SUBSIDIARITY AND THE MORAL JUSTIFICATION OF INTERGOVERNMENTAL EQUALISATION GRANTS TO DECENTRALISED GOVERNMENTS

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Abstract: An important problem with decentralised government relates to its tendency to create disparities between the various units with respect to their capability to provide public goods. In response to this problem, intergovernmental equalisation grant transfers are a ubiquitous feature of many systems of decentralised government. However, since the earliest times, scholars of fiscal federalism have struggled to provide a convincing moral justification for providing intergovernmental equalisation grants. We outline how the principle of subsidiarity might be employed to create a robust moral justification for providing equalisation transfers. In addition, we explicate the steps required to operationalise a subsidiarity-based grant system and conclude with a consideration of some of the difficulties that might be encountered in doing so.

It has been convincingly argued that decentralised government 'increases economic welfare above that which results from the more uniform levels of such services that are likely under national provision' (Oates 1999, 1122). This is said to occur both as a result of a better knowledge of the preferences of citizens, as well as a more fulsome understanding of the specific costs and benefits of rolling out programs in decentralised government areas.

However, decentralised government – whether federations of states or systems of local government within unitary states – tend to give rise to disparities with respect to both revenue capacity and need (Boadway and Shah 2009). Quite simply, some decentralised regions are wealthier than others as a result of natural endowments, patterns of immigration, and paths of industrialisation (Bird 2006). Indeed, as the remit of decentralised government expands, particularly in the context of high household mobility, economists generally expect that horizontal disparities will be exacerbated (Oates 1999).

In order to mitigate horizontal disparities between decentralised government areas within nations it is quite common for regimes of intergovernmental equalisation grants to be established (Boadway and Shah 2009). We acknowledge that many other systems of grants (such as tied, matching and special purpose grants) operate in both federations and unitary states and with a plethora of objectives (such as mitigating vertical fiscal imbalance). However, in this article we are concerned only with grants made for the purpose of equalising disparities between decentralised governments. For example, equalisation schemes operate in countries including Australia, Japan, Germany, Canada, and Switzerland under various legal instruments (sometimes legislation, as in the case of Australia, but at other times prescribed by the Constitution, such as occurs in Germany) and according to numerous formulae and criteria (Beland and Lecours 2014).

What is common to all of these arrangements is the desirability of being able to articulate a moral justification for equalisation transfers. Fundamentally, equalisation transfers involve the movement of pecuniary wealth from one group of persons to the benefit of another group of persons within a federation or nation. Effectively taking the wealth of some persons in order to gift it to others, in the absence of mutual and voluntary agreements, ought to be justified irrespective of whether an explanation is indeed politically required (Messner 1952; Riker 1986).[1] Indeed, this need for moral justification seems to have been acknowledged very early by the luminaries of public economics (Pigou 1946; Buchanan 1950).

Perhaps the best known attempt at moral justification for equalisation grants is found in the work of James Buchanan (1950) who invoked Pigou's (1946, 63) famous normative dictum that 'different people should be treated similarly unless they are dissimilar in some *relevant* respect' (original emphasis). Buchanan (1950) founded his ethical argument on people, rather than decentralised government units, in response to the commonly held assumption that only sentient beings (rather than entities) are worthy of moral consideration (see also McLean 2004).

As has been recognised by a number of scholars, however, this search for a proxy deemed suitable for moral consideration has led to at least three significant problems (Mieszkowski and Musgrave 1999). First, the proposition that 'equals should be treated equally' as a moral justification for equalisation grants necessarily assumes that the current distribution of wealth is somehow morally just (something that Sen and many others would contest – see McCloskey 1998). Second, it can easily be shown that unless decentralised governments are forced to distribute equalisation grant money in a manner designed specifically to achieve equal nett fiscal benefits for individuals, then equal persons will not in fact end up being treated equally at all (Buchanan 1950; Mieszkowski and Musgrave 1999).

