mufti is indeed successful in breaking the current impasse and in sustaining the revival of the political process he will likely have to brace for an upsurge in *jihadi* violence before it finally subsides. ⑥

Many do believe that this has been one of the fairest elections in Kashmiri history. - Shujaat Bukhari, Indian journalist.



Pakistani elections: A setback for federalism and democracy?

BY SAJID MANSOOR QAISRANI

After three years of military rule, an elected government is in place in Pakistan. The country's new prime minister, Mir Zafarullah Khan Jamali, heads a weak coalition government that could muster just enough support to survive a vote of confidence. While observers said that election-day procedures were for the most part fair, they did not consider the election rules to be entirely free or fair (see box "How fair and free were the Pakistani elections?").

General Pervez Musharraf, the Chief of Army Staff, continues as the country's president as the result of an extra-constitutional and controversial referendum with powers to sack the elected assemblies and the federal and provincial governments. And, under his tight control, the federal system seems to be weaker than ever before.

Commenting on the situation, Sanaullah Baloch, a former member of the National Assembly from Balochistan, said that the military has taken everything directly into its own hands and that Pakistan is no longer a federal democratic state. I.A. Rehman, Director of the Human Rights Commission of Pakistan, suggested that "The federal system is being eroded," and that "The new dispensation is based on unified command – it has failed earlier and it will fail again." An ongoing tussle between Pakistan's military leadership and political institutions is what most people predict, and some believe that the new government will not survive beyond a year.

There were many firsts in the elections held on October 10, 2002:

- the number of National Assembly seats was increased to 342 from 217;
- the minimum voting age was reduced to 18 years from 21 years;
- graduation with a bachelor's degree was made the minimum educational qualification for candidates for the assembly;
- 60 assembly seats were reserved for women; and
- 10 assembly seats were reserved for non-Muslims.

Changing the rules

The Musharraf establishment had made it clear even before the start of the campaign that it would not allow two former prime ministers return to power. One of them, Benazir Bhutto, had been prime minister from 1988 to 1990 and from 1993 to 1996. The other, Nawaz Sharif, was the prime minister who was overthrown by Musharraf. The government decreed that the membership of either Bhutto or Sharif in any political party would disqualify that party from contesting the election. In addition, a new law was enacted stipulating that any person who had served twice as the prime minister or as the chief minister of a province would not be entitled to seek a third term in office.

To avoid disqualification Nawaz Sharif's party, the Pakistan Muslim League, changed its leadership. Benazir Bhutto's party,

the Pakistan Peoples Party, used another tactic: it registered a party under a slightly different name, the Pakistan Peoples Party Parliamentarians, without Bhutto as a formal member.

A process to undermine these parties also had begun long before the election was called. Breakaway factions had been created and potential winning candidates from the two parties had been coaxed and coerced to join these factions. Corruption cases had been withdrawn against those politicians who had assured the military government of their support while charges had been laid against some who had dared to reject the offer.

Intimidation and a slim majority

On election day there were widespread complaints of intimidation and vote rigging. But, notwithstanding these interventions, the Musharraf establishment at first failed to form a government of its own choice. So then the horse-trading and arm-twisting began, and, in the end, Jamali managed to form a coalition that would have a slim majority in the Assembly.

The voter turnout was 41 per cent nationwide. A breakaway, pro-Musharraf faction of the erstwhile Pakistan Muslim League, the PML-Q, won 118 seats in the 342-member National Assembly. The successor to Bhutto's party, on the other hand, won the second-largest representation with 81 seats.

Perhaps the most surprising outcome of the election was the success of a religious group, the Mutahidda Majlis-e-Amal (or MMA). This party is a loose coalition of Muslim religious parties of all shades, which, with 60 seats, has emerged as the third-largest political force in the assembly. These elements had been brought together by some former insiders of the regime with the tacit support of conservative groups strongly opposed to General Musharraf's pro-West policies. They succeeded in forming a government in the North-West Frontier Province and in becoming a coalition partner in Balochistan.

Under the circumstances, the Musharraf establishment had to depend on smaller groups to form a government to its own taste. The constitution's "defection clause" was suspended to allow 10 members of the successor to Bhutto's party to join the coalition. This breakaway faction cast their crucial votes for the election of Mir Zafarullah Khan Jamali as prime minister.

A government of breakaway factions

The largest element of Jamali's coalition government is the PML-Q, the pro-Musharraf faction of the original Pakistan Muslim League. It enjoys the support of four smaller parties and the 10 defectors from the successor to Bhutto's party. It also received the endorsement of other small groups and parties in the assembly that are not formally part of the coalition.

For many, Jamali's emergence as the Pakistan Muslim League-Q's candidate for premiership came as a surprise. He had been chosen because the regime did not want a prime minister from the provinces of Punjab or Sindh. Coming from Balochistan, the least populous province, Jamali has a small power base and so

Sajid Mansoor Qaisrani is currently working for the leading Pakistani women's rights NGO, Aurat Foundation, as Director of Resource Service.

Party Standings in the National Assembly

Party	Abbrev.	Seats
Pakistan Muslim League (Quaid-e-Azam)	PML-Q	118
Pakistan Peoples Party Parliamentarians	PPPP	81
Muttahida Majlis-e-Amal Pakistan	MMA	60
Pakistan Muslim League (Nawaz Sharif)	PML-N	19
Muttahida Qaumi Movement	MQM	17
National Alliance	NA	16
Pakistan Muslim League (Functional)	PML-F	5
Pakistan Muslim League (Junejo)	PML-J	3
Pakistan Peoples Party (Sherpao)	PPP-S	2
Pakistan Awami Tehrik	PAT	1
Pakistan Muslim League (Zia-ul Haq)	PML-Z	1
Pakistan Tehrik-e-Insaf	PTI	1
Muhajir Qaumi Movement Pakistan	MQM-P	1
*Balochistan National Party	BNP	1
*Jamhoori Watan Party	JWP	1
*Pukhtunkhwah Milli Awami Party	PMAP	1
Independents, including 12 from FATA**		14

* parties pushing for greater provincial autonomy

** Federally Administered Tribal Areas

is considered a weak prime minister by many analysts. He does not have a strong personal following within the ruling coalition.

The Pakistan Muslim League-Q is currently under great strain as its members feel that they are not being accommodated to the same extent as members of the smaller coalition groups. And there are dangers of a split within party ranks.

The fragility of the government can be gauged from the fact that, shortly after endorsing Jamali as prime minister, the Muttahida Qaumi Movement (or MQM) decided to withdraw its support. It was only with great difficulty that this, the fifth largest party in the assembly, was manoeuvred back into the coalition.

Pressure on the federation

The federation of Pakistan is under pressure from a variety of factors. The popular parties that support federalism and the rights of constituent units have been weakened by the Pakistani establishment's attempts to maintain its centralist control. The regional parties and groups that had waged a long struggle for the economic, cultural and social rights of the constituent units have been swept off the political stage. This has created a dangerous void in a country where price spirals have put the necessities of life beyond the reach of the common citizen and unemployment is at an all-time high.

The presidency and the parliament are likely to remain on a war-path. Nawaz Sharif's former party and the successor to Bhutto's party are bitterly opposed to Musharraf because they attribute their defeat to his actions. Together with the religious party, the Muttahida Majlis-e-Amal (or MMA), they are also opposed to the package of constitutional amendments known as the Legal Framework Order, which was made a part of the constitution by the Musharraf government days before the convening of the National Assembly. In this struggle the opposition parties have the backing of major elements of Pakistani civil society.

Anti-Americanism and religious orthodoxy

The opposition religious party is also vociferously challenging the government's pro-West policies. Its leaders are demanding that the General should leave the post of Chief of Army Staff by March. They have threatened country-wide protests if the

government backs a possible U.S. attack on Iraq. They are also demanding an immediate end to the presence of U.S. troops and officials in Pakistan. Furthermore, they want the weekly holiday shifted back to Friday from Sunday and support the imposition of restrictions on co-education and liberal television programs. This party's popularity may heighten friction with India.

