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Different forms of decentralization and their impact on government performance: Micro-level evidence from 113 countries[☆]

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ABSTRACT

This study of the effect of decentralization on government performance differs from the vast literature on the topic in three major ways. First, we compare the effects of four different forms of decentralization, namely, fiscal decentralization, administrative decentralization, federalism, and aggregate decentralization. Second, we study the effect on three dimensions of government performance, namely, tax administration, business licensing and permits, and corruption. Third, the effects are judged in terms of the perceptions of nearly 100,000 business leaders located in 113 countries. Seven statements summarize our findings. First, fiscal and administrative decentralization improve perceptions of government performance. Second, federalism is associated with worse perceptions. Third, the effect of aggregate decentralization is ambiguous. Fourth, service industries tend to perceive decentralization more favorably than others. Fifth, large firms perceive decentralization less favorably than other firms. Sixth, the effect of the same form of decentralization varies in magnitude across the three government activities. Seventh, therefore, decentralization may not be oversold as a policy prescription to improve government performance; the form of decentralization and its contextualization in terms of the targeted area of government activity need careful consideration.

1. Introduction

The role that decentralized government structures might play in promoting good governance has intrigued policymakers and researchers for some time. On the one hand, decentralized governments are closer to the populace and can better understand and deliver services that are tailored to specific needs. There is also greater transparency of government actions as citizens can better observe government actions at the local level. The scope of this has somewhat broadened with e-government services. On the other hand, there are some drawbacks to decentralization, notably regarding the (in)ability to coordinate the provision of services at various levels of government (see Prud'homme (1995), Shah and Thompson (2004)), the appropriation of benefits due to spillovers across jurisdictional boundaries (Oates (1972)), and potentially less media scrutiny of the actions of public officials. Overall, the trend towards greater decentralization has been promoted by major international organizations (e.g., International Monetary Fund (2009), United Nations (2009) and the World Bank (1999))

and has found favor in recent years, as noted by Rodríguez-Pose and Gill (2003), Stegarescu (2005) and the World Bank (1999).¹

Given its numerous possible dimensions, several classifications of government decentralization have been proposed. For instance, as noted in a recent survey by Martínez-Vázquez et al. (2016), government decentralization may be viewed along expenditure/revenue, policy, or political dimensions (also see Rodden (2004)). While the expenditure/revenue aspect of decentralization has been most widely studied, overlapping government jurisdictions and institutional complexities make clear inferences difficult. Other aspects also come into play, leading to ambiguities in formal analyses. For instance, a reliable set of answers or clear policy prescriptions have failed to evolve due to a number of reasons. First, no two nations (or even regions within a country) are alike and differ in numerous aspects. This poses challenges in terms of applying similar policies across jurisdictions (Should there be x number of government hospitals for every y population in every jurisdiction? Then, what about tropical regions that are more prone to certain diseases?). Second, there are many aspects to

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¹ See also The Online Sourcebook on Decentralization and Local Development (<http://www.ciesin.columbia.edu/decentralization/>).

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government decentralization that are qualitatively (in terms of delivering the services) and operationally (in terms of setup costs and timelines) different. For instance, geographic and administrative decentralization are legislatively quite time consuming to alter, whereas fiscal decentralization is somewhat easily altered. Thus, it is quite difficult to compare the effects of different forms of government decentralization. The related measurement issues have been noted by several scholars, including [Blume and Voigt \(2011\)](#), [Brueckner \(2003\)](#), [Prud'homme \(1995\)](#), and [Stegarescu \(2005\)](#).² These issues, coupled with the level of aggregation available in most data, have led to ambiguous findings regarding the effects of decentralization on government performance (see [Martinez-Vazquez et al. \(2016\)](#)).

The present paper attempts to address the ambiguity in the effects of decentralization in several ways. First, we analyze the effects of different types of decentralization on government performance in a cross-country context. These include fiscal decentralization and federalism, which have been widely used in past literature, and two relatively new indicators (see [Ivanyna and Shah \(2014\)](#)): “aggregate decentralization” and “administrative decentralization.” The latter two measures are designed to assess the independence and actual authority in the hands of local authorities when it comes to decision making. Such measures are intended to mitigate the comparability problems with the more traditionally-used decentralization measures discussed above, especially within the context of cross-country data sets.