Thus, in the absence of grantors dictating the spending decisions of decentralised governments – which would negate most of the benefits of decentralisation – the asserted moral imperative will become little more than a watered-down platitude. Third, if equal treatment for equals is indeed the moral objective, why not simply pass the money directly to persons, rather than employing a decentralised government middle-man?

There are, in fact, a number of other justifications routinely employed to argue in favour of equalisation grants. For example, the vague *pathos* of 'fairness' is commonly appealed to – which is rather unconvincing in the absence of a robust moral theory (Buchanan 1950). In addition, supposed economic imperatives – the need to discourage inefficient migration of capital and labour, or the desirability of promoting regional development – have also been raised (Herrero-Alcade and Martinez-Vazquez 2011; Oates 1999). Moreover the political desirability of formula based equalisation transfers – to reduce pork barrelling, dampen political conflict, and combat secession movements – have also been employed by way of justification. However, 'any discussion of the operations of fiscal system…must be centred around some concept of fiscal justice' (Buchanan 1950, 586). The pursuit of a more coherent and robust moral justification for equalisation grants thus forms the focus of our article.

We argue that the natural law principle of subsidiarity is ideally suited to the moral justification of fiscal equalisation transfers to decentralised governments directly (rather than as a proxy for persons). Moreover, in the next section, we will show that the principle of subsidiarity also provides a compelling case for why governments should even contemplate transferring fiscal resources in the first place.

In order to establish a more robust moral case for equalisation grant regimes we next explore the main tenets of the principle of subsidiarity. Following this we briefly examine

some of the well-known problems that plague the practice of extant equalisation schemes as well as providing some detail regarding how a subsidiarity-based scheme might be expected to differ. We conclude with a survey of some of the main problems faced by any party wishing to operationalise a subsidiarity-based approach to intergovernmental equalisation grants.

Subsidiarity and Its Justification for Intergovernmental Equalisation Grants

The principle of subsidiarity is located within the vast and deep natural law traditions that can be traced back to at least the time of Aristotle (some might say Plato). At its core is the idea that the 'right' course of action can be discerned by observation of nature and the application of practical reason (Finnis 2013). Moreover, each of the monotheistic faiths have a body of natural law scholarship associated with them that also point to the revelation by scripture as an 'efficient' way of understanding the natural law (Emon et al. 2014).

Subsidiarity, consistent with its natural law origins, posits a plurality of social forms required for human flourishing (Drew and Grant 2017).[2] This preference for plurality responds to the observation that each association of persons has a specific *munera* (loosely translated as gift) which it may contribute. For example, the family, is considered the most fundamental unit of association ideally position to provide loving care and nurture to the next generation (Kenney 1955). Moreover, because each association has a specific *munera* associated with it, the preservation of the association becomes critical to the continuation of certain irreducible ends. This need to preserve *munera* therefore confers onto associations a right to moral consideration (Evans and Zimmermann 2014).

'Next to the family, the local community is the smallest of the lesser groups that have functions of their own, and therefore rights, within the state community' (Messner 1952,

321). Thus, in subsidiarity, decentralised government units (instantiated first in local governments, shires, and municipalities) are also identified as important associations which bring forth specific *munera* not able to be performed by smaller units (for example, the provision of local roads). Moreover, other functions – such as systems of education and the provision of defence – require even larger government units, therefore explaining the existence of states and nations respectively.

