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Do mergers of large local governments reduce expenditures? – Evidence from Germany using the synthetic control method[☆]



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ABSTRACT

States merge local governments to achieve economies of scale. Little is known to which extent mergers of county-sized local governments reduce expenditures, and influence political outcomes. I use the synthetic control method to identify the effect of mergers of large local governments in Germany (districts) on public expenditures. In 2008, the German state of Saxony reduced the number of districts from 22 to 10. Average district population increased substantially from 113,000 to 290,000 inhabitants. I construct a synthetic counterfactual from states that did not merge districts for years. The results do neither show reductions in total expenditures, nor in expenditures for administration, education, and social care. There seems to be no scale effects in jurisdictions of more than 100,000 inhabitants. By contrast, I find evidence that mergers decreased the number of candidates and voter turnout in district elections while vote shares for populist right-wing parties increased.

1. Introduction

For decades, states merge small and medium sized municipalities to achieve economies of scale in expenditures (Fox and Gurley 2006, Holzer et al. 2009, Bird and Slack 2013). The empirical evidence however is at least mixed. Reingewertz (2012), Blom-Hansen et al. (2014), and Welling Hansen et al. (2014) document that expenditures of merged municipalities in Israel and Denmark decreased. By contrast, Lüchinger and Stutzer (2002) and Fritz (2016) show that merged municipalities in Switzerland and South Germany increased expenditures. Moisiu and Uusitalo (2013), Allers and Geertsema (2016), Blesse and Baskaran (2016), Blom-Hansen et al. (2016), and Studerus (2016) do not find significant effects of municipal reforms on total public expenditures in Finland, in the Netherlands, East Germany, Denmark, and Switzerland.¹

Against the background of the evidence on consolidations of small entities, little is known to which extent mergers of large local governments affect public expenditures. However, politicians debate in many countries whether to merge county-sized administrations, for example, in Germany, the United States, Austria, or Ireland.² I examine the effects of mergers of large local governments

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¹ Blesse and Baskaran (2016) however show that compulsory municipal mergers reduced administrative expenditures, which however are only a minor share of overall municipal expenditures. Blom-Hansen et al. (2016) find cost reductions in some spending categories that are however compensated by increases in other categories.

² See, e.g., Germany: Die Zeit, “Neuer deutscher Größenwahn”, 15.07.2016, <http://www.zeit.de/2017/21/gebietsreformen-ostdeutschland-landkreise-populismus>; US: NBC15.com, “Lawmaker Wants to Merge Counties To Save Money”, 07.08.2007, <http://www.nbc15.com/home/headlines/9018942.html>; The State, “EXCLUSIVE: Merging Columbia, Richland County getting serious consideration”, <http://www.thestate.com/news/local/article90107087.html>, 16.07.2016; Austria: Der Standard, “Zusammenlegung der Bezirkshauptmannschaften startet”, 05.07.2016, <http://derstandard.at/2000040461646/BH-Zusammenlegung-der-Verwaltung-startet>; Ireland: The Irish Times, “Galway politicians split on plans to merge city and county councils”, <http://www.irishtimes.com/news/ireland/irish-news/galway-politicians-split-on-plans-to-merge-city-and-county-councils-1.2824077>, 10.10.2016.

covering more than 100,000 inhabitants on average. In 2008, the state government of the German state of Saxony reduced the number of districts (*Landkreise*) from 22 to 10 (see Fig. 1). The average population of Saxon districts increased substantially from around 113,000 to 290,000 inhabitants. Because all Saxon districts were affected, I use the synthetic control method and construct a synthetic counterpart to Saxony as a whole. Districts of ten other German states which did not merge districts for years constitute the donor pool. The results do neither show that mergers of large local governments reduce total expenditures per capita, nor expenditures in main expenditure categories such as social care, education or administration. These findings are in line with anecdotal evidence on the Saxon merger reform reporting that “great expectations changed into great disillusion”.³

Yet, scholars did not examine scale effects in expenditures of large local governments by exploiting a merger reform.⁴ Prior studies investigate small entities such as municipalities. German districts, by contrast, have a population of around 190,000 inhabitants on average which roughly corresponds with the US county level. I confirm considerations of previous studies and surveys that suspect no further gains in efficiency in large local governments (Holzer et al. 2009). The results of this study do not show that there are any economies of scale in local governments beyond a population size of around 100,000 inhabitants. This finding holds true for total expenditures but also for expenditures in all main functions of German districts (administration including public order and safety, social care, and education). Mergers, by contrast, seem to bear some political costs. I provide evidence that the number of candidates and voter turnout decreased in merged districts while the populist right-wing gain support.