There is another tension in Pakistan, shown by the opposite poles of those calling for autonomy and those wanting a centralized form of federalism. The part of the intelligentsia advocating a centralized federalism believes that the federation is stronger today than ever before. Characterizing the election results as a genuine expression of public opinion, this element argues that this is the first time in the country's history that the forces of autonomy have been virtually wiped out in the provinces. The autonomists captured only three seats in Balochistan; in the North-West Frontier Province and in Sindh they did not even win a single seat. "The weaker the autonomists, the stronger the federation," is the mantra of these intellectuals.

These same people attribute the decline of the autonomy movements in part to the creation of newly empowered local governments. They also attribute the weakening of the autonomy movements to another factor: the breakdown of unofficial channels of capital flow after the terrorist attacks on the U.S. of September 2001. This, they say, dried up the financial resources of the forces of autonomy, which no longer have access to unaccountable money.

These intellectuals argue that the choice of a prime minister from Balochistan may further strengthen "federalist forces". Balochistan is the smallest and weakest but most radically separatist and resource-rich province in the federation. Pakistan's only abundant non-renewable resource, natural gas, comes from that province. ⑥

How fair and free were the Pakistani elections?

Human Rights Watch (New York City, USA):

"Pakistan's military government has employed a variety of legal and political tactics to control the process and outcome of the elections. Those tactics include constitutional amendments giving President Pervez Musharraf virtually unfettered powers over parliament and government, and the revision of electoral procedures that effectively eliminate the leaders of the two major political parties from participating in the election."

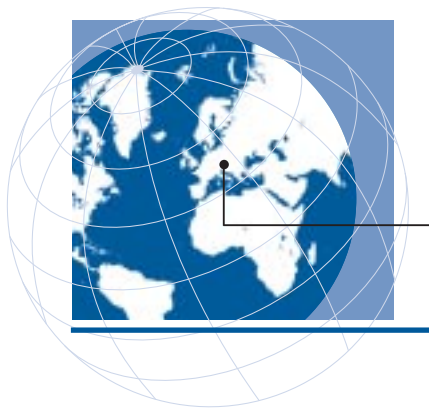
International Human Rights Commission (Lahore, Pakistan):

"The International Human Rights Commission (IHRC) while appreciating the efforts of the Election Commission of Pakistan observed that the elections 2002 were held in a fair, free and transparent manner. In its detailed report on Elections 2002 released here today, the IHRC declared that these elections were free and fair since the 1970 election in the history of Pakistan."

- *Dawn*, Lahore, Pakistan, Nov. 9, 2002

EU Election Observation Mission to Pakistan (Brussels, Belgium):

"The holding of a general election does not in itself guarantee the restoration of democracy. The unjustified interference with electoral arrangements ... resulted in serious flaws being inflicted on the electoral process. Additionally, questions still remain as to whether or not there will be a full transfer of power from a military to civilian administration."



Austrian far-right vote cut by two-thirds

Conservatives gain seats from party that Haider led.

BY MELANIE SULLY

The parliamentary election of November 2002 saw the largest fluctuation in voter support in post-war Austrian politics. It led to the dramatic electoral collapse of the far-right Freedom Party, dominated by Jörg Haider, to the benefit of the centre-right People's Party under the leadership of Federal Chancellor Wolfgang Schüssel. Austrians were also surprised to see the Social Democratic Party lose its position as the party with the most votes and seats in parliament for the first time since 1966. Schüssel had called a snap election for the 183-seat parliament in September, following resignations by key Freedom Party ministers from his coalition government.

In the campaign, a number of federal-state issues emerged, some as a complete surprise:

- a possible increase in the power of states and cities ("subsidiarity", a People's Party promise);
- bringing animal rights under federal control (equality for pigs in all states!); and
- the role of state parliaments in an enlarged European Union.

A vigorous debate concerning the scope and limits of these areas of federal and state jurisdiction would play an important role in subsequent negotiations to form a governing coalition.

The road to Knittelfeld

Some senior officials and ministers in the Freedom Party (FPÖ), including leader Susanne Riess-Passer, withdrew from politics after disputes with Jörg Haider, far-right governor of the state of Carinthia. Haider had embarrassed his party leader earlier in the year by an impromptu visit to Iraq where he shook hands with Saddam Hussein. His frequent "resignations from resignations" had become the laughing stock of the political columnists. Haider had become an unpredictable factor for his party's work in government. Furthermore, many of his zealots were disgruntled with the party's poor performance in regional elections and yearned for a return to the heady days of opposition.

A stormy meeting took place in September in the Styrian town of Knittelfeld when a compromise paper that had been hammered out between Riess-Passer and Haider was to have been put to the radicals for discussion. The Haider rebels tore up the paper in disgust and the moderates around Riess-Passer

could see little point in continuing in government. The coalition that had begun in February 2000 under the shadow of EU sanctions had come to an abortive end. Knittelfeld was to become synonymous with a political culture rooted in radical politics, inability to compromise and anti-Europeanism.

Jörg Haider, whose astute political judgment had for so long brought him unabated success, had badly miscalculated. He had banked on his ministers staying in office and had been sure that Schüssel would not call an early election. For Schüssel the gamble paid off in spite of its inherent risks. The People's Party (ÖVP) had not stood high in the public-opinion polls and the implosion of the Freedom Party, which in 1999 had been so favoured by working people, had threatened to benefit the opposition Social Democrats (SPÖ).

"No" to Red/Green

The coalition between the ÖVP and the FPÖ revolved around a reform project to bring in lean government and social welfare reform and to cut the budget deficit. Over its short life span it began to tackle a backlog of problems in the pensions and social-security system with varying degrees of success. Many voters apparently wanted to continue with these policies in

2002 and were prepared to entrust Wolfgang Schüssel with the realization of such a program. On the negative side, voters were deterred from opting for a change to a left-of-centre government by the weak economic performance of the Red/Green government in neighbouring Germany.

The SPÖ seemed apathetic in appealing to disillusioned Haider fans; it preferred instead to woo the Greens. The strategy of the Social Democrats had always been to ostracize the FPÖ – a party that, particularly under Haider, the SPÖ saw as fundamentally repulsive. The Social

Democrats' inability to court disaffected Freedom Party supporters was a logical continuation of this politics of exclusion. In contrast, the ÖVP adopted a tough stance on asylum and immigration to entice wavering FPÖ supporters. It also staged a spectacular coup just before polling day by announcing that Karl Heinz Grassner, who had resigned as FPÖ Finance Minister after Knittelfeld, would be included in a future ÖVP cabinet.

Anti-Vienna complex

Grassner, the youthful and good-looking "sunny boy" of the nation, had been mocked by the Haider rebels for his affluence and smart life-style. He was reckoned to be out of touch with

Knittelfeld was to become synonymous with a political culture rooted in radical politics, inability to compromise and anti-Europeanism.

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2002 Election Results

Party	Seats	Gain + Loss -	Per cent of votes	Gain + Loss -
Social Democratic Party (SPÖ)	69	+ 4	36.5	+ 3.3
Freedom Party (FPÖ)	18	- 34	10.0	- 16.9
People's Party (ÖVP)	79	+ 27	42.3	+ 15.4
Greens (Die Grünen)	17	+ 3	9.5	+ 2.1
Others	0	0	1.6	- 2.6

Turnout: 84.3% of eligible voters

the "ordinary man" that the radicals purported to represent. At the root of much of the Knittelfeld rebellion was resentment against Vienna and its chic, trendy "jet set". Many FPÖ ministers were welcome in the Establishment circles of the Austrian capital and obviously enjoyed the social life. The provincial branches of the FPÖ, however, detested the Viennese "air".

