The Lack of Competition in Governance as an Impediment to Regional Development in Australia

Brad R. Taylor

Regional Australia faces many and diverse challenges and opportunities. Given that one-size-fits-all policy solutions are not appropriate for these diverse conditions, I argue that increasing interjurisdictional competition can foster regional development and resilience. If individuals and businesses are able to ‘vote with their feet’ for the local jurisdictions they prefer, market-like incentives are brought to bear on government. This would limit government power, enable lower-risk policy experimentation, make government more responsive to citizen needs and allow for policy more suited to local circumstances.

Introduction

Australia is a large and diverse country. This diversity is obvious when we compare the densely populated southeast to the sparse and underdeveloped north, but significant economic differences exist even across rural areas. As the country transitions from the mining investment boom, diverse regions face diverse pressures and impediments to adjustment. Although all regions must adjust to some extent, there are no one-size-fits-all solutions to regional development in Australia (Productivity Commission 2017).

The relative underdevelopment of Australia’s north and interior also presents a major opportunity. Development would provide greater economic opportunities for those living in rural communities and could also benefit other Australians and the world at large. Australia has sound institutions and abundant space. Refugees and immigrants seek access to Australia but are turned away, and those in the south
complain of high and rising housing costs. Regional development would mitigate these problems by making more of Australia a socially and economically practical place to live.

The policies most appropriate to promoting regional development are not obvious ex ante. Formulating ideas for regional development policy is easy, but solutions need to be economically and politically feasible. As such, policy options must be tailored to local conditions and acceptable to local constituencies. Rather than looking to the Commonwealth Government for direction, I argue that regions and communities should be empowered by jurisdictional autonomy and incentivised by competition to find their own solutions. If individuals and firms can more easily ‘vote with their feet’ for the policies and public services that best meet their needs, we bring market-like incentives to bear on competing governments. This, I argue, limits government power, enables lower-risk policy innovation, makes government more responsive to citizen needs and allows for policy more suited to local circumstances. Although some degree of such competition already exists in Australia, I argue that this could and should be increased.

Competitive governance

The modern theory of competitive governance begins with the ground-breaking paper by Charles Tiebout (1956), which modelled citizen-consumers as choosing among a set of local jurisdictions offering varying levels of collective goods and charging varying levels of taxes. Extant public finance theory, and indeed the democratic model of government, asks governors to adapt to citizen preferences despite a lack of good information about what those preferences are or a reliable way of aggregating them. Tiebout suggested instead that even if governors made no attempt to respond to citizen preferences, the adoption of jurisdictions by mobile citizen-consumers would produce a sorting of citizens into different jurisdictions by preference. Given low costs of mobility and a wide selection of jurisdictions to choose from, we should expect that most citizen-consumers will be reasonably happy with the jurisdiction they choose.

There is evidence that households do respond to differences in governance when making locational decisions (Dowding et al. 1994). The effect of governance on locational decisions seems even stronger for firms (Ribstein and O’Hara 2009). As with any actually existing market, the competitive pressures in any real or feasible governance market is likely to be less than perfect. Frictions resulting from imperfect information, limits on citizen mobility and finite diversity in governance offerings will prevent citizens from getting exactly what they want. Nevertheless, Tiebout suggests, citizen mobility can improve the degree to which citizens are able to get what they want from government.
Competition as a constraint on government

Subsequent work has built on Tiebout’s work to argue that jurisdictional competition limits government power and provides incentives for effective governance. Brennan and Buchanan (1980: Chapter 9) suggest that even under the ‘Leviathan’ model of government, in which a selfish and powerful ruler seeks to extract as much rent as possible, jurisdictional mobility can limit rent extraction. Buchanan (1995) builds on this analysis to argue for competitive federalism as an objective of constitutional reform. On this understanding of Tiebout competition, citizen mobility between jurisdictions limits the power of state governments to extract rents from citizens. Any state government attempting to extract excessive rents would find itself losing citizens to its less extractive neighbours. States are forced to compete for citizens (and tax dollars) in roughly the same way that firms in a competitive market are forced to compete for customers. Thus, individual exit options limit the power of state governments. The federal government, however, is not similarly constrained by individual exit options. For Buchanan, the power of central government must be constrained by the ability of states to exit the union through secession.

Competition and discovery

Competition among governments for mobile citizens also promotes policy innovation and learning. As Hayek (1948) persuasively argued, competition acts as a discovery mechanism. No producer knows ahead of time whether a new product will succeed or fail, and through the harsh reality of market competition, good ideas are sorted from bad. In this sense, producers are constantly conducting economic experiments to discover what consumers want (Rosenberg 1992). Understood in this way, the market is a creative process primarily concerned with the generation of knowledge (Buchanan and Vanberg 1991). This idea has been embodied in the vast literature of evolutionary economics, which has produced a wealth of formal modelling (Safarzyńska and van den Bergh 2010) and empirical study (Malerba 2006).

