



Shared accountability and partial decentralization in local public good provision

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ABSTRACT

Recent decentralization reforms in developing countries have often lead to the coexistence of multiple tiers of government in given policy areas, triggering new accountability issues. This paper provides a novel theoretical treatment of the efficiency consequences of such 'partial expenditure decentralization.' It develops a political agency model in which two levels of government are involved in the provision of a local public good, with voters imperfectly informed about each government's contribution to the public good. A central result of the model is that partial decentralization is desirable only if the benefits of vertical complementarity in public good provision outweigh the costs of reduced accountability, which result from detrimental vertical strategic interactions operating through the electoral process. Through variants of the model, the interplay between decentralization and democratization is analyzed. From a positive point of view, the model predicts a relationship between electoral incentives and equilibrium decentralization.

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1. Introduction

Decentralization of expenditure responsibilities from central to local levels of government is often implemented in order to increase overall government accountability, by bringing the policymaking process closer to citizens – in accordance with Oates's (1972) seminal decentralization theorem. For example, the World Bank (2003) has strongly advocated decentralization on the basis that it might help to solve corruption problems in developing countries. But empirical evidence from decentralization reforms in these countries highlights potentially sizeable accountability problems associated with the implementation of decentralization reforms.¹

A possible culprit in explaining the disappointing results of decentralization is the incomplete nature of many decentralization reforms. Indeed, years after the implementation of decentralization reforms, central governments often remain heavily involved in the provision of the local public goods targeted by decentralization. Such 'partial expenditure decentralization' (PED) – as opposed to complete decentralization

or complete centralization – may be the result of either explicit de jure shared expenditure responsibility, but more often of implicit de facto arrangements caused by delays in reform implementation, fuzzy assignment of responsibilities, political struggles, etc. PED is thus an increasingly common institution in developing countries. For example, the central and local governments may be together involved in the provision of public education by village schools while teacher management powers are retained by higher-level governments (Khemani, 2010); building a new road may involve a local agency and the central government (e.g. for the bridges); security in a region may be provided by both central and local police forces; etc.

One major issue with PED is a blurring of the electoral accountability channel, which typically works best when observable policy outcomes can straightforwardly be assigned to a given elected official. In the context of PED, making coherent collective choices is a complex undertaking for voters, who need to garner information about the contribution of each level of government to the aggregate policy outcomes that they observe. As pointed out by Keefer and Khemani (2005), Bardhan and Mookherjee (2006c) and Mani and Mukand (2007), such informational issues are especially problematic in developing countries, where voters tend to be less educated and where the circulation of accurate information is poorer. The accountability consequences of an increased prevalence of PED in developing countries may thus be especially acute, given poorly informed

¹ Surveying the empirical literature, Treisman (2007) notes: "Empirical studies have found almost no solid, general results about the consequences of decentralization. Decentralizing government in a particular place and time is very much a leap in the dark."

electorates and the partial democratization contexts in which decentralization reforms are often implemented.²

To the best of the author's knowledge, this paper is the first to set out an analytical framework devoted to assessing the efficiency consequences of PED in a democratic context, and in particular the consequences for government accountability of imperfect information about fiscal policy *induced by decentralization*. The paper develops a political agency model in which politicians allocate government revenues between a public good valued by voters and 'rents' (valued only by themselves).³ Two levels of government are involved in the provision of a local public good and voters, who are called upon to set reelection incentives, are imperfectly informed about each government's contribution to the good. Partial decentralization is socially optimal in the model provided that there is vertical complementarity in public good provision. However, that desirability does not necessarily hold if governments display opportunistic behavior. Under partial decentralization, policy outcomes are the joint result of actions taken by politicians at different levels of government. This joint accountability in public good provision has two important consequences: First, it gives rise to informational issues which complicate the task faced by voters in disciplining politicians via the ballot box. Second, partial decentralization introduces vertical strategic interactions between levels of government in public good provision, operating through the political process.

The model yields both positive and normative implications. From a positive point of view, the model's main predictions concern the determinants of the equilibrium degree of decentralization. Under shared expenditure responsibility, the degree of decentralization is endogenous and depends on three factors: (i) the relative technological advantages of both levels of government in the production of public inputs, (ii) their relative rents from holding office, captured in the model by each level of government's access to public revenues, and (iii) the political conditions prevailing at both levels, i.e. the extent to which each level of government can affect its electoral fortunes by contributing to the public good.