Riess-Passer's successor as party leader who should have led the FPÖ in the election was Mathias Reichhold, a Carinthian. He lasted just over 40 days in the job before resigning, ostensibly on the grounds of ill health. From the beginning Haider issued a warning that the new boy should not become too influenced by the insidious atmosphere of the capital. Reichhold's support by the Carinthian party was lukewarm and election posters in the state failed to carry his photograph. He was succeeded by yet another Carinthian, Social Minister Herbert Haupt, who defended the Haider line with gusto for the rest of the election right up until the disastrous results.

Federalism and animal protection

Most of the interest in the campaign circled around whether the ÖVP would overtake the SPÖ as the strongest political force. Many issues were subordinate in this struggle for the post of Federal Chancellor. There was little movement in the standard policies supported by the parties. The SPÖ predictably stressed jobs, pensions and education. The Green Party wanted a ministry for women and an end to student fees.

One surprise change came a few days before polling day on the issue of a centralized animal-protection law endorsed by the influential mass daily, the *Kronen Zeitung*, and all the main parties apart from the People's Party representing the interests of farmers. The ÖVP abandoned its hostility and announced that it would support a measure in the new parliament to ask the federal states to hand over animal protection to the federation. Under this program, laws on hunting would remain within the competence of the states whilst the varying statutes from state to state on animal rights would be brought within the jurisdiction of the federation. As the leader of the Social Democrats Alfred Gusenbauer stated: "A pig in Upper Austria should not be treated any worse than a pig in the state of Vorarlberg."

The Green Party further supported the transfer of competence over matters concerning social assistance and homes for the sick from the states to the federation. Generally speaking, the Greens support decentralization and more financial autonomy for local authorities. The Freedom Party is an advocate of the concept of "subsidiarity" – in other words, that to the greatest extent possible action should be taken by the order of

government that is closest to the individual citizen, in the jargon of the European Union. In contrast, the Social Democrats, by virtue of their party structure and *Weltanschauung*, take a more centralistic view of politics. The People's Party, on the other hand, with a decentralized party structure favours a larger degree of federalism. In its "A-Z" election platform it stressed the decentralization of power to smaller units and supported self-administration for the municipalities.

One federal element in the Austrian constitution consists of the Second Chamber or *Bundesrat* (Federal Council) with 62 members,

permanently in session, representing the constituent units of the country. Changing the procedural rules and their application in the Bundesrat to make it a true "chamber for the states" is a perennial item on the political agenda – even though such a constitutional change would require a two-thirds majority.

Reform of the federation had been agreed upon in the coalition pact between the ÖVP and the FPÖ in 2000, but the parties together lacked the necessary majority in parliament to effect substantial reform of this nature. The coalition pact of 2000 aimed to "strengthen the rights of the states and local authorities with due regard for the principle of subsidiarity." Further, it referred to the removal of "existing restrictions in the federal constitution to give sufficient scope to state organs to adopt statutory provisions of their own."

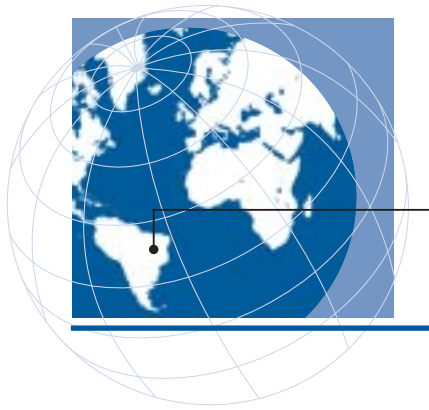
A new government with a solid majority in parliament could return to the pressing issue of the interaction between policy-making at the EU on the one hand, and the national and *Länder* governments on the other. Ideas for reducing the size of the state parliaments have been discussed but are sensitive points involving job losses and vested interests. For a small country, Austria has a superfluity of decision-making organs at several different levels that could benefit from rationalization. The debate on the European Convention could also lead to change and a greater role for the national parliaments in an enlarged Europe. Under this scenario the national parliaments could become "state parliaments" on the road to a federal Europe.

Federal Chancellor Wolfgang Schüssel has several options open for coalition building, a process that can often be harder and longer than the election campaign. He seeks to continue the reform policies begun in 2000 reflecting as far as possible the message from the electorate. The President of Austria entrusted Wolfgang Schüssel with the task of forming a government but this has proven to be a long, drawn-out process. Two months after the election there were no signs of a breakthrough in negotiations between the ÖVP and the other parties in parliament. ⑥

Further Reading

Federations, Vol. 2 No. 3, April 2002, "Jörg Haider uses his power base in Carinthia as a springboard for broader ambitions", by Melanie Sully

Werner Zögernitz, *Bundesrat-Geschäftsordnung*, Manz, Vienna, 2002 – a detailed account of Austria's second chamber



Brazil's new government: Ready to reform taxes?

BY CARLOS ARAÚJO LEONETTI

If Brazilian President Luís Inácio Lula da Silva finds a way to feed all of Brazil's poor, he will have to confront yet another huge challenge: how to pay for the new food program.

Brazil's tax structure under the 1988 constitution cannot support the current level of government services and commitments, let alone a program to eradicate hunger. In fact, if the Brazilian government fails to increase its tax revenues it will surely face unmanageable deficits and the loss of vital IMF support.

The present Brazilian tax structure was under considerable pressure at the beginning of 2003. Politically, the tax system undermines fiscal federalism and encourages "fiscal warfare" among orders of government. Economically, the system penalizes production and foreign trade. These are some of the fiscal constraints Lula must grapple with if he is to succeed in feeding Brazil's poor.

Constitutional constraints

The Brazilian constitution sets clear limits on the taxation powers of the federal government (known as "the union"), the states and the cities. It even stipulates the tax powers of the Federal District of Brasília. The union is competent to impose taxes on foreign trade, incomes, rural properties, industrialized goods, credit operations, currency exchange, insurance and financial instruments. States may tax motor vehicles, inheritances, gifts and sales in general. And cities may tax real estate, sales and services in general. The union, states and cities can also charge fees for public services or law enforcement.

Only the union may collect other taxes, called "compulsory loans" and "special contributions". The "compulsory loans" are assessed in response to extraordinary expenses caused by wars or other calamities, or in support of urgent public projects. After a time period fixed by law, the federal government must refund all the money collected on this basis to taxpayers. The "special contributions", on the other hand, are federal taxes collected to help finance social security and

other public expenses. Finally, only the union may impose taxes not specifically mentioned in the constitution.

The states and cities feel that their hands are tied because they may only collect those taxes that have been allocated to them by the constitution. This constraint usually results in states and cities lacking the financial capacity to meet all of their policy commitments. Moreover, the Fiscal Responsibility Act of 2001 imposes heavy penalties on all authorities that run a budget deficit or spend money on programs not set out in the annual

budget. This statute has added yet another constraint to governments' freedom of fiscal action.

Two major aspects of Brazil's tax structure require particular attention: the value-added tax and the "special contributions". The value-added tax – known as the ICMS for its acronym in Portuguese for "tax on the circulation of goods and services" – is collected by the states and not by the central government as is the practice in most European countries and in Canada. This difference enables each state to set its own rules for the ICMS – a state of affairs that

contributes to "tax warfare" among the states. Another problem arises from the fact that the ICMS applies to inter-state sales: companies operating nationwide incur significant expenses in attempting to comply with often contradictory state regulations.

Federalize the value-added tax?

Arguably, the ideal solution would be to transform the ICMS into a federal tax. This would involve transferring the power to legislate on the ICMS away from the states to the union, leaving enforcement and collection to the former. This way, Brazil could have a nationwide ICMS system and thereby both avoid a fiscal war among orders of government and reduce the cost structures of multi-state companies. This innovation would require a constitutional amendment, not an easy feat given the fact that it would require the consent of at least three-fifths of the members of each house of the National Congress – that is, the Chamber of Deputies and the Federal Senate. Such a change would also threaten states' fiscal independence because the ICMS as it stands is the most important revenue source for the majority of states.