Second, we address the impacts or consequences of decentralization from business leaders' perceptions of government performance as they relate to running their businesses. These include business manager perceptions as to how government licensing and permits, taxation (specifically, tax administration), and corruption affect their operations.³ Government performance in the licensing and permits area is especially relevant for the purpose at hand as it is an activity that is typically carried out at the local level (e.g., liquor licenses for bars, zoning permits, etc.). We can assess how greater decision-making authority in the hands of local officials affects business perceptions of government performance in this area. Further, corruption is prevalent in many societies and permeates many levels of government in its interactions with the public and corruption at the local level can be a significant issue, perhaps more so than at the national level ([Transparency International \(2009\)](#)). Bribes may be offered and/or solicited to speed up government functions or to get undue favors from government officials. These corrupt transactions might be facilitated at the local level due to closer proximity between bribe givers and bribe takers. Our analysis examines business' perceptions of the impact of corruption on their operations and how such perceptions are affected by the type of decentralization. Although the decentralization-corruption relation has been extensively studied in the literature (e.g., [Fan et al. \(2009\)](#), [Fisman and Gatti \(2002\)](#), [Goel and Nelson \(2011\)](#), [Treisman \(2000\)](#)), the present analysis is at the micro level and is based on perceptions of business leaders. This is in contrast to the majority of the literature that uses aggregate indices of corruption perceptions (see [Lambsdorff \(2006\)](#), [Treisman \(2007\)](#)).

Third, the underlying data draw upon thousands of individual responses regarding perceptions of government services across more than a hundred countries. Thus, we are able to examine how certain widely prevalent government functions are perceived following different types of decentralization. All these aspects enable us to address the role of decentralization in a deeper (using micro-level data) and wider (across various types of decentralization and many nations) manner than previously considered in the literature. Specifically, while some studies in the literature have examined the effects of decentralization on government performance in some areas (see, for example, [Adam](#)

[et al. \(2014\)](#)), the scope of analysis (both in terms of decentralization types and the government performance aspects considered) and the consideration of perceptions of government performance by actual users (i.e., business firms) are new.

Key questions addressed in this research are:

- Are the effects of a government decentralization measure similar across different dimensions of government performance?
- Do government performance perceptions differ across various measures of decentralization?

The analysis, based on World Enterprise Surveys of nearly 100,000 individual business owners and top managers in 113 countries, shows that fiscal decentralization and administrative decentralization are qualitatively alike in that greater decentralization in each case improves perceptions of government performance. In contrast, opposite conclusions are reached when decentralization is based on distinctions between federalist states and unitary states. With regard to tax administration particularly, fiscal and administrative forms of government decentralization result in better outcomes than aggregate decentralization. At a related level, while a larger government results in worse outcomes with regard to tax administration and business licensing, it improves perceptions of government performance with regard to corruption. This finding is consistent with the view that a larger government machinery involves greater attention to checks and balances. We also find that relative to the entire sample, business manager perceptions are different in service industries and at large firms. Overall, our findings provide useful insights into the effects of various forms of devolution of powers to subnational government units. We turn next to a discussion of the underlying theory and related literature.

2. Literature and theoretical background

The broader literature on the choice by governments to decentralize operations (and provision of services) can be tied to the work of [Besley and Coate \(2003\)](#), [Oates \(1972\)](#), and [Panizza \(1999\)](#); also see [Faguet \(2014\)](#). In a nutshell, government decentralization can have positive as well as negative effects on public sector performance. On the positive side, decentralization of government functions leads to greater electoral control and greater yardstick competition among competing jurisdictions ([Salmon \(1987\)](#)). On the down side, decentralization reduces scale economies in the provision of government services, creates the potential for mismatch between the spatial incidence of the benefits for government services and the political boundaries, empowers local interest groups to better drive their agendas, and likely makes attracting qualified applicants for government jobs difficult (see [Adams et al. \(2014\)](#), [Prud'homme \(1995\)](#)).⁴ Thus, analyses with greater size and scope of data are required to discern some of the underlying linkages - which this paper attempts to do.

The literature on the impacts of decentralization has mostly focused on the effects of fiscal decentralization on various indicators of government and macroeconomic performance (see, for example, [Adam et al. \(2014\)](#), [Ebel and Yilmaz \(2003\)](#), [Kyriacou and Roca-Sagalés \(2011a\)](#), [Lago-Peñas et al. \(2011\)](#) and [Yeung \(2009\)](#)). The findings vary and are sensitive to the data and methodology employed. A few studies examine alternate or multiple forms of decentralization (see [Fan et al. \(2009\)](#), [Goel and Nelson \(2011\)](#), [Goel and Saunoris \(2016\)](#), [Kyriacou and Roca-Sagalés \(2011b\)](#), [Nelson \(2013\)](#) and [Rodríguez-Pose and Ezcurra \(2011\)](#)). However, these broad effects mask qualitative distinctions across decentralization types and govern-

² Also see [Knack and Keefer \(1995\)](#) for a broader perspective.

³ These aspects of government performance can be seen as tied to the wider discussion on the quality of government (see [La Porta et al. \(1999\)](#)).

⁴ [Bodman et al. \(2012\)](#) present a theoretical model of the dynamic effects of taxation and investment on the steady state output level of an economy, with consideration of multi-level governments.

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