The possibility of innovation and learning through competition is implicit in Louis Brandeis’s understanding of states as ‘laboratories of democracy’, and a small number of Austrian economists, evolutionary economists and Public Choice theorists have extended this dynamic conception of competition to competition among governments (Friedman and Taylor 2012; Vanberg and Kerber 1994; Vihanto 1992; Wohlgemuth 2008). The practical implication of these ideas is that competitive governance can not only constrain government power, but also allow the testing of new policy ideas in a lower-risk way. As local jurisdictions implement

---

2 See Sinn (1992) for a similar argument at the international level, with national governments competing for mobile capital.
3 See also Buchanan and Faith (1987).
new policies, citizen-consumers vote with their feet for the successful and against the unsuccessful. As in economic markets, good ideas are copied by competitors and bad ideas are abandoned.

**Competition and the risks of reform**

Constitutional political economists (e.g. Brennan and Buchanan 1985; Brennan and Hamlin 2004; Buchanan 1975) have used Public Choice theory to argue on utilitarian grounds for constitutions that limit political innovation. If the risk of breaking existing political order outweighs the potential benefits of reform, the sensible option is to leave well enough alone and to protect the status quo through constitutional constraints limiting political experimentation. Although this conservative argument for stability is always worth keeping in mind, decentralisation and competitive governance can reduce the risks of experimentation. In an obvious sense, a policy experiment conducted in a small local jurisdiction imposes a lower risk than a similar experiment in a large national jurisdiction. Exit options reduce the risk of experimentation further by allowing mobile citizens and businesses to escape the negative effects of failed experiments but enjoying the positive effects of successful ones. Not all resources are mobile and reform always carries some risk, but as exit becomes easier, institutional gambles become more one-sided and the optimal level of risk taking increases (Taylor 2013).

To the extent that competitive governance allows lower-risk policy experimentation, it addresses a major policy concern identified in the recent Productivity Commission report *Transitioning Regional Economies: The Resilience and Adaptive Capacity of Regional Australia* (Productivity Commission 2017). Robust systems continue to perform well even under unfavourable conditions (Levy 2002). There are reasons to think that decentralisation and competition promote robustness. Decentralisation allows diverse communities to respond to external shocks in ways sensitive to local conditions. Given the diversity of regional Australia (Productivity Commission 2017: 70–72), this is important. A bad decision in one jurisdiction need not spell disaster for the system as a whole, and Tiebout exit allows individuals and businesses to mitigate the downsides of failed policy responses.4

**Competition and democracy**

It is easy to see exit and voice as competing ways for citizens to control government, but there are also important complementarities. As Hirschman (1970) has argued, exit options might make citizens less willing to voice their concerns. On the other hand, exit options can empower citizens by providing them with a credible threat that increases their bargaining position (Sørensen 1997; Warren 2011).

---

4 Bednar (2014) makes a similar argument regarding the American federal system.
Exit options may also go some way towards overcoming the epistemic problems of democracy. Collective voice decisions tend to be made based on poor information and with little rational deliberation, since each voter has an insignificant chance of determining electoral outcomes and therefore virtually no incentive to vote wisely (Caplan 2007; Somin 2013). Individual exit decisions provide sharper incentives and are therefore likely to prompt a more thorough search for information and more careful deliberation. If voters routinely make individual exit decisions on the same issues they make collective voice decisions—e.g. choosing their child’s school and also voting on education policy, choosing whether to move to a strictly zoned jurisdiction and also voting for politicians who differ in their support for strict zoning—the information gathered and processed as part of an exit decision becomes available to voters for collective voice decisions. Thus, given overlap in the domains of individual and collective choice, exit options make political decisions more informed and well-considered (Taylor 2016).

**Competition and diversity**

In terms of regional development, competitive governance has the additional benefit of allowing greater institutional and policy heterogeneity. The optimal policy mix in Sydney differs greatly from that in Darwin. State and local government allows some degree of heterogeneity, but allowing greater choice in rules would increase diversity. Although the market for governance is unlikely to cater as effectively to diverse needs and preferences as markets for goods and services, decentralisation combined with choice can move us closer to this ideal.