Another possible reform of the ICMS regulations would entail reforming the principle that regulates the taxation of inter-state sales. According to the "origin principle" – the one currently in

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Two faces of Brazil's cities:

Photos: Reuters Digital Fellowship



A beach in Recife shows one face of Brazil's cities: affluence and a tourist paradise.



A mother and child on the street of a "favela" – a Brazilian urban shantytown near an affluent neighbourhood.

force – ICMS revenues from inter-state sales belong to the seller's state. This approach benefits the richer jurisdictions, where most industries are located, and punishes the poorer ones. Replacement of the origin principle with the destination principle would raise the non-industrial states' ICMS revenues and thus increase the fairness of the tax system as a whole.

The other major issue regarding Brazilian tax reform concerns the "special contributions" collected by the union. This tax is imposed on almost all business transactions, from food sales to telephone communications, on a cumulative basis. In other words, this tax is applied to each transaction involving the same good without taking into account the taxes levied on preceding transactions. This system inflates the prices of goods and services, imposing a heavy burden on consumers.

The consequences are perhaps even more severe when the special contributions are applied to exports: Brazil's goods lose competitiveness on international markets. The union has always resisted the idea of simply eliminating these special contributions because they generate significant revenues. It is possible that Lula's administration will change the current profile of these taxes to a non-cumulative basis in order to reduce the burden on exporters and consumers. Such a reform would not require a constitutional amendment, only an act of the National Congress.

Non-progressive income tax

Many Brazilians are also demanding reforms to other aspects of the tax system. Among these, the personal income tax is currently receiving particular attention. In Brazil, only the federal government has the authority to impose taxes on personal incomes. Brazilian income taxes are only modestly progressive as there are only two income brackets, the first applying to annual incomes above 12,684 reals (about US\$3,960) at a rate of 15 per cent and the second applying to incomes above 25,753 reals (about US\$8,040) at a rate of 27.5 per cent. In comparison with many countries, the list of eligible itemized deductions is quite short. Consequently, many citizens are asking for further deductions to be allowed.

Another important issue closely connected to tax reform is the constitutional division of powers. At the same time as the constitution divides taxation powers among federal, state and local authorities, it reserves the greatest flexibility for the union: only the federal congress may impose taxes that have not yet been allocated to one of the three orders of government.

The state and local authorities, on the other hand, often find themselves unable to raise sufficient funds to meet their constitutionally mandated commitments. Given that Brazilian sub-national governments provide the majority of the services on which most citizens depend, it's fair to say that the country's fiscal *status quo* is strongly weighted in favour of the privileged classes of the society.

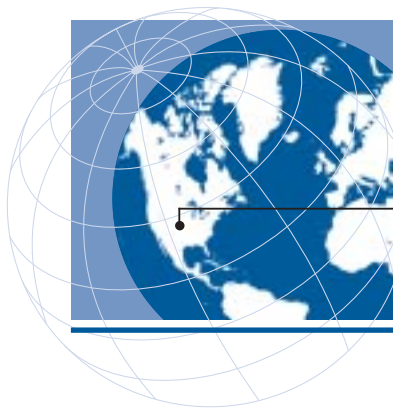
The consequences are perhaps even more severe when the 'special contributions' are applied to exports: Brazil's goods lose competitiveness on international markets.

Division of powers

Ideally, tax reform and the division of powers should be discussed at the same time because they are so closely intertwined. The country's state and municipal authorities currently have a habit of flying to Brasilia, the federal capital, to ask for financial help. An effective and responsible tax reform could well reduce or even eliminate such cap-in-hand requests. Moreover, President Lula da Silva's decision to establish a federal "Ministry of Cities" with responsibility for municipal affairs is arguably another example of a concerted effort to bolster the institutions of fiscal federalism.

Tax reform was a major plank in Lula's campaign platform, though his proposals in this regard were rather vague. The essence of his policy on public finance rested on the transfer of the major burden of the tax system from taxes on production to taxes on income and estates. On the other hand, Lula cannot curtail federal revenues without running the risk of breaking perhaps his most important campaign promise – the eradication of hunger among Brazil's poor.

Lula's challenge is clear: he must find a way to strike a new fiscal balance in the Brazilian federation that will allow him to meet his many policy commitments. (6)



U.S. states: Corporate taxes wane

Recent declines have many questioning the effectiveness of the corporate tax system.

BY *WILLIAM F. FOX*

In the United States, a corporate income tax is imposed not only by the federal government but also by almost all state governments. In 2002, Iowa levied a record 12 per cent corporate income tax and the rates for Minnesota and Massachusetts were greater than nine per cent. Yet, because they compete for investment capital, states generally choose to lower rather than increase corporate income taxes. The federal corporate income tax rate has also been declining, from a top rate of 46 per cent in 1985 to a rate of 35 per cent in 2001.

The use of corporate income taxes by states as a revenue source is under increasing pressure in the United States. Many analysts are asking what can be done to raise more revenues, while others are questioning the tax's long-term viability. The hefty 20.1 per cent decline in state corporate tax revenues during the fiscal year ending in June 2002 has brought these concerns into sharper focus. Some of the revenue decline can be attributed to the recent drop in corporate profits, but the slowdown in corporate income taxes began much earlier.

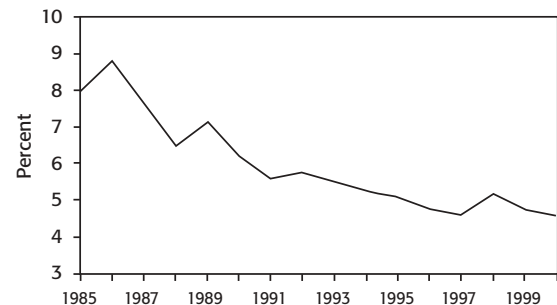
Long history

U.S. state governments have relied on corporate income taxes for approximately a century, with the first corporate income tax being levied by Wisconsin in 1911. Hawaii first imposed a corporate income tax in 1901, but it was not a state at that time. Over the years more jurisdictions followed suit and today 44 states (together with the District of Columbia) impose a corporate income tax, of which 31 levy progressive rates. The 12 per cent rate imposed by Iowa is the highest in the country and the 4 per cent rate imposed by Kansas is the lowest. In addition, a number of states charge a tax on the value of corporate capital, and two states, Michigan and New Hampshire, levy variants of an origination-based value-added tax as part of their business tax structure.

Despite their seemingly broad use by states, corporate income and franchise taxes generated only 7.2 per cent of state tax revenues in 2000, down from 10.7 per cent in 1979. Decline in the relative importance of corporate tax revenues has been consistent over this 20-year time period. The effective corporate tax rate has also been falling, down from 7.1 per cent of corporate profits in 1989 to 4.6 per cent in 2000 (see Figure). This rate is calculated as total state corporate tax revenues divided by total corporate profits.

There are a number of reasons for this decline. National policy changes and administrative practices have lowered state tax bases. Most state corporate taxes begin with the federal definition of corporate profits, which states then adjust for

State Corporate Tax Erosion
(Corporate Profits Tax as a percent of corporate profits)



their own purposes. Policy decisions by the president and the Congress change the federal tax base and these choices are often made with little regard for the effects on state tax revenues.

In some cases, states simply accept the revenue consequences of federal decisions. In other cases, states do not incorporate federal changes. For example, at least half of the states did not mirror the accelerated depreciation provisions enacted by Congress as part of the 2002 economic stimulus package. Tax-planning decisions by businesses – such as the timing of profit repatriations by subsidiaries of U.S. corporations – also influence the federal tax base and, in turn, state tax bases. Policy decisions in Washington and tax planning both appear to have reduced states' corporate tax bases.

Lower rates and tax breaks

As well, states have directly legislated changes in their tax bases and rates. From the 1960s through the mid-1980s states gradually increased their average tax rates. But growing tax competition in subsequent years has dramatically altered this pattern. Only 13 states raised rates and 14 decreased rates between 1986 and 2001. On top of that, many states have narrowed their tax base with generous tax incentives to business.

