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In government we trust: The role of fiscal decentralization

Jenny E. Ligthart [a,1], Peter van Oudheusden [a,b,*]

[a] Tilburg University, CentER and Department of Economics, P.O. Box 90153, 5000 LE Tilburg, The Netherlands
[b] World Bank, Finance and Private Sector Development Research Group, 1818 H Street NW, Washington, DC 20433, USA

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ABSTRACT

This paper looks whether fiscal decentralization is associated with trust of citizens in government related institutions. We expect a positive relationship based on the argument of governments' improved responsiveness to preferences of citizens that is perceived to result from more decentralized fiscal systems. Survey data from up to 42 countries over the period 1994–2007 confirm this positive relationship. It is robust to controlling for unobserved country heterogeneity and a wide array of other explanatory variables that are associated with trust in government related institutions. Moreover, we do not find that the positive association with fiscal decentralization extends to other, non-government related institutions.

1. Introduction

During the last decades, many governments in developed and developing countries have devolved parts of their fiscal policy-making authority to their sub-national levels. This process of fiscal decentralization has been promoted by changes in the geopolitical landscape—such as the enlargement of the European Union and the breakup of the former Soviet Union—dissatisfaction with the role of the central government in setting policies, and, to a smaller extent, the policy advice of international policy institutions (Tanzi, 1995). An important argument for fiscal decentralization follows from the subsidiarity principle as discussed by, for example, Tiebout (1956) and Oates (1999). They argue that the greater responsiveness of governments to their citizens' preferences, brought forth by more decentralized fiscal systems, is believed to enhance service delivery. This improved preference matching argument is often used to point out possible improvements in allocative efficiency as a result of fiscal decentralization.

Various empirical studies have measured the potential effects of fiscal decentralization on allocative efficiency. In particular, a lot of attention has been paid to the question whether fiscal decentralization can boost economic growth. So far, the empirical evidence on the fiscal decentralization and economic growth nexus is mixed.[2] The strong focus on allocative efficiency implies that other possible

* Corresponding author at: World Bank, Finance and Private Sector Development Research Group, 1818 H Street NW, Washington, DC 20433, USA. Tel.: +1 31655520250.
E-mail address: p.vanoudheusden@gmail.com (P. van Oudheusden).
[1] Deceased (Former Professor of Macroeconomics at Tilburg University).

[2] Davoodi and Zou (1998) and Zhang and Zou (1998) find evidence of a negative relationship between fiscal decentralization and economic growth, whereas Thiessen (2003) and Iimi (2005) show that fiscal decentralization enhances economic growth. Others do not find a significant relationship (Woller and Phillips, 1998; Thornton, 2007).

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favorable effects of fiscal decentralization, such as lower corruption or improved governance, have received less attention.[3] More importantly, other, more direct outcomes of fiscal decentralization, such as the effect on citizens' satisfaction with or trust in government related institutions—here defined as the 'judgment of the citizenry that the system and the political incumbents are responsive, and will do what is right even in the absence of constant scrutiny' (Miller and Listhaug, 1990, p. 358)—have not received any attention at all. This paper looks at such an outcome and investigates the relationship between fiscal decentralization and trust in government related institutions. To our knowledge, we are the first to analyze this relationship in a systematic way.

Most importantly, the existence of a relationship provides evidence in favor of, or against in case of a negative one, the use of the preference matching argument in studies that look at the possible consequences of fiscal decentralization. There are, however, also other reasons to look at trust in government related institutions, henceforth also called trust in government. From an economic perspective, a high level of trust in government may indirectly contribute to improved economic performance. Knack and Keefer (1997) show that a higher level of trust in government is associated with a higher level of social capital which in turn is found to be associated with a higher rate of economic growth.[4] From a political science perspective, trust in government is important for political leadership and governance. More specifically, a larger degree of trust in government makes it easier to commit resources that are needed for collective action or to obtain citizens' compliance with policy without coercion (Keele, 2007).

