

Competitive Federalism

John Hyde

Among the claimed virtues of federalism is that it is a defence against excessive government---a minefield in the way of marauding Prime Ministers. Comparing the United Kingdom with the United States, or New Zealand with Australia, invites the conclusion that unitary governments get their economies into (even) greater messes than federated systems.

State chauvinists are rare creatures---even in WA and Queensland---but Australians remain enthusiastic federalists. Canberra seems unlikely to govern with the Third-World incompetence and impropriety familiar to Queenslanders, Western Australians and Victorians. Even so, few people share Whitlam's dream of centralised government. Perhaps they merely recall Khemlani, but I think, being neither State chauvinists nor centralists, they prefer the federal system for its checks and balances.

In theory, Federalism should maintain a degree of competition in the public sector. For example, it offers you the opportunity, if you don't like life under Mr Cain, of living under Mr Greiner. Or if the cost of WA Inc. should make WA's tax and government benefit package sufficiently unattractive, you can migrate to a better-managed South Australia. And so on.

In spite of these apparent opportunities, Philip Grossman (AIPP, Critical Issues No.11) was able to cite only one example of aggregate migration between Australian States in response to Government policy. This followed the abolition of death duties in Queensland---it became "a great State to die in". Within six years all other States had also abolished the tax, thus matching the competition and stopping the migration. This reaction was a typical market reaction.

Grossman notes that the inability to detect net policy-induced migration does not preclude the possibility that people are moving in both directions attracted by different aspects of State government policy. Nevertheless, there is much less evidence in Australia than in the United States of people migrating interstate to take advantage of better fiscal packages---that is, less evidence of worthwhile competition among the Australian States than there is of competition

between states of the United States. Dr Grossman looks for reasons why decentralisation plays so small a role in explaining public sector size in Australia.

First: we have fewer competing jurisdictions than has the US. We have only 6 States and 2 Territories compared with 50 States in the US. Although we have enough local governments (840) to encourage competition, our cities, towns and shires spend only 6% of total government expenditure and raise much less than that in tax. Thus, the differences between them are seldom a big enough issue to cause people to migrate.

Second: Australian mobility is restricted by distance, and by the monopolies which make our transport systems expensive.

Third: our States avoid the competitive pressures of Federalism by collusive action. Abetted by the Commonwealth Government, they have made cartel-like agreements concerning their tax-and-service packages. Consequently, each State is substantially like another, and the citizen gains little by interstate migration. The States' cartel allows each of the States to provide a worse tax/service package than it would have to provide, if it faced effective competition from other States.

A State government can use the cartel in many ways: It can run a bigger government sector than their voters would have chosen. This benefits the bureaucrats and politicians with bigger empires, more promotion, more kudos and more perks. As well, politicians might consciously direct government expenditure to marginal seats, and public-sector unions might direct expenditure to their members. Then again, politicians and bureaucrats might settle for the quiet life by, say, not standing up to union pressure they would have had to resist, had they faced the prospect of their citizens migrating to a better-managed State.

The cartel is especially effective on the revenue side of State government ledgers. Grossman's finding---that the States cooperated with each other and with the Commonwealth to avoid competition---should not have surprised me. I remember some bright-eyed lay members of the WA Liberal Party taking States' Rights so seriously that they suggested to Sir David Brand, then Premier, that the WA Government assume responsibility for its own budget. We recognised that the power to spend was inevitably tied to the responsibility to tax, so we suggested that WA revert to raising its own income taxes in lieu of Commonwealth grants. Sir David said that was not a good idea at all.

Now, in a changed political climate, and because they are responding to economic necessity, the Federal Liberals are trying to devise policies to reduce taxes by making government smaller and more efficient. They have an ingrained preference for the federal system and would, no doubt, like to achieve a competitive market for public goods and services by returning responsibilities to the States. They, nevertheless, sometimes

find their options limited by the knowledge that the States will not compete with one another to provide cheaper government. The *raison d'être* of federalism is missing.

With the present revenue-sharing rules, why would a State government offer smaller government? If it were to cut down on services it would be excoriated by its employees and perhaps also by the electorate, and it would not be praised by anybody--the most visible taxes are collected by the Commonwealth.

The Commonwealth, which runs the revenue cartel, is a considerable natural monopolist--only the wealthiest people and companies can move off-shore. The Commonwealth can, therefore, raise more tax than individual competing States could raise in aggregate. It therefore suits the State governments to have the Commonwealth raise the revenue, even though the price the State governments pay for this is the 'States' Rights' they claim to cherish.

And so the public suffers bigger government than it would in a properly-working Federation.

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