The key argument of subsidiarity is that it is imperative to preserve the plurality of social forms by striking a balance between the competing demands of human dignity, on the one hand, and the common good on the other. In natural law philosophy dignity means the right of persons or associations to pursue their existential ends without undue interference (Golemboski 2015). The common good is the help available to members of greater associations as a result of their co-operation that is greater than the mere sum of contributions (Messner 1952). The principle seeks to strike this desirable balance by imposing both positive and negative obligations onto associations

The positive obligation requires greater associations to provide *subsidium* according to specific constraints. Consistent with the commonly cited etymology for the neologism of subsidiarity itself, the term *subsidium* is derived from the Latin *sub sudeo* which refers to the Roman military practice of deploying reserve troops to strengthen battle lines only in times of desperate need and then only for as long as absolutely necessary (so that they could be recalled for further deployment should the need arise; Drew and Grant, 2017). ‘As supreme guardian of the common good, the state has a duty to offer lesser communities such ‘help’ as is needed for them to realise their distinctive ends and pursue their unique goods’ (Evans and Zimmerman 2014, 73). Thus, it is a moral imperative for federations and higher tiers of government to provide *subsidium* – not merely an economic, Constitutional, or political argument for the desirability of doing so.

Notably, the principle of subsidiarity (and natural law more broadly) requires *subsidium* to be provided with care so that it does not unduly impinge on the dignity of persons and persons in lesser associations. First, *subsidium* should only be provided for cases of *bona fide* need – this means that greater associations are not obligated to provide support for mere wants, nor when a smaller association is competent to fulfil the need itself. Second, *subsidium* must be provided in a way that recognises the desirability of reciprocal responsibility – that is, *subsidium* is fundamentally *help* to assist an association or person to fulfil its needs, *not* fulfilling the needs for a person or association. Merely helping, rather than taking over the performance of a *munera*, means that the person or lesser associations still have important contributions to make which preserve both their competence and the long-run distribution of power (Messner 1952). Third, *subsidium* should have designed into it mechanisms to make its provision become superfluous as quickly as practical. Failing to build in 'redundancy' to help provided assumes that failure will be a constant state of affairs which ultimately robs persons or associations of their dignity (Sirico 1997, 564).

The negative obligation imposed by the principle of subsidiarity is a prohibition on greater associations subsuming the provision of *munera* of persons or persons in lesser associations. This negative obligation complements, and *ipso facto* exceeds, the constraints set forth for the provision of *subsidium* that prevent 'financial support [being used by central government] to extend its controlling powers until local authorities become more and more merely executive organs of the central authorities' (Messner 1952, 324). Indeed, in the first use of the neologism Pope Pius XI declared that 'it is an injustice and at the same time a grave evil and disturbance of right order to assign to a greater and higher association what lesser and subordinate organisations can do'.

Taken together, the two obligations articulated as part of the principle of subsidiarity, are consistent with a preference for delivery of ends through the smallest association possible.

It is argued that smaller associations have a greater moral claim to effecting a resolution to needs, often have greater knowledge and understanding of the problem by virtue of their closer proximity, and generally are more efficacious in their interventions (Sirico 1997). Therefore equalisation grants provided to decentralised governments in response to the principle of subsidiarity would be focussed on respecting the dignity of these smaller units of government and preserving their competencies to perform their particular *munera*.

In sum, we contend that the principle of subsidiarity is the most useful and defensible *moral* foundation for the provision of equalisation grants to decentralised governments. It establishes a system of intergovernmental transfers as a moral duty – not merely an economic desirability or political expediency – because decentralised governments perform a range of irreducible *munera* that make them deserving of moral consideration. Moreover, the principle of subsidiarity also stipulates how this help should be provided to ensure that power and competence remain dispersed and this has important implications for the practice of providing intergovernmental equalisation grants – the matter to which we now turn.

The Practice of Intergovernmental Equalisation Grants

Extant systems of intergovernmental equalisation grants generally employ complex formulas to estimate need (based on assumed unit costs and estimated adjustment factors for socio-demographic influence) and sometimes also adjust for assumed revenue capacity (often based on average taxation rate yields) (Boadway and Shah 2009). Few understand these formulas and even fewer could predict whether the formulas would indeed yield sufficient grant revenue to bring about capacity equalisation. Moreover actual allocations are often politicised in the media and politicians routinely struggle to justify why regions should be equalised in the first place (McLean 2004).