From a normative point of view, as is customary when moving from first-best to second-best analysis, otherwise welfare-improving partial decentralization (because of beneficial complementarities among levels of government) may not be desirable when voters cannot hold each level of government individually accountable for its contribution to public good provision. Unless voters can observe each level of government's effort towards the provision of the public good (arguably a very strong assumption), the ability of voters to hold politicians accountable is in general lower under partial decentralization than under either complete decentralization or complete centralization. Thus, a reform from one of these polar cases towards partial decentralization will, in general, have ambiguous efficiency consequences, the benefits associated with the vertical complementarity of governments having to be weighed against the loss of accountability following from imperfect information and potentially detrimental vertical interactions. Partial decentralization is especially detrimental when the features of the political environment distort the degree of decentralization towards the level of government that has the least technological advantage in providing the public good.

The paper proceeds as follows. After having surveyed the relevant literatures in the upcoming section, Section 3 moves on to set up the political agency model of PED. Section 4 derives the main theoretical

results of the paper. Section 5 then explores two extensions of the model intended to capture the interplay between democratization and PED. Section 6 concludes by discussing policy implications, empirically-testable predictions and further extensions.

2. Relation to the literature

The paper belongs to two main strands of literature, at the intersection of development economics and public economics. First, from a theoretical point of view, the model developed in this paper belongs to a growing group of "second generation fiscal federalism" models (Weingast, 2009), which study fiscal federalism and decentralization in environments with opportunistic governments. Second, it builds upon insights from a quickly developing literature, both theoretical and empirical, which study the string of decentralization reforms that were implemented in developing countries in the recent past. That literature is progressively painting a comprehensive picture of the benefits and costs of decentralization.

2.1. Partial decentralization: theory and definitions

Papers in the Second Generation fiscal federalism literature are conveniently described by whether they focus on: (i) public expenditures, public revenues, or both; and (ii) horizontal interactions among governments, vertical ones, or both. So far, the main theme in the Second Generation literature has been horizontal interactions and externalities, especially when it comes to the study of expenditure decentralization.⁴ While vertical interactions involving expenditures – the focus of this paper – have been little explored, a growing literature on vertical interactions on the revenue side has been sparked by Keen and Kotsogiannis (2002).⁵ This paper complements the Second Generation literature by studying the political economy of vertical interactions between two levels of government involved in the provision of public goods that are valued by the same constituency, i.e. partial expenditure decentralization (PED).⁶

The phrase 'partial decentralization' can be traced back to Seabright (1996), where partial decentralization refers to the provision of public goods by an intermediate level of government situated between the central and local governments in the hierarchy of levels of government. More recently, Brueckner (2009) – introducing political economy considerations in a Tiebout-style model – defines "partial fiscal decentralization" as a situation where spending authority is devolved to the subnational level while financing relies on transfers from the central government. Khemani (2010) proposes a special interest politics model aimed at explaining why partial fiscal decentralization is a durable political institution, focusing on the vote-buying role of targetable intergovernmental transfers for central politicians. Devarajan et al. (2009) retain a more general definition of partial decentralization, as decentralization attempts that have not led to citizens being able to hold local governments accountable for budgetary allocations and their outcomes. In yet a different environment, in which decentralization is measured by the fraction of goods that are provided by lower-level governments, Hartfield and Padro i Miquel (2012) define partial decentralization as a situation where some goods are provided and funded at the local level, while others are provided centrally or internationally.

² For a comprehensive discussion of the political failures (including imperfect information) associated with democratization, see Keefer and Khemani (2005). While most of their discussion does not deal with decentralization per se, they pointedly outline that voters at the local level "cannot easily determine whether service providers, higher-level ministry officials, or politicians are responsible for breakdowns or improvements" (my emphasis). For a pioneer treatment of the consequences of democratization, see Foster and Rosenzweig (2004), and for an empirical assessment of the allocation of central funds by elected vs. unelected agencies, see Khemani (2007).

³ The distinction between useful and wasteful public spending makes this kind of model especially fruitful to study the consequences of decentralization in developing countries, given that an explicit objective of many decentralization reforms is a reduction in corruption. Closely related (but distinct) is the difference between targetable and nontargetable public expenditures (Keefer and Khemani, 2005).

⁴ See, for example, Lockwood (2002), Besley and Coate (2003) and Hindricks and Lockwood (2009).

⁵ For an early, comprehensive treatment of vertical competition between governments, see Breton (1996).

⁶ Related contributions on the political economy of decentralization include Bardhan and Mookherjee (2000, 2005, 2006a) and Tommasi and Weinschelbaum (2007), though these papers do not deal with PED. A comprehensive discussion of the literature is provided by Lockwood (2006).

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