Political and Fiscal Decentralisation: Benefit and Cost

Glenn Withers

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Consumer Warning: The topic is decentralisation in industrial countries especially Australia

- “For federal benefits to be reaped, relatively non-corrupt, socially stable and democratic conditions should be in place”
  - Feld, Zimmerman and Doring, IZA, December 2006
1. Australian Federalism Is Under Seige

- The Commonwealth has been using its financial powers (as seen recently in the Murray Darling Basin plan) and increased legislative power (as seen most recently in NSW v Commonwealth) to intervene more and more in areas of State responsibility.

- Centralism appears to be the order of the day: there is almost a conventional wisdom among commentators that centralist solutions are the way forward for Australia (Abbott and Costello).
International trends are the exact opposite

☐ In the rest of the world, the prevailing trend is towards decentralisation and federalism.

☐ Belgium, France, Spain, Italy, Germany, Switzerland, UK in Europe alone.

☐ Federalism is now regarded as one of the best governmental systems to deal with the twin pressures of globalisation:
  - upward pressure to deal with some matters at the supra-national level;
  - downwards pressure to bring government closer to the people.
2. Myths about federalism need to be challenged

- An historical accident or relic
- Irrelevant in a globalised world
- Generating excessive levels of Government
- Duplicating government activity
- Creating complexity and inefficiency
- Generating conflict and buck-passing
- Too generously funded
The Benefits of Federalism need clear restatement: the six C’s

- Checks
- Choice
- Customisation
- Competition
- Creativity
- Co-operation
3. Arguing and documenting the myths. Example: Tiers of Government

<table>
<thead>
<tr>
<th>Country</th>
<th>National</th>
<th>State</th>
<th>Regional</th>
<th>Local</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>1</td>
<td>6 States, 2 Territories</td>
<td></td>
<td>673</td>
</tr>
<tr>
<td>Canada</td>
<td>1</td>
<td>10 Provinces</td>
<td></td>
<td>3160</td>
</tr>
<tr>
<td>France</td>
<td>1</td>
<td>22 regions</td>
<td>96 departments</td>
<td>36,679</td>
</tr>
<tr>
<td>Germany</td>
<td>1</td>
<td>16 Länder</td>
<td>439 districts</td>
<td>12,320</td>
</tr>
<tr>
<td>Italy</td>
<td>1</td>
<td>20 regions</td>
<td>110 provinces</td>
<td>8101</td>
</tr>
<tr>
<td>Japan</td>
<td>1</td>
<td>47 Prefectures</td>
<td></td>
<td>3100</td>
</tr>
<tr>
<td>Russia</td>
<td>1</td>
<td>89 regions</td>
<td></td>
<td>12,215</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1</td>
<td>26 Cantons</td>
<td></td>
<td>2867</td>
</tr>
<tr>
<td>United States</td>
<td>1</td>
<td>50 States</td>
<td></td>
<td>87,849</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1</td>
<td>3 devolved governments</td>
<td></td>
<td>367</td>
</tr>
</tbody>
</table>
Dealing with Myths: coping better with globalisation

Ratio of Real GDP per Capita, Australia and New Zealand, 1974-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio of GDP per Capita: Australia to New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974</td>
<td>0.97</td>
</tr>
<tr>
<td>1984</td>
<td>1.05</td>
</tr>
<tr>
<td>1994</td>
<td>1.14</td>
</tr>
<tr>
<td>2004</td>
<td>1.28</td>
</tr>
</tbody>
</table>
Dealing with myths: Excessive Government example

General Government Revenue: Anglo-American Countries, 2005

- USA: 32.8%
- Australia: 36.7%
- Canada: 40.7%
- UK: 41.8%
- NZ: 42.9%
Dealing with myths: Central Government Efficiency example

- **Collins Class Submarines**: $1 billion cost over-run including new combat systems and repairs.
- **Project Bushmaster Infantry Transport**: $170m contract in 1999 for 370 vehicles has escalated to $329m for 299 vehicles.
- **Jindalee Over the Horizon Radar**: Four years late and $500m over budget.
- **Amphibious Ships**: Four years delay and cost overrun of $200m for two ships, Manoora and Kanimbla.
- **Wamira RAAF Trainer**: 1980s Australian-designed trainer project costing $70m scrapped.

And many others listed in the Report—such as immigration (Cornelia Rowe), IT acquisition, broadband, universities regulation, and even legislation itself (next chart)
Commonwealth efficiency (cont’d): pages of primary legislation
Dealing with myths: the Growth Tax example

- Net payments to the States over the whole post-GST period remain at levels **below the pre-GST average of 6% of GDP** for the whole period of the 1980s and 1990s.

- During the same period, the Commonwealth’s revenue **rose by a further 2% to 20% of GDP**.
4. Arguing and Documenting the Benefits. Example: Checks on Power

Perceptions of Integrity in Federal and Unitary Countries: OECD, 2006

- Federal: 82.1
- Unitary: 77.9

Corruption Perceptions Index (100 = No Corruption)
Benefits Example: Competition


Federal: 13.6%
Unitary: 15.5%
Benefits Example: Innovation

- road safety campaigns and the compulsory use of seat-belts;
- the establishment of the first Environmental Protection Authority;
- the enactment of various kinds of anti-discrimination laws;
- the use of casemix funding of public hospitals;
- the establishment of health care call centres;
- the development of the mutual recognition scheme;
- the development of markets for the trading of salinity credits and biodiversity credits;

and many others specified in the report
5. Estimating the Overall Economic Payoff from Australian Federalism

