



# Decentralization and political career concerns<sup>☆</sup>



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## ABSTRACT

Politicians' career paths often start at some subnational governments and end at the national one. Allocation of authorities among national and subnational governments affects (i) how tempting the prospects of taking national offices are, and hence how strong bureaucrats' political career concerns are, and (ii) whether the incentives generated by these political career concerns can be put into productive use at subnational governments. We illustrate this tradeoff in determining the optimal degree of decentralization using China as a case study. We also compare the equilibrium degree of decentralization in autocracy and in democracy.

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## 1. Introduction

The literature on federalism has evolved through what Qian and Weingast (1997) and Weingast (2009) refer to as two generations of development. The first generation treats each governmental unit as a benevolent social planner, and examines the costs and benefits of decentralization in terms of scale economies, inter-regional spillovers, heterogeneity across regions, etc. The second generation recognizes the incentive problems of politicians at different governmental units, and examines how the degree and the form of decentralization affect their incentives.

Despite these developments, much of the second-generation literature on federalism assumes that politicians at subnational governments are surrogates of their corresponding regions, and represent their regions (however imperfectly due to incentive problems) when they interact with other politicians to make collective decisions at the national government (Besley and Coate, 2003; Coate and Knight, 2007; Knight, 2004; Luelfsmann et al., 2015). Such an

assumption is appropriate when we study legislators in a democracy (such as senators in the U.S.), but less so when the politicians concerned are administrators, whose political career paths typically start at some subnational governments and end (hopefully) at the national one. For such politicians, their political career concerns are part and parcel of their incentives (Myerson, 2006). In an autocracy like China, where politicians at subnational governments are not subject to electoral checks and balances, such political career concerns are arguably even the dominant, if not the only, forces that incentivize these politicians to perform (Li and Zhou, 2005; Xu, 2011). The omission of political career concerns hence renders the second-generation literature on federalism especially inadequate in studying the degree of decentralization in an autocracy.

Recognizing the importance of political career concerns points us to the following new tradeoff in determining the optimal degree of decentralization. A lower degree of decentralization shifts more responsibilities from subnational governments to the national one. Along with this shift in responsibilities are shifts in various kinds of authorities,<sup>1</sup> which make the prospects of taking national offices more tempting. This strengthens the political career concerns of politicians at subnational governments. However, the resulting

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<sup>1</sup> Throughout this paper, we shall use *authorities* as a catch-all term for all kinds of political resources, power, and authorities that accompany political responsibilities. They, however, should not be confused with people who wield these authorities.

stronger incentives to perform may not be put into productive use when too little decentralization leaves too few authorities for subnational governments. Therefore, too much and too little decentralization can both be counter-productive, and the optimal degree of decentralization lies somewhere in between.

In this paper we provide a simple model to formalize this tradeoff. In our model, politicians at subnational governments are called bureaucrats. In responding to their political career concerns, bureaucrats have at least three options to choose from, one is to genuinely work hard, the other is to cook the books in order to increase the chance of promotion,<sup>2</sup> and the third is to engage in rent-seeking by abusing their authorities. When bureaucrats have these options at their disposal, the degree of decentralization would affect their optimal mix. Too little decentralization leaves too few authorities for bureaucrats to abuse or to put into productive use, and hence they spend most of their time cooking the books. A small increase from this low degree of decentralization would only shift authorities from the more productive national government to these do-nothing subnational governments, and result in further decrease in welfare. A moderate increase in the degree of decentralization, however, can tilt the bureaucrats' optimal mix from cooking the books to doing genuine work. Too much decentralization would backfire again. As the prospects of taking national offices become relatively less tempting, bureaucrats no longer bother to cook the books or to prove themselves through doing work, but would instead spend most of their time engaging in rent-seeking by abusing the enormous authorities entrusted to them.

Political career concerns, like career concerns in the marketplace (Dewatripont et al., 1999; Holmstrom, 1999), incentivizes bureaucrats to perform because performing is a way to prove competence. A corollary is that the degree of decentralization, by affecting the strength of bureaucrats' political career concerns, also affects their incentives to prove their competence and hence the society's ability to select competent politicians into the national government. As such, *today's* degree of decentralization has a first-order effect on the productivity of *tomorrow's* (national) government. This kind of dynamic externality is reflected in our model as well, and does not have a natural counterpart in much of the second-generation literature on federalism.<sup>3</sup>

As we dig deeper into the interplay between decentralization and political career concerns, it becomes clear that there are actually two different degrees of decentralization that jointly interact with bureaucrats' political career concerns. While *today's* degree of decentralization determines whether bureaucrats' incentives to perform can be put into productive use, it is *tomorrow's* degree of decentralization that determines how tempting the prospects of taking national offices are, and hence how strong bureaucrat's political career concerns are. Of course, in a steady state equilibrium, tomorrow's degree of decentralization will be the same as today's. But it is still helpful to conceptually distinguish the two, as doing so helps reveal yet a second kind of dynamic externality. Today's degree of decentralization imposes an externality not only on tomorrow's government, as explained in the previous paragraph, but on *yesterday's* government as well. If there is any exogenous factor that affects today's degree of decentralization, the anticipation of that would

<sup>2</sup> That cooking the books being a viable option should not be new to those familiar with the history of China's Great Leap Forward, where bureaucrats engaged in massive efforts to fake grain production many times higher than the actual figures, squandering much on the way, and misleading the national government into procuring more grain than peasants could spare based on the false figures, hence triggering the worst man-made famine in history.

<sup>3</sup> A notable exception is Boffa et al. (2016), who study how decentralization affects citizen-voters' ability to monitor politicians. In their model, like ours, today's degree of decentralization also affects the productivity of tomorrow's government by directly affecting how citizen-voters' information is aggregated.

affect yesterday's bureaucrats' political career concerns, and hence their incentives to work. Again, this kind of dynamic externality is reflected in our model, and does not have a natural counterpart in the second-generation literature on federalism.

Perhaps the easiest way to appreciate both kinds of dynamic externalities is to compare two different political regimes, one with the politicians at the national government (called the leaders) choosing today's degree of decentralization, the other with citizen-voters choosing it. We shall call the first regime autocracy, and the second democracy, without pretending that real-life autocracies and democracies differ only in this single aspect. Since leaders have a natural self-serving reason to choose a lower degree of decentralization than preferred by citizen-voters, the difference between the two regimes provides an exogenous factor that affects today's degree of decentralization. We show that, if each generation of citizen-voters care only about themselves and do not internalize externalities imposed on the generations before and after, they would tend to choose too high a degree of decentralization. Autocratic leaders, on the other hand, by self-servingly choosing a lower degree of decentralization than preferred by citizen-voters, would paradoxically partially correct for this problem.

Since political career concerns are an especially important component of bureaucrats' incentives in an autocracy, we build our baseline model with an autocracy like China in mind, and proceed to compare it with a democracy subsequently. To model an autocracy like China, we follow Che et al. (2013, 2014) and build our analysis on an overlapping principal-agent model. The main feature of an overlapping principal-agent model is that today's principal was promoted from among yesterday's agents, and will promote one of today's agents as tomorrow's principal. Che et al. (2013, 2014) argue that such a model captures many important features of an autocracy like China that other models, such as those with an infinitely-lived dictator, cannot.<sup>4</sup>

Our paper bridges two previously disjoint literatures. The first literature concerns how high-power incentives can backfire by distorting the composition of efforts (Acemoglu et al., 2008; Holmstrom and Milgrom, 1991; Milgrom, 