**Options for promoting competitive governance in Australia**

This section considers some possible options for strengthening jurisdictional competition as a force for regional development in Australia. The focus here is on the broad options, with issues of implementation left to future work. In general, the preconditions for effective competition among governments are two-fold: first, citizens (or businesses, investors) need to be willing and able to make locational decisions partly on the basis of policy or institutional quality; second, policy makers need to respond to this mobility by seeking to attract and retain migrants, businesses and investors. In discussing the practical options for competitive governance, it is important to keep these preconditions in mind.
Competitive federalism

The most obvious option for promoting competition is through the decentralisation of power to existing political units—from national to state and from state to local governments. Although Australia was founded as a competitive federation, the degree of competition in Australia’s current federal structure is limited by the power of the central government and, in particular, vertical fiscal imbalance (Fenna 2008). Since taxes are raised primarily by the Commonwealth Government, there is little tax competition among the states.

Nevertheless, there is some evidence that Tiebout exit does occur within Australia and that this has promoted competition (e.g. Drew and Dollery 2015; Grossman 1990). Recent proposals by the Turnbull Government to return taxing powers to the states, though now abandoned, suggest that increasing competition in the Australian federal system is a politically feasible option. The case for, and the path towards, competitive federalism has been discussed extensively elsewhere (e.g. Carling 2006; Kasper 1995).

Master planned communities

Master planned communities (MPCs) are large mixed-use (but primarily residential) private sector developments. Typically, a single developer will buy a large ‘greenfield’ (i.e. undeveloped) section of land, work cooperatively with local government to build infrastructure and amenities, and sell plots of land for residential and commercial purposes. The developer is able to plan the mix of amenities and land use in order to attract residents and thus increase the value of their land (Bajracharya et al. 2007; McGuirk and Dowling 2007). The largest MPC in Australia is the 2,860-hectare Greater Springfield, Queensland, with a current population of around 32,000 and a planned future population of 138,000. Like many other MPCs, Greater Springfield is located within commuting distance of a major city (Brisbane).

This approach has proved effective in the creation of commuter cities and special-purpose developments such as retirement villages, but has important limitations as a tool of regional development. MPCs introduce choice and competition into urban planning and infrastructure development, but do not allow for communities to opt out of national, state or local regulations. Thus, the potential benefits of policy heterogeneity discussed above cannot in general be achieved through MPCs. Secondly, MPCs require large investments of private money. Greater Springfield and similar commuter towns are attractive investments because there is a clear demand for housing in the region. This is not the case in the underdeveloped regions of Australia and as such a similar undertaking in, for example, the Northern Territory would be much riskier.
Special economic zones

Special economic zones (SEZs) are regions within a nation’s borders that are designated as operating under a different set of rules than the surrounding country. There are now thousands of SEZs around the world, ranging from small technology parks to large general-purpose cities such as Shenzhen, China (see generally Farole and Akinci 2011). There has been some interest from government in the use of SEZs as a tool of development in northern Australia, with the Rudd Government in 2013 proposing an SEZ (with unspecified cuts in company tax) in the Northern Territory. The Institute of Public Affairs and Australians for Northern Development & Economic Vision have also been active in promoting the prospect of SEZs in the north.5

Whether a northern SEZ, if implemented, would be successful in promoting regional growth would depend very much on the details of implementation. The international experience suggests that privately operated SEZs are cheaper to operate and produce greater economic benefits than publicly operated SEZs (FIAS 2008: 45–47). From an economic perspective, this makes sense, since privately operated SEZs provide stronger economic incentives. Moberg (2015) argues further that SEZs can give rise to rent-seeking and may in some cases be harmful. Privately run zones that provide benefits to a broad range of resident individuals and businesses are likely to be successful, whereas focus incentives such as single-factory SEZs have less-obvious benefits in terms of regional development.

Conclusion

Tiebout competition is potentially a powerful tool of regional development in Australia, but the most effective and feasible ways of promoting such competition are as yet unclear. MPCs have demonstrated that the private sector can play a major role in the development of new cities in Australia, but this has so far been confined to areas near existing population centres. SEZs have found some support across the political spectrum, but it is unclear whether SEZs with sufficient autonomy and the right institutional mix are politically feasible in Australia. Competitive federalism is a perennial subject of debate, but despite strong arguments from classical liberals and the occasional proposal from government, there has been little indication that power will return to the states anytime soon.

Despite these challenges, the promotion of competitive governance is a worthy goal. Public-choice theory, and constitutional political economy in particular, tells us that rather than complaining about specific policy problems we should consider the

5 See andev-project.org/.
constitutional structure that produces those policies. A more competitive system of governance would alter the incentives of the political system in a way which robustly promotes policy suited to individual interests. In expected value terms, the low probability of meaningful reform is offset by the large benefits.

References


THE LACK OF COMPETITION IN GOVERNANCE AS AN IMPEDIEMENT TO REGIONAL DEVELOPMENT