<table>
<thead>
<tr>
<th>Australian GDP per Capita</th>
<th>Without Federation</th>
<th>With Present Federation</th>
<th>With Better Federation</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ Australian</td>
<td>39,666</td>
<td>43,091</td>
<td>45,946</td>
</tr>
</tbody>
</table>
6. Reform Options

1. Abolish the States and establish regional governments
2. Continue the centralist drift: including through opportunist federalism
3. Make federalism work better: co-operation and/or competition?
Diagnostics

Taxation Per Capita, Commonwealth and States, 2000-05

<table>
<thead>
<tr>
<th>Year</th>
<th>Commonwealth</th>
<th>State Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999-00</td>
<td>8,043</td>
<td>2,305</td>
</tr>
<tr>
<td>2000-01</td>
<td>9,106</td>
<td>2,025</td>
</tr>
<tr>
<td>2001-02</td>
<td>9,106</td>
<td>2,053</td>
</tr>
<tr>
<td>2002-03</td>
<td>9,860</td>
<td>2,207</td>
</tr>
<tr>
<td>2003-04</td>
<td>10,486</td>
<td>2,404</td>
</tr>
<tr>
<td>2004-05</td>
<td>11,336</td>
<td>2,462</td>
</tr>
</tbody>
</table>
Diagnostics

- The Commonwealth collects $11336 per capita in tax
- It transfers $3060 to States and Territories (including GST) and retains $8275 for own delivery purposes
- GST transfers (“entitlement”) represent $1813 and SPPs (Commonwealth discretion) represent $1247 per capita

ABS Taxation Revenue 2004-2005
Diagnostics

Company Tax and GST Growth, Australia, 2002-07 ($m)

Company Tax

GST Payments to States
Diagnostics

**Vertical Fiscal Imbalance: Selected Federations, 1990s**

- **Australia**: State and Local Share of Total Public Spending: 39.7, Own-Share of Total Public Revenue: 17.2
- **Canada**: State and Local Share of Total Public Spending: 58.7, Own-Share of Total Public Revenue: 44.1
- **Germany**: State and Local Share of Total Public Spending: 66.4, Own-Share of Total Public Revenue: 29.3
- **Switzerland**: State and Local Share of Total Public Spending: 66.3, Own-Share of Total Public Revenue: 40.4
- **USA**: State and Local Share of Total Public Spending: 54.2, Own-Share of Total Public Revenue: 31.7
Diagnostics


Income Taxes as Percentage of State and Local Own Revenue

- Australia: 0
- Austria: 52.8
- Canada: 43.4
- Germany: 50
- Switzerland: 75.9
- USA: 38.8
Diagnostics

National-State Shares in Public Health Outlays: Selected Federations, 2004

<table>
<thead>
<tr>
<th>Country</th>
<th>National Share</th>
<th>State Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>52%</td>
<td>48%</td>
</tr>
<tr>
<td>Austria</td>
<td>68%</td>
<td>32%</td>
</tr>
<tr>
<td>Canada</td>
<td>7%</td>
<td>93%</td>
</tr>
<tr>
<td>Germany</td>
<td>3%</td>
<td>97%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2%</td>
<td>98%</td>
</tr>
</tbody>
</table>
Making Federalism Work Better

- Reallocate roles between Commonwealth and State governments
- Improve mechanisms for inter-governmental co-operation
- Reform federal-fiscal financial relations
- Hold a Constitutional Convention for constitutional reform
Conclusions:

- The myths about federalism that are not borne out by the evidence.

- We need a more constructive debate that takes into account international experience; it needs to balance fairly the advantages against the disadvantages.

- Such a debate will assist reform of our federal system, taking full advantage of the benefits while eliminating or reducing the problems.

- The potential ‘reform dividend’ from a new federalism is an estimated $86 billion pa or more.
Appendix

☐ Other Studies (Costs Only): Drummond, Access Economics
☐ Previous Studies Updated: Dowrick & Nguyen, Castles & Dowrick
☐ Previous Studies Extended: Twomey & Withers
Regression Evidence: Model 1

- **Equation 1: Federal Institutions**
- Dependent Variable: GROWTH in per capita GDP (PPP)
- Method: Least Squares
- Sample: 1 21
- \( g = 4.69(21.1) - 0.0017(-8.14) + 0.38(1.84) \)
  \[ r^2 = 0.80 \]
- Implies 15.1% advantage from politically autonomous sub-national governments
Regression Model 1

- **Equation 2: Fiscal Decentralisation**
- Dependent Variable: GROWTH
- Method: Least Squares
- Sample: 1–21
- $G = 4.48(20.55) - 0.0017(-8.65) + 0.017(2.12)$  
  $r^2 = 0.81$
- Implies 10.46% federation benefit from average fiscal decentralisation relative to practice of unitary states
Regression Model 3

- **Equation 3: Federal Institutions and Fiscal Decentralisation**
- Dependent Variable: GROWTH
- Method: Least Squares
- Sample: 1 21
- \[ g = 4.61(21.02) - 0.0018(-8.61) + 0.27(1.25) + 0.01(1.66) \]
- \( r^2 = 0.83 \)
- Implies a 10.46% political autonomy effect and a 5.63% federal fiscal decentralisation effect
Source


- Accessible on Crawford School website: Glenn Withers’ staff page: www.crawford.anu.edu.au

- Or contact Glenn.Withers@anu.edu.au for supply of an electronic copy.