Using survey data covering up to 42 countries over the period 1994–2007, we find a positive relationship between fiscal decentralization and trust in government related institutions. Quantitatively, the relationship is only somewhat weaker than the strongest one we find, which is that with the respondent's view of the importance of politics in life, and compares well with more established relationships in the literature such as that between trust and income inequality. Moreover, we find evidence that is consistent with the causality running from fiscal decentralization to trust in government. The relationship is robust to controlling for additional explanatory variables, both at the individual and aggregate levels, and unobserved country heterogeneity.

Our analysis is related to studies analyzing the determinants of trust defined more generally, which can be either trust in persons or institutions.[5] Brehm and Rahn (1997), Alesina and La Ferrara (2002), Keele (2007), Gustavsson and Jordahl (2008), Dincer (2010), and Blanco (2013) study the determinants of trust using data for a single country. Except for Gustavsson and Jordahl (2008) and Blanco (2013), who use Swedish and Mexican data, respectively, all studies pertain to the United States. Knack and Keefer (1997) and Zak and Knack (2001) employ data for several countries to explain cross-country differences in trust.

Studies that explicitly look at the relationship between fiscal decentralization and trust are Dincer (2010) and de Mello (2011), where both authors look at trust in persons. Exploiting variation across states within the United States, Dincer (2010) finds that trust in persons is higher in states where there are a larger number of local governments or where revenue and expenditure decentralization rates are higher. For Brazil and Indonesia, de Mello (2011) uses decentralization reforms to show that fiscal decentralization is positively associated with provoice attitudes, which in turn are related to trust in persons. This approach identifies a specific transmission mechanism through which fiscal decentralization may promote social capital. Finally, Kincaid and Cole (2010) document public attitudes and trust in various orders of government for the three North American federations Canada, Mexico, and the United States.

This paper is also somewhat related to papers studying aggregate determinants of individual outcomes.[6] Of these studies, the one that comes closest to ours is that of Bjornskov et al. (2008) who analyze the relationship of fiscal decentralization with subjective well-being.

The remainder of this paper is organized as follows. Section 2 presents some theoretical considerations and discusses the data on trust in government related institutions and fiscal decentralization. Section 3 presents the results and addresses endogeneity concerns. Section 4 concludes the paper. The web appendix to the paper contains additional estimation and robustness results.

2. Trust in government and fiscal decentralization

This section sheds light on the relationship between fiscal decentralization and trust in government related institutions. We first present some theoretical considerations to support our hypothesis of a positive relationship. Subsequently, we provide a descriptive analysis of this relationship with the data we use in the formal analyses in Section 3.

2.1. Theoretical considerations

To our knowledge, there are no existing theories describing the relationship between fiscal decentralization and trust in government related institutions. In fact, the literature on the possible non-economic benefits of fiscal decentralization is sparse in general. However, the theories on the possible economic benefits of fiscal federalism provide a natural reference point in discussing the potential relationship between trust in government related institutions and fiscal decentralization. An important and fundamental argument in favor of fiscal decentralization is the subsidiarity principle as discussed by, for example, Tiebout (1956) and Oates (1972, 1999). They argue that governments that are closer to their citizens "will be more responsive to the particular preferences of their constituencies and will be able to find new and better ways to provide these services" (Oates, 1999, p. 1120). We propose the hypothesis

[3] Exceptions are for example Treisman (2000), Fisman and Gatti (2002), and Oto-Peralías et al. (2013) who look at the relationship between fiscal decentralization and corruption, Enikolopov and Zhuravskaya (2007), who study its relationship with governance and public goods provision, and Baskaran (2011) who studies its relationship with the size of the public sector.

[4] Not only Knack and Keefer (1997), but also Rodrik (1999) and Zak and Knack (2001) find that economic growth is positively associated with social capital. Peiró-Palomino and Tortosa-Ausina (2013) look at this relationship in more detail, while Dearmon and Grier (2011) look at the underlying mechanisms of this relationship.

[5] The definitions of trust in persons differ in the literature on trust but generally refer to citizens' confidence in each other as members of a community.

[6] See Mishler and Rose (2001), Tella et al. (2003), and Bjornskov et al. (2008).