Decentralization and the post-war political economy

FRANCIS G. CASTLES
Research School of Social Sciences, Australian National University

Abstract. This paper uses cross-national data for 21 OECD nations to examine whether there is evidence of a connection between measures of political and fiscal decentralization and the major, long-term, performance parameters of the post-war political economy. Findings of what is necessarily an exploratory analysis of a wide range of policy outcomes suggest that federalism and the proliferation of constitutional veto-points have inhibited the expansion of the socially protective state and that a low level of fiscal centralization appears to have restrained post-war inflationary pressures and gone along with higher rates of post-war economic growth. No evidence is found to connect either political or fiscal measures with postwar labour market performance.

The question

The question I ask in this paper is whether there is evidence of a connection between the degree of centralization of the state and the character and performance of the economy. With regard to the issue of the expansion of the size of the tax state – and, in particular, the growth of the post-war welfare state – there is now a substantial body of argument and evidence suggesting that political decentralization in the form of either federalism or a proliferation of constitutional veto-points has limited the growth of the post-war public economy. However, despite the emergence of a substantial literature on decentralization and regional autonomy in recent years, there has only been a limited analysis of how decentralization impacts on the functioning of the economy, with suggestive insights produced by public choice theory and a few comparative studies of the links between political and fiscal structure and macroeconomic outcomes.

In contrast, the economic impact of decentralization has been a hot topic of political debate in many nations at one time or another during the post-war era. Wherever fiscal powers or policy-making responsibilities are divided between branches of government or between national and sub-national units, there is likely to be on-going controversy on the probable consequences of changing the existing rules of the game. In federal systems, such issues are always salient just because the basic rules of the political process are
built around issues of territorial jurisdiction and because more power for one level of government necessarily means less for another. In unitary systems, questions concerning the financial resources and political powers of local governments also emerge, not least because changing the level at which the political game is played can have an immediate bearing on its outcomes (i.e., Margaret Thatcher’s attempt to reduce aggregate public spending by reducing the powers of local authorities).

On the whole, the post-war era has seen a major increase in the taxing and directive powers of central governments at the expense of both the autonomy of sub-national units and the sharing of powers between different branches and organs of government. The standard account of such developments has been couched in terms of the role of central government as the primary agency for satisfying the socially protective demands intrinsic to the nature of modern mass democracy. Despite this, in recent decades, a number of countries – including Belgium, Italy and Spain and, presently, the United Kingdom – have taken steps to alter their constitutional arrangements so as to provide greater institutional guarantees of local and regional autonomy.

When decentralization issues are on the political front-burner, the protagonists of different positions generally claim that their favoured institutional arrangements will lead to superior economic performance or, at least, that the adoption of their opponents’ positions will lead to economic disaster. I will give an Australian example because that is the case with which I am most familiar, but readers are likely to be able to provide instances of similar controversies in their own countries. Australia is, of course, a federal state and, in the early 1990s, the Hawke Labor government, recognizing the massive shift in fiscal power from the states to the Commonwealth since World War II, mooted the possibility of some reallocation of taxing powers and program responsibilities between levels of government. In the debate that followed, the advocates of greater powers for the states argued that a devolved taxing power would lead to a higher level of ‘fiscal accountability’, making it more difficult for governments to evade responsibility for ‘economically irresponsible’ public expenditure growth. In contrast, those who wished to maintain the existing division of powers argued that if the Commonwealth no longer controlled the ‘big levers’ of fiscal power, it would be unable to achieve either its equity or its full employment objectives.

Arguments of this nature link institutional arrangements (i.e., the character of inter-governmental relations) to policy outcomes, implying that certain types of arrangements are to be preferred because they are conducive to particular kinds of consequences. As articulated in the political arena, such arguments are generally given their force by ideological rhetoric rather than by empirical evidence. In the Australian debate, the need for central con-