Automobile plants have been one important target for tax breaks. Some southern states have granted sweeping concessions to vehicle manufacturers. Alabama has provided tax breaks valued at more than US\$250 million to attract a Mercedes-Benz plant, and South Carolina and Georgia have granted automakers concessions worth around US\$300 million.

The fact is that many states have pursued a deliberate policy of sacrificing tax revenues in an attempt to ignite economic growth and impress their voters. Savvy corporations are using sophisticated tax-planning techniques to lighten their overall burden. One of these methods consists of creating complex

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corporate structures – often involving limited-liability subsidiaries – that facilitate the transfer of potentially taxable profits to low-tax or no-tax states. The combined effects of state policy changes and more aggressive tax planning have been to reduce the tax burden on profits earned by *multi-state* corporations but not on those earned by *single-state* firms. The result is a tax levied unevenly across businesses and increasingly paid by firms that are relatively small and located in a single state.

Time to abolish the tax?

Many analysts have questioned whether the taxation of corporate income is a good policy. Arguments exist both pro and contra. Two primary arguments can be marshaled in favour of the tax. First, some mechanism for taxing corporations may be necessary to achieve equity. According to this view, a corporate income tax should operate hand-in-hand with individual income taxes to ensure that taxpayers are taxed evenly on all parts of their income. In the absence of the corporate income tax, many individuals would house income within a corporation and defer taxation of that income until they withdraw profits from the corporation. The amount of income earned in corporations could grow if states were to eliminate the corporate income tax because of the greater incentive to shift income to the corporate form.

If this were to happen, the incentives for housing income within corporations would be mitigated by the imposition of a federal corporate income tax. Such an approach would result in the application of a corporate rate to all profits generated within the corporation and of an individual rate to any distributions to the shareholders.

A strong case can be made for businesses helping to finance public services. Levying taxes on businesses according to the benefits they receive helps to ensure that the costs of delivering public services are borne in proportion to the use of those services.

The “benefit” argument would tend to support the concept of a corporate income tax. Yet corporate taxes are usually ineffective mechanisms for taxing benefits because they are only levied on corporations (not on all businesses) and only on profitable corporations (not on all corporations). Since all businesses benefit from public services, one can argue that all should pay if a benefit tax were to be imposed. However, a tax on corporate profits would not be an effective means to this end. Several researchers have argued that an origin-based value-added tax is a preferable means of taxing benefits. This would be levied at the source rather than at the destination (as are the value-added taxes used in Europe and Canada) and can operate as a tax on the value of production rather than on the value of consumption.

There are also two primary arguments against state imposition of a corporate income tax. First, economists have generally concluded that sub-national governments should restrict themselves to the taxation of relatively immobile activities and resources and should leave the taxation of mobile activities and resources to the national government. Among productive

resources, capital is relatively mobile. This suggests that a corporate income tax is likely to influence the location of business capital in ways that distort the functioning of the market, thus making this approach a poor choice for state governments.

Second, the compliance and administrative burdens of the corporate income tax are costly, especially for multi-state firms. Firms must make many decisions, including the determination of the states in which they must file, the types of income that are taxable in each state, the expenses that are attributable to taxable and tax-exempt activities, the set of affiliated companies that is taxable in each state, and so forth.

In principle, the attribution of income between jurisdictions can be done either by requiring companies to engage in separate accounting for each jurisdiction in which they operate or by using “formulary apportionment”. The latter, which is used by U.S. states, is a system of formulas applied to the income of multi-state corporations with a view to ensuring that each sub-national government receives its fair share of revenues from those corporations.

Historically, states have made some attempts to harmonize corporate taxes in order to reduce the compliance burdens, but recently inter-state tax competition has resulted in decreases in uniformity.

Policy decisions by the president and the Congress change the federal tax base and these choices are often made with little regard for the effects on state tax revenues.

What to do?

Ultimately, any judgment on the wisdom of corporate taxes must strike an appropriate balance between equity and efficiency. States in the U.S. may have to make fundamental reforms to their tax structures in order to address the causes of the decline in effective tax rates. Such reforms would ensure that taxes are collected evenly and that corporate and individual income taxes operate as a seamless package. But tax competition makes such changes politically difficult and potentially undesirable for individual states. It follows that a good tax policy may involve the replacement of the corporate income tax with a more effective instrument.

An alternative is for the federal government to take one of two courses of action. Congress could pass legislation that would prevent states from imposing corporate income taxes. This approach would be undesirable from the perspective of maintaining the independence of state governments within the federal system.

The second avenue would be for the federal government to impose a single corporate income tax at the national level with the revenues (or some share thereof) distributed to state governments. This would substantially mitigate the perverse effects attributed to the corporate income tax.

Both the compliance burdens and the incentives for corporations to go “location shopping” would be smaller because the tax structure would be consistent across the country. But such a policy would effectively eliminate an independent source of state revenues and would add another level of complexity to the intergovernmental transfer program. And under such a scenario the states could be expected to object vigorously to their loss of autonomy. ⑥



the **Practitioner's** *page*

Godelieve Van Den Bergh of Belgium **Belgium's communities and regions** **take on foreign affairs**

Belgium's constitutional reform of 1993 confirmed the status of the country's three regions – Flanders, Wallonia and Brussels – and of its three linguistic communities serving Flemish-, French- and German-speaking citizens. Each of the regions has its own parliament and executive, as does each of the communities. The institutions of the Flemish community government and of the regional government of Flanders have been merged. The communities, the regions and the federal government are linked together through a complex division of responsibilities.

Godelieve Van Den Bergh is an ambassador with Belgium's unit for Relations with the Regions and Communities, which is a part of the federal Department of Foreign Affairs, External Trade and Cooperation in Development. The unit acts as an intermediary between the Department and Belgium's constituent entities.

Ms. Van Den Bergh recently met with David Mac Donald of the Forum of Federations to discuss the roles played by Belgium's federal government and constituent units in bringing about a new approach to that country's foreign relations.

Federations: Belgium was originally a unitary state. How did it become a federal country?

Van Den Bergh: In 1993, Belgium amended its constitution and the first article now stipulates that "Belgium is a federal state consisting of communities and regions." There are accordingly the federal government, three regions and three communities. The communities have exclusive jurisdiction over everything pertaining to the individual. These are the so-called "personalized" areas such as culture, education, young people and health. The regions, for their part, have exclusive jurisdiction over everything pertaining to the soil: the environment, water, electricity, and so on.

The former unitary state no longer exists, apart from the federal government. I myself, for instance, am a diplomat with Foreign Affairs and am still in the federal government. However, more and more international jurisdictions have been transferred to the constituent entities. For example, foreign policy is a federal responsibility in Belgium but the

constituent entities have the power to sign international treaties within their areas of jurisdiction.

Take, for instance, the cultural field: the federal government no longer has any powers in this field because it pertains to the individual and is therefore now a community responsibility.

Federations: Do you send cultural representatives of the communities to other countries?

Van Den Bergh: Yes, from some communities but not from all. For example, I was still a cultural attaché in Mexico from 1983 to 1986. I think that I was one of the last from the Belgian federal government. Now, if there are any, they represent the communities, and so it is no longer completely federal. In order to work better together, we have concluded a cooperation agreement with the officers from the constituent entities who work in federal premises abroad, particularly in embassies and consulates general. There are rules to follow, but it works out very well.

If in a treaty there are aspects pertaining to culture or to another area within the jurisdiction of the constituent entities, the federal government cannot conclude the treaty unilaterally. These are called "mixed treaties" regarding subjects of concern to both the federal government and the constituent entities. This keeps us busy.

Federations: There is a tremendous amount of consultation....

Van Den Bergh: Yes, there is a tremendous amount of consultation in advance. This is what happened, for example, when Belgium held the presidency of the European Union [from July 1 to December 31, 2001]. The Council of the European Union is the main decision-making body in the Union, and all the member states rotate into the presidency for a period of six months. Throughout the time when it occupied the presidency, the federal government was constantly consulting with the constituent entities.