Prior studies usually compare merged and unchanged local governments within a difference-in-differences setup. I abstract from micro-level data and apply the synthetic control method to state-level aggregates. The synthetic control method is a powerful tool to evaluate policy reforms if the number of treated units is small, and only aggregated outcomes are observable (see also Abadie et al. 2015). I show that the method is superior to difference-in-differences estimations, when the common trend assumption seems to be violated (see also Kreif et al. 2016). Only a small number of studies in public finance employed the synthetic control method (e.g., Mukherji and Mukhopadhyay 2011, Koehler and König 2015, Falkenhall et al. 2015, Green et al. 2016, Pfeil and Feld 2016).⁵ As the most related study, Hämäläinen and Moisio (2015) use the synthetic control method to evaluate the implementation of a second layer of local government in one region in Finland while other regions do not change institutions. Hämäläinen and Moisio (2015) do neither report cost savings nor increases in expenditures, which is also in line with the results of this study.

2. Institutional background

2.1. Districts in Germany

Germany has a federal system with two layers of state government (national level, state level) and two layers of local government (districts, municipalities). The about 10,000 German municipalities (*Gemeinden*) are responsible for local public services such as public safety and order, waste disposal or cultural institutions and can set their own tax rates on property and local business. The 295 districts (*Landkreise*) constitute the upper-level local governments and roughly correspond with US counties in terms of population. Districts are mainly responsible for social care (youth and social welfare, accommodation costs of long-term unemployed), public safety and order, economic development, public transport, and parts of education. In education, for example, districts design the location of primary and other schools, maintain school buildings, and provide adult education centers and music schools.⁶ The functions of districts, however, differ across German states to some extent. In addition to the 295 more rural districts, about 107 large cities (*kreisfreie Städte*) exercise both district functions and municipal functions as one. I exclude large cities from the analysis because these municipalities are not comparable to districts in terms of functions and expenditures.

German local governments can spend and borrow on their own behalf but are regulated by fiscal supervisors of the federal states (Roesel 2016a). In 2013, total expenditures of German districts amounted to 34 billion Euros (around 620 Euro per capita). This was about 25% of overall local government expenditures in Germany (large cities excluded). Social care was the most important expenditure category of districts, followed by administrative expenditures including public safety and order. Social and administrative expenditures account for about two third of total gross expenditures of German districts. Districts do not hold own tax competences. To finance expenditures, districts levy contributions from the municipalities, receive transfers from the states, and borrow. Contributions from municipalities are linked to fiscal capacity, and are substantial (for details see Baskaran 2014). In 2013, the share of municipalities' fiscal capacity transferred to the district level (i.e., the contribution rate) varied between 30% and 70% across federal states.

³ Translation by the author. Original in German language: “Die Erwartungen waren groß, heute ist es die Ernüchterung.” See RBB online, So lief die Kreisgebietsreform in Sachsen, 24.02.16, <http://www.rbb-online.de/politik/beitrag/2016/02/landkreisreform-sachsen.html>. Similar disenchantments are reported for the state of Mecklenburg-West Pomerania which experienced large-scale district mergers in 2011: “Even five years after the reform, reductions of costs have not been realized.” (Translation by the author. Original in German language: “Auch fünf Jahre später ist die Reform noch immer eine große Baustelle: Die erhofften Einsparungen lassen auf sich warten.”). See RBB online, So lief die Kreisgebietsreform in Mecklenburg-Vorpommern, 24.02.16, <http://www.rbb-online.de/politik/beitrag/2016/02/landkreisreform-mecklenburg-vorpommern.html>.

⁴ There are studies on consolidations of special-purpose entities such as school districts. For the seminal work see Brasington (1999). Further evidence is provided, e.g., by Duncombe and Yinger (2007), and Knight and Gordon (2008).

⁵ Most public economics studies using the synthetic control method evaluate regulations of tobacco (Abadie et al. 2010, Bharadwaj et al. 2014), alcohol (Marcus and Siedler 2015), and economic impacts of institutions (Zhou 2017).

⁶ Employing teachers and designing school curricula, by contrast, are responsibilities of the states.

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