The Macroeconomic Consdequences of Regional Fiscal Decentralisation

Topic: IO modeling: Computable General Equilibrium Modeling and Social Accounting Matrices
Author: Peter McGregor
Co-Authors: Graeme Roy, Katerina Lisenkova, Kim Swales

There is considerable momentum in the UK, Europe and across the world towards greater decentralisation of fiscal powers. The devolution of powers over public spending is typically motivated in terms of the efficiency gains emphasised by the fiscal federalism literature. The devolution of tax powers is often advocated on the basis of improved accountability and the enhanced incentive that such powers provide to Sub Central Governments (SCGs) to pursue growth-promoting policies. In this paper we explore the sensitivity of regional economies to the nature and extent of fiscal decentralistion. At one end of the spectrum â€“ one which broadly characterises many UK regions - SCGsâ€™ expenditures are governed by a block grant system, with very limited (if any) devolution of taxes. At the other end is full fiscal autonomy â€“ control over public spending and universal autonomous taxes. And there are several options in between. The key question is whether greater regional fiscal autonomy improves SCG's incentives to pursue growth-enhancing policies.

The OECD makes a distinction among â€œstrict tax sharingâ€•, â€œsoft tax sharingâ€• and â€œautonomous taxesâ€• (BlÃ¶chliger and Nettley, 2015). Under strict tax sharing tax revenues accrued by the SCG meet an â€œindividual proportionalityâ€• criterion (BlÃ¶chliger and Petzold, 2009); the revenue generated to the SCG from a tax is strictly related to the amount of revenue generated on its territory. Soft tax sharing refers to instances, like the Australian General Sales Tax (the equivalent of value added tax), where revenues are collected centrally and redistributed across the Australian states based on need. The rates and revenues associated with autonomous taxes are controlled by the SCG.

In this paper we use an intertemporal computable general equilibrium (CGE) model, calibrated on a social accounting matrix of a SCG region, Scotland, to explore the macroeconomic consequences of a range of regional fiscal frameworks that capture, in a stylised manner, key aspects of actual regional fiscal frameworks. In particular, we assess the extent to which greater regional fiscal autonomy improves the incentive to pursue growth-enhancing policies.

Keywords: Sub Central Governments; Regional fiscal autonomy; computable general equilibrium.

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