Federations: In view of the fact that the unit for Relations with the Regions and Communities comes under the Minister of Foreign Affairs and External Trade, it probably plays an active role in the negotiation and signing of international treaties.

Van Den Bergh: The Minister of Foreign Affairs is also the Minister of External Trade. Since the last agreements signed in 2002, external trade has been completely regionalized. Only Belgium's representation in international organizations such as the World Trade Organization (WTO) is still a federal responsibility. However, even though Belgium is represented by a federal minister, what is done in these portfolios has to be agreed upon in advance by the constituent entities and the federal government.

In addition, the Minister of Foreign Affairs and External Trade is also the Minister of Cooperation. And international cooperation is going to be regionalized in 2004. This is why we still haven't instituted any cooperation agreements.

Federations: The regions will therefore be represented at La Francophonie, for example. Even though the regionalization of international cooperation is within federal jurisdiction, there must be quite a consultation process....

Van Den Bergh: The Minister of Foreign Affairs is appointed by the King. All of us diplomats who represent the country of Belgium abroad are therefore appointed by the royal authority, but there is still consultation. I am thinking for example of the economic and commercial attachés, as they are called in the embassies, who are completely regionalized. They promote trade with Belgium abroad. In other words, they do microeconomic promotion, while macroeconomic analysis is a federal responsibility. It's actually quite complicated. Most of the cooperation agreements go back to 1994, and I think that they need to be refined, adapted. So there is still work to be done.

Federations: Belgium is a veritable laboratory of federalism....

Van Den Bergh: Yes, that's right. I chair the "mixed treaties" working group. Even though a treaty is mixed and the federal government and constituent entities are therefore joint participants, it is still the responsibility of the Department of Foreign Affairs, the federal government therefore, to decide whether or not to enter into a negotiation process. In some cases, we don't have diplomatic relations or we have some difficulties. In any case, in order for a treaty to be ratified, everybody has to agree. This often explains why the ratification process takes so long in Belgium.

Federations: Is there any desire to streamline things?

Van Den Bergh: The constituent entities have to agree to the treaty, and this takes so long, I think, that an attempt should possibly be made to simplify things, or to see what could be done to speed up the process. Agreements often have to be ratified quite quickly in order for treaties to take effect, but everybody has to wait for Belgium. Many people have commented to the Prime Minister about this. I think that it will take a long time before everything works ideally.

Federations: Do you suffer from "meetingitis", as we say, or in other words are you constantly attending meetings?

Van Den Bergh: I think that it is helpful to speak with one another, to meet face to face, and discuss problems. You have to try to find solutions. The problems are there to be solved. We want to work and come up with something....

Federations: Do you think that the transfer of responsibilities to the regions will continue or will it stop now?

Van Den Bergh: The country of Belgium will always be the sovereign state, but the constituent entities – the regions and communities – have exclusive jurisdictions that they will be entitled to internationalize, to develop. And these jurisdictions will only increase in scope.

Federations: This is what in Québec is called the "Gérin-Lajoie philosophy." Mr. Gérin-Lajoie was a provincial minister who maintained that it was important for Canadian provinces to be able to internationalize their exclusive jurisdictions, especially in the area of education.

Van Den Bergh: Internationalize their jurisdictions, that's what has been happening in Belgium since 1993. But I don't think that it has been done in Canada, at least not yet....

Federations: I know that some Canadian provinces have been studying the Belgian model in regard to environmental and natural resource issues. Since there are many negotiations that are continent-wide now in the Americas, the provinces would like to participate in them.

Van Den Bergh: This is already being done in Belgium. Everything pertaining to agriculture, for example, has been regionalized since the 2002 agreements. I think that in the case of the Agriculture Council of the European Union, the constituent entities were able to chair it. That was the first time when Belgium was the chair, so lots of new things are happening. And then there are many, many preparatory meetings. In this way, everybody's views can be taken into account. In advance. ⑥



Canada's cities seek new status

Municipalities push for a charter with new powers and funding.

BY DAVID LEWIS STEIN

Signs and portents are growing steadily more favourable for Canada's urban partisans. Many municipal politicians in Canada now believe that it is only a matter of time, and a short time at that, until Canadian cities at long last achieve a place in the country's federal system.

Already cities operate with what some have taken to calling "a *de facto* constitution" that is beginning to supersede existing formal structures. A number of recent trends and events have been cited as indications of greater autonomy for Canada's cities. First, a series of court cases has expanded the independence of city governments. Second, many provinces are rewriting legislation to give municipalities more degrees of freedom. And third, the federal government recently appointed a tough-minded, outspoken member of parliament from Toronto, the country's largest city, to head up a parliamentary task force on urban issues and then establish a civil-service task force to act on the report.

In addition, the leading candidate to succeed Prime Minister Jean Chrétien of the federal Liberal Party has declared himself a champion of cities, and prominent media, a national organization of municipalities and a group of politicians and community leaders in five of Canada's largest cities are all pushing hard for more money and power for municipalities.

However, Canadian cities still have a long way to go before they gain a permanent seat at the constitutional table. Legally, the Canadian federal system has only two orders of government, the federal and the provincial.

"Creatures of the provinces"

The legal status of Canada's cities dates back to an act of 1849 – to an era when a handful of rustic British colonies was scattered along the United States' northern frontier. The laws limited cities to such homely responsibilities as keeping pigs off the streets and controlling drunkenness. These responsibilities were not enlarged in 1867 when the British North America Act linked the colonies together to form the Dominion of Canada. Cities were still considered of such little importance that they could be left to the new provincial governments. Cities, as the popular phrase has it, were merely "creatures of the provinces"; they could only exercise such powers as provincial governments allotted them.

David Lewis Stein has an M.A. in Regional and Urban Planning and recently retired after 30 years as a columnist on urban issues for the *Toronto Star*.

Cities have changed a bit since 1867, even though their place in the constitutional structure has not. In many instances, cities and surrounding farm towns have grown into each other creating such urban regions as Greater Montréal, Greater Toronto, Greater Winnipeg, the "Calgary-Edmonton axis" and Greater Vancouver. Over half of Canada's population now lives in urban regions or, at least, in cities with more than 100,000 residents. Municipal responsibilities have grown to include public health, housing, social assistance, care for children and the elderly, and protection of the natural environment. And yet, cities' constitutional status remains unaltered.

Cities ... were merely 'creatures of the provinces': they could only exercise such powers as provincial governments allotted them.

Cities' status changing

This is changing – in some cases dramatically.

When the town of Hudson, Québec, banned pesticides a chemical company launched a legal challenge to the municipality's action. The courts ruled that cities are competent to pass regulations to protect residents' health as long as these do not contravene provincial laws. Municipalities can even make their criteria more stringent than those of the provinces in order to promote residents' welfare.

The most important component of this acknowledgement of municipal responsibility is, according to constitutional expert Peter Hogg, the recognition of the "principle of subsidiarity". Hogg is dean of Toronto's Osgoode Hall Law School. Subsidiarity, as he pointed out, has been borrowed from the European Union. For some time, the EU has been trying to arrange matters so that broader policy decisions are handled at "upper levels" while the services on which people regularly depend gravitate "downward" to the order of government "closest" to the people.

"Nobody would deny the basic proposition that Canadian municipalities only have powers granted by provinces," Hogg said. "But this is open to interpretation. In the Hudson case, the courts gave a very liberal interpretation of the rights of a municipality. It was more the kind of interpretation you might expect in a ruling on the constitutional rights of a province."

The Hudson case was cited in an Ontario court decision that overturned a decision by the Ontario Municipal Board, a provincial tribunal, to prevent the City of Toronto from controlling the conversion of rental apartments to condominiums. Another decision stopped Ontario's Minister of Municipal Affairs from interfering with the City of Ottawa's plan to redraw ward boundaries.