The outcome of complex formula-based transfers are opaque, generally annual, flows of revenues that essentially reduce the actual cost paid by citizens on a wide range of decentralise government goods and services (Bird 2006). This difficult-to-identify subsidy on a broad range of decentralised government goods and services gives rise to fiscal illusion which has important implications for financial sustainability (Drew 2020). Moreover, funds provided in untied equalisation grant regimes are often quite fungible and may be ultimately employed to reduce decentralised taxation, rather than meet *bona fide* needs (Oates 2011). Extant systems rarely require reciprocal responsibility, and often stand accused of fostering dependency and learned helplessness (Oates 2005; Boadway and Shah 2009).

By way of contrast, any subsidiarity-based grant transfer scheme must acknowledge the responsibility of greater associations, such as higher tiers of government, to provide *subsidium* for cases of genuine need in a manner which respects the dignity of the local government. This implies that help should be provided under the assumption (indeed insistence on) reciprocal responsibility and in a way that discourages dependency. To achieve these moral objectives in a system of grant transfers will require considerable work focussed around three key steps – the identification of *bona fide* need, the establishment of reciprocal responsibilities, and the negotiation of a plan to meet the need.

Under a subsidiarity-based system it would be the responsibility of decentralised governments to identify *bona fide* need and approach higher tiers for *subsidium* if deemed necessary. Having to identify the need and self-assess its *bona fides* introduces a high degree of accountability at the very beginning of the process as well as respecting the dignity of the decentralised government. *Bona fide* need can be defined as infrastructure or services required to facilitate irreducible ends consistent with human flourishing that can't be provided by a smaller competent association.

Next, reciprocal responsibility must be acknowledged and reflected in the request for *subsidium*. Harnessing even insufficient resources is important to preserve competence and extant power distributions (Messner 1952). Indeed, an insistence on reciprocal responsibility is an insistence that failure will not be an ongoing state of affairs. Before requesting *subsidium* a decentralised government must therefore look first to itself with respect to ensuring a satisfactory revenue effort, high levels of technical efficiency and potential divestment of non-essential discretionary services. Moreover, consistent with the etymology of the neologism it should be recognised that there is potential for some of the *subsidium* to be provided by way of a loan – particularly if the unmet need is merely a reflection of a cash flow problem.

The final step in a subsidiarity-based system of intergovernmental grants is a period of focussed negotiation. The quantum of *subsidium* sought will be the *bona fide* need less contributions committed to by the decentralised government after having evaluated its reciprocal responsibilities. It will be important that negotiations test the veracity of these evaluations and result in an agreement regarding the precise good or service for which *subsidium* is sought, specific plans that the decentralised government will put in place to reduce future dependency, and the particular actions and delivery times necessary to ensure that the need is actually met. Potential problems to this approach relate to the high information costs as well as the opportunities for pork barrelling if negotiations are not facilitated through an independent grants body (Hepp and von Hagen 2011; see also the next section for further information on this).

Under a subsidiarity-based equalisation grants scheme, decentralised governments with *bona fide* need will continue to receive funds to meet *specific needs*, but other decentralised governments which can perform their responsibilities without *subsidium*, may no longer receive equalisation grant revenue. Because the overall equalisation grant pie is

likely to be cut into less pieces under this proposal, those decentralised governments with real needs that can't be met through their own efforts are more likely to get sufficient help to eliminate need. Subsidiarity is not about reducing the quantum of intergovernmental grant transfers, but rather aimed at ensuring that the money is better targeted at meeting *bona fide* need in a manner that respects the dignity of decentralised governments and fosters reciprocal responsibility (Drew and Grant 2017).