And so legal precedents expanding municipal powers continue to pile up. At the same time, many provinces have, over the past decade, been revising legislation to give municipalities more autonomy.

Alberta has defined spheres of municipal interest and has given local governments the authority to act within those spheres. Ontario's new municipal act gives municipalities more leeway to borrow money. Just last June, Québec signed an agreement with the City of Montréal defining their relationship for at least the next five years and giving the city more revenue sources. Nova Scotia has given municipalities more freedom. On the other coast, British Columbia is introducing a bill that acknowledges municipalities as "an independent and accountable order of government."

Charter-city status

"It's the closest thing we have to the city-charter status that Toronto, Winnipeg and other big cities are trying to achieve," says Donald Lidstone, a Vancouver constitutional lawyer who acts as legal counsel for 150 Canadian municipalities as well as The Federation of Canadian Municipalities, or FCM.

"The constitution still recognizes only two orders of government, federal and provincial, but we are getting significant changes in customs, usage and tradition. They are beginning to create a *de facto* constitution that is getting close to providing cities with the legislative autonomy and adequate financial resources they should have according to the International Union of Local Authorities."

A caveat – a large caveat – is the absence of adequate financial measures from these new political and legal arrangements. Municipalities still depend on property taxes for 52 per cent of their revenues. They do not have a guaranteed share of the revenues that Ottawa and the provinces raise through income taxes and other taxes. Money for cities from the provincial and federal governments still comes in the form of grants and special-purpose funding that can be arbitrarily withdrawn at any time.

Throughout the 1990s, the federal and provincial governments steadily reduced their contributions to the programs municipalities depend on. The cutbacks have been most painful in the fields of infrastructure and housing. At the same time as the upper echelons of Canada's constitutional hierarchy were withdrawing support for cities, the insights of Toronto urban philosopher Jane Jacobs became a commonplace in Canadian political discourse. One can hardly go to a public meeting these days without hearing some politician solemnly proclaim that "The wealth of the nation depends on the economic activity of cities."

In 2001 Prime Minister Chrétien appointed Liberal MP Judy Sgro to head the Prime Minister's Caucus Task Force on Urban Issues. Sgro has a gut feeling for the problems of cities. She is a former Toronto city councillor who won great public respect for criticizing Toronto's police force.

Cities on the next PM's agenda?

In June, then federal finance minister Paul Martin announced at the annual meeting of The Federation of Canadian Municipalities that he favoured "a new deal for Canadian municipalities". Martin received a standing ovation but, upon returning to Ottawa, he lost his job as finance minister. Although it's not clear whether Martin was fired or was given

time to tender a resignation, this hardly matters from the municipal standpoint. Chrétien has announced that he will resign by early 2004 and Martin, who openly covets the top job, has already gathered so much support that he looks like a sure bet to become the next prime minister.

After the caucus task force recommended last November that Ottawa provide more support for housing, infrastructure and transportation, the federal government began to deal directly with cities in a quiet way. Ottawa has contributed C\$250 million to a "green fund" that cities can use for such environmental projects as retrofitting buildings to conserve energy and installing windmills to generate electricity. The money is actually distributed by The Federation of Canadian Municipalities, so Ottawa is one step removed from dealing directly with cities. But the point is that the provinces are not involved at all.

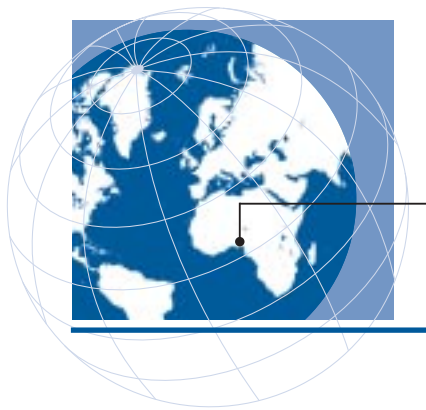
The Federation of Canadian Municipalities is itself a bit of an odd bird. Cities are the responsibility of the provinces, but the century-old FCM is a national organization that has grown from 350 member municipalities a decade ago to 1,050 today – a number representing 82 per cent of the population of Canada. The FCM has developed into a formidable pressure group. In its submission to the federal parliament's Standing Committee on Finance in November 2002, the FCM argued that, "The sustainability and vitality of our communities is threatened by outdated institutional and fiscal arrangements...."

Pressure from social democrats and the press

The FCM has made similar statements before, but now the language is getting tougher and political pressure is growing. Jack Layton, a Toronto city councillor who served as president of the FCM, became the leader of the left-leaning New Democratic Party, or NDP, in a landslide first-ballot victory at the party's convention in January. Layton pushed the FCM into endorsing the Kyoto Accord. This endorsement, in turn, helped push the federal government into backing the Kyoto Protocol. Over the last decade the NDP has been reduced to a handful of members in the House of Commons. Layton wants to broaden the NDP's appeal by getting the party to develop a solid urban base while downplaying its class-war social doctrines.

Meanwhile the *Toronto Star* launched a year-long campaign of editorials, stories and columns all designed to pressure Ottawa into reinvesting in cities. The country's two national newspapers, the *Globe and Mail* and the *National Post*, did not exactly join *The Star's* crusade, but they did increase municipal coverage, thus making readers more aware of urban problems. The mayors of five large cities – Toronto, Montréal, Winnipeg, Calgary and Vancouver – recently met in Winnipeg with Jane Jacobs. They decided to collectively call themselves the "C5" and initiated a campaign for "charters" aimed at giving cities more autonomy. The C5 movement has gained clout because it has drawn in boards of trade and heads of the United Way charitable drives to form a united urban front.

It would be rash to predict that this emerging *de facto* constitution means cities are about to secure a place in Canada's written constitution. But there has never been so much activity surrounding the challenges and the potential of urban governance. Indeed, for Canada's urban partisans 2003 is emerging as a year for living hopefully. (6)



YOUTH PERSPECTIVE

Nigeria: Facing the challenges of globalization in a federal system

BY EYENE OKPANACHI

Eyene Okpanachi was selected as a participant in the Forum of Federations' Youth Summer Session on Federalism 2002. Each participant was asked to submit an article in response to the question, "What are the challenges posed by globalization to your federal country?"

How does one organize a government to satisfy citizens' needs for peace, order and prosperity? Those three goals were championed by U.S. Chief Justice Oliver Ellsworth in 1802, by British aristocrats half a century later and by Nigerian President Olusegun Obasanjo in a speech delivered last June. But without democracy, these goals are sure to ring hollow.

Today, the reality of globalization – a new competitive environment, the internationalization of capital, trade liberalization and the information revolution – has made this question more relevant than ever. In a multi-ethnic country like Nigeria, globalization could accentuate ethnic nationalism and weaken state authority. Such consequences could, in turn, increase the potential for ethnic and religious confrontation and violence. How can these problems be effectively managed? What system of political organization is best suited for harnessing the forces of diversity to achieve sustainable development in a rapidly changing world?

Federalism offers a solution as it provides a dynamic balance between the centripetal and centrifugal forces in society. Indeed, at the heart of federalism is what Daniel J. Elazar called "the linkage of individuals, groups and polities in lasting but limited union in such a way as to provide for the energetic pursuit of common ends while maintaining the respective integrities of all parties." Yet federalism is not always a "ready-to-wear" solution: it may also contain within it the seeds of its own destruction. Nigeria's experience dramatically demonstrates this.

Federalism under pressure

In the 1954 constitution, a federal solution established a framework to hold together the diverse nationalities that had been arbitrarily incorporated into a unitary colonial state by the British Empire.

Since independence, however, deep ethnic and religious cleavages, a "rentier" culture, military rule and attendant over-centralization of power have limited the effectiveness of federalism. Federalism did not provide a means to cope with the rise of ethnic militias such as the Egbesu Boys, the Odua People's Congress, Arewa Youths and the Bakassi Boys. Nigeria's federal structure could not resolve the struggles over resource control, indigenous rights and citizenship, nor did it prevent violations of states' rights by the central government.

Eyene Okpanachi has a B.Sc. in Political Science from the University of Ibadan in Nigeria and has worked as a research assistant in the Program on Ethnic and Federal Studies in Ibadan.

Given all these problems, should Nigeria simply jettison the federal idea? No, federalism retains its utility for Nigeria's multi-ethnic society, and increasingly so in a globalizing era. The crucial question is how Nigeria can revitalize its system so that it manages its own tensions while effectively grappling with the problems and the possibilities of globalization.

The challenges are stark: conditions for economic development in Nigeria are limited by the persistence of ethnic and religious conflicts, by poor political leadership and endemic corruption, and by uncertain weather conditions. Nigeria's most talented individuals shun the public sector or, assisted by the increasing flow of goods and persons across borders, are lured abroad by the promise of greater income and security.

As globalization progresses, the interplay of demographics, disease and weak governance – if left unchecked – could lead to the further marginalization of Africa. Nigeria would not likely be an exception among African countries. Peace and good governance are hard to come by under the best of circumstances. Since independence, ethnic and communal tensions have intensified, periodically escalating into open conflict, spreading across borders and spawning secessionist movements that threaten to unravel Nigeria's federal structure.

Globalization is not only changing the very nature of the global economy: it is also transforming the traditional balance of power within states. In Nigeria, liberalization and democracy have given states greater influence over foreign policy, a field that hitherto was the sole preserve of the federal government. Indeed, these states are now attracting foreign capital, investment and loans.

Dealing with globalization

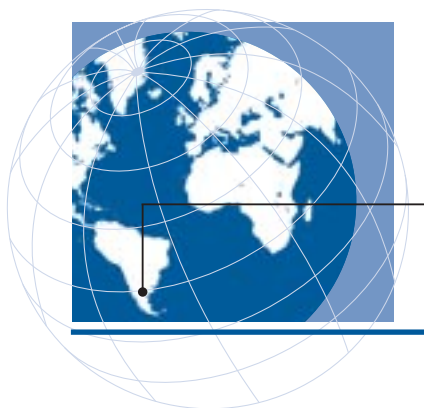
How can Nigeria's system of intergovernmental relations cope with the present reality? How can sub-national governments respond to the challenges of globalization without undermining national security? How can Nigeria reap the benefits of intergovernmental cooperation in a globalizing age without sacrificing the benefits of competitive federalism?

Although no consensus yet exists on federal reforms in Nigeria, the current situation requires action, not reaction. Pro-active reforms could include:

- the decentralization and safeguarding of the non-centralizable powers of states and localities;
- the introduction of residency rights for all Nigerians living in any state of the federation;
- the resuscitation of the National Council on Intergovernmental Relations; and
- the implementation of principles of good governance.

Until Nigeria becomes a genuine democracy, none of the above is likely to succeed. Developing a framework that integrates federalism and democratic governance is an imperative of Nigerian politics that has yet to be realized. Globalization has provided an opportunity for a policy re-evaluation in this direction. Nigeria now has a chance to take up this challenge. ⑥





YOUTH PERSPECTIVE

Argentina: How to cope with regional economic disparities

BY JULIA POMARES

Julia Pomares was selected as a participant in the Forum of Federations' Youth Summer Session on Federalism 2002. Each participant was asked to submit an article in response to the question, "What are the challenges posed by globalization to your federal country?"

In less-developed countries, globalization imposes burdens on some and confers benefits on others. Argentina, though wealthy in comparison with many developing countries, is no exception.

Globalization tends to exacerbate regional and social disparities, in Argentina and elsewhere. Regional imbalances in Argentina are astonishing: five of the 24 Argentine provinces generate 85% of the country's GDP and only three provinces produce 65% of its exports. Moreover, less than two per cent of the investments of the top 500 Argentine companies goes to the poorest provinces.

This pattern is also evidenced by regional differences in "human development", with only Buenos Aires earning a high score in the UN's Human Development Index. Income distribution is similarly distorted: the richest fifth of the population earns twenty-eight times more than the poorest fifth.

One solution to this problem would be to put in place a new pact between the constituent units of the federation. Such a pact would establish new functions and responsibilities for each of the parties involved in the federal decision-making process.

Provincial veto power

The effects of globalization cannot be considered in isolation. Internal trends in Argentina have fostered the process of regional differentiation. The decentralization process that began in the 1990s, together with the over-representation of small provinces in the National Congress, has led to the consolidation of the provincial veto power over decisions made by the federal order of government. The relationship between the two orders of government generates a pattern of "divided government" and, at times, political paralysis.

This inequality in representation exists in both houses of the federal congress – that is, in the upper house (the "Senate of the Nation") and in the lower house (the "Chamber of Deputies of the Nation"). Argentine electoral law stipulates that the upper house be comprised of 72 senators, with three senators per province regardless of population. Thus, the province of Tierra del Fuego, with a population of 115,000, has three seats, as does the province of Buenos Aires with a population of 11 million.

Julia Pomares works as a consultant for the Under-Secretary of Criminal Policy, Ministry of Justice and Human Rights in Buenos Aires. She graduated from the University of Buenos Aires in 1998 and is working on a Master's degree in discourse analysis.

The 257 deputies in the lower house are elected according to proportional representation following "D'Hont method", with three per cent of the popular vote being the threshold for a party to gain the minimum level of representation and with no fewer than five deputies coming from each province. The province of Buenos Aires, which accounts for 38 per cent of Argentina's population, holds only 28 per cent of seats in the Chamber of Deputies while the six provinces with the fewest inhabitants – together comprising four per cent of the population – hold 11 per cent of the seats.

A new federal pact would not require a constitutional amendment. Instead, such a pact would likely establish new procedures whereby negotiations between the federal government and the constituent units would not simply be zero-sum games and would, therefore, achieve substantive results.

Lack of coordination

These new procedures must tackle another major problem of the Argentine federation: the lack of coordination between the different orders of government in the policy-making process. New inter-agency efforts and multi-stakeholder initiatives have not yet delivered their anticipated results. New mechanisms to produce stable, long-term agreements can only be effective if they fulfill two conditions. The first condition is the need to overcome the increasing inequality among regions. The second is the need to create incentives for fiscal responsibility among the constituent units. Heavily imbalanced federal systems like that of Argentina clearly require new, efficient approaches to fiscal equalization in order to mitigate poverty in disadvantaged regions.

The common pool problem

Fiscal responsibility is another major issue in Argentina. Some specialists have pointed out that Argentina displays a relatively high level of expenditure decentralization, vertical fiscal imbalance and borrowing autonomy among orders of government. These features have generated perverse incentives for provincial governments. Indeed, these factors create what is called the "common pool problem" and thereby tempt provincial authorities to behave opportunistically. Mark Hallerberg of the University of Mannheim in Germany explained the "common pool problem" as follows:

"Since a representative's district pays only a small portion of the central government's tax revenues, he or she will ask for more spending than when the central government pays for them than when they have to be paid for with local taxes."

The road to a new federal agreement will no doubt be a long and hard one. To admit the sheer complexity of this task will have to be the first step. New approaches to intergovernmental relations and more efficient agencies within each order of government are critical to meeting the challenges presented by the forces of globalization. (6)

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Bob Rae, Chair of the Forum of Federations, discusses federal issues with G.L. Peiris, chief negotiator for the Government of Sri Lanka, at the peace talks in Thailand.



Harold Tarbell, moderator, and C.T. (Manny) Jules, Co-Chair Chiefs' Committee on Fiscal Relations, Assembly of First Nations (Canada), at the Forum-sponsored International Indigenous Governments Fiscal Systems conference in Vancouver, Canada.



Céline Auclair, Interim President of the Forum of Federations, speaks with Peter Bußjäger of the Institut für Föderalismus of Innsbruck, Austria, at the International Conference on Federalism in Saint Gallen, Switzerland.

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