The benefits of a subsidiarity approach are many. First, a subsidiarity-based system of equalisation grants is much easier to justify to the public than a system based on population proxies delivered through institutions that may not act in a manner consistent with equalisation objectives. Fundamentally a subsidiarity-based equalisation scheme is simply a way to extend help to communities that stand in genuine need – and it is unlikely that this proposition would prove politically contentious or difficult to 'sell' to the public. Second, subsidiarity inspired equalisation systems involve dialogue and negotiation, rather than relying on complex and inaccessible formulae. This ensures that all parties understand precisely what is being contributed and the need to which the funds must be directed. Third, a subsidiarity-based equalisation program is far more transparent – funding is provided for specific infrastructure or programmes with a particular time limit and there should thus be considerably less fiscal illusion as a result (assuming appropriate communication and signage for the public). Fourth, subsidiarity equalisation grants would be considerably less fungible – specific contributions would need to be made by the decentralised government according to the negotiated agreement and therefore leave relatively little room for inappropriate deployment of funds (such as for taxation relief). As a result identified needs would be actually met, rather than merely potentially met as is the case for most extant equalisation schemes. Fifth, equalisation schemes motivated by the principle of subsidiarity are considerably less likely to result in dependency because they would not represent a relatively

predictable and on-going source of revenue and thus are less likely to be budgeted in as an effective subsidy for a broad range of service provisions. Table 1 summarises the main differences between extant and subsidiarity-based systems of equalisation grants.

[INSERT TABLE 1 HERE]

Potential Obstacles to Operationalising Subsidiarity Inspired Equalisation Grants

Transferring wealth from one group of persons to another is a morally grave matter that ought to be justified. In this article we have shown that the principle of subsidiarity is an ideal moral argument for equalisation grant transfers. Not only does it make a moral case obliging higher tiers of government to provide help, but it also provides strong guidance on how such help should be provided in order to both protect the dignity of decentralised governments and preserve the benefits of decentralisation. Moreover, we have identified a number of practical benefits associated with adopting a subsidiarity inspired regime of equalisation grants including *inter alia* greater transparency, reciprocal responsibility, accountability, and efficacy (needs must actually be met rather than merely potentially met as is often the case with extant practice). However, there are a few obstacles that would have to be overcome, and in this concluding section we briefly survey the most imposing matters.

Identification of *bona fide* need could prove problematic. Many decentralised governments and the citizens that they represent seem to have difficulty discerning the difference between ‘wants’ and ‘needs’, as well as the appropriate remit for a given tier of government (Drew and Grant 2017). A need, according to natural law, is something without which ends could not be achieved and persons could not flourish. This is a considerably smaller sub-set of decentralised government goods and services than is often provided. Moreover, to be considered as part of the legitimate remit of a given decentralised

government it would be important to show that a smaller association is not competent to provide for the need. For example, a road is a need (necessary for economic activity and unlikely to be provided by a smaller association), but an aquatic park is more in the line of a want (it is not essential and could be provided by smaller associations including business). Notably, the pecuniary cost associated with a need can't be reliably projected by employing standardised or average costs because, as the decentralisation theorem clearly attests, actual costs will differ according to a range of factors.

Similarly evaluating efficiency is not something that can be reliably done through desktop analysis – higher costs don't necessarily reflect inefficiency because the specific topography, demographics or climate often has a large bearing on expenditure. It is also important to accurately assess revenue effort (with respect to flow of revenue rather than stocks of wealth which is often used, see Ladd and Yinger, 1989) to ensure that decentralised governments have exerted reasonable effort towards meeting their own needs. All of these tasks involve high information costs that will need to be overcome. However, it might be noted that extant systems also have high information costs (Bird 2006) and moreover that the information collected could also be put to other important uses (such as monitoring financial sustainability).

It might also be argued that one must be cognisant of vertical fiscal imbalance (the likelihood that higher tiers of government generate more revenue relative to their remit than lower tiers) and tax assignments when designing any system of equalisation transfers. Typically intergovernmental grant transfers conflate the two specific objectives of mitigating vertical fiscal imbalance on the one hand, and horizontal inequity on the other. We believe that this is a mistake because it results in a considerable reduction to transparency and makes it almost impossible to tease out whether either of the objectives are actually met (Drew 2020). We therefore propose that the matters of vertical fiscal imbalance and appropriate tax

assignment are dealt with as a separate issue which would ensure that the subsidiarity motivated equalisation grants will be both transparent and amenable to the evaluation of efficacy.

On a related matter it might be questioned whether it is reasonable to insist that equalisation grants be designed in a manner to make them superfluous. Surely there are some decentralised governments that are so relatively disadvantaged as to require ongoing support? Perhaps this is the case; but a sunset date should nevertheless be placed on all offers of *subsidium* to ensure: (i) that failure is not assumed to be a constant state of affairs, and (ii) that the particular circumstances of the decentralised government will be reviewed at appropriate intervals so that adjustments may be made to reflect changes in local economic conditions and need. As Milton Friedman (1993) astutely noted almost three decades ago the problem with government is that once a program begins people acquire a vested interest in its continuation irrespective of whether it continues to meet a *bona fide* need or not. The surest way to ensure that governments don't end up funding ineffective or redundant programs is to stipulate a regular review.

In addition, we have shown how a change in moral justification will require a change to practice. These changes will require amendments to legislation (perhaps even changes to the Constitution) where methodologies for equalisation transfers are currently specified in a manner inconsistent with what we have outlined. To bring about these changes will therefore require a high degree of political will as well as effective rhetoric and heresthetic.

Perhaps the most imposing problem standing in the way of an implementation of a subsidiarity-based equalisation grant regime is the strenuous opposition emanating from decentralised governments no longer receiving strong flows of predictable revenue. Part of the solution to this problem is to separate out the various conflated objectives of many extant

grant transfer systems so that citizens can clearly see what money is flowing for what purposes. The second part of an effective response is to draw to the attention of the wider community that extant equalisation schemes have largely failed to meet *bona fide* need (as attested to by the scholarly literature). The final piece of the puzzle is to ensure clear messaging – affirming that equalisation grants must mitigate genuine needs of communities.

The obstacles to implementation are indeed imposing. However, if we truly believe that transfers of wealth ought to be morally justified and that horizontal inequities should actually be mitigated then it seems that the principle of subsidiarity is the most defensible way forward.

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Table 1. Comparison of Extant Systems and Subsidiarity Justifications for Intergovernmental Equalisation Grants.

Extant Systems	Grant Transfers Based on Subsidiarity
Common moral justification is 'equal treatment for equals'. This moral argument is found wanting because it is inconsistent with practice and does not specifically justify transfers to decentralised government.	Obligates higher tiers to provide *subsidium* in cases of genuine need direct to decentralised government invested with moral standing.
Often employs complex formulae that may not result in need actually being satisfied.	Employs self-assessment, verification and negotiation that insists on *bona fide* needs being met within a given timeframe.
May be employed to subsidise a broad range of goods and service 'wants', thus generating fiscal illusion.	Provides support for a specific good or service 'need', over a carefully delineated timeframe.
Does not require reciprocal responsibility.	Insists that decentralised government should look first to itself to meet needs and contribute according to the best of its capacity.
Guarantees future flows of revenue that are baked into budgets, thus creating a state of dependency.	Delivered in a manner designed to make the help superfluous as quickly as possible.

NOTES:

[1] Constitutional requirements or lengthy traditions of equalisation probably lessen the practical need for politicians to justify redistribution of wealth. However, as many ethicists will attest, just because an act is commonly practiced it doesn't automatically follow that it is morally licit, nor that it should continue into the future (Messner 1952).

[2] Natural law generally and the principle of subsidiarity more specifically are sophisticated and complex topics that require more than a mere journal article to explicate comprehensively. Interested readers are referred to the seminal works of Messner (1952), and Finnis (2013), as well as recent applied contributions by Golemboski (2015) and Drew and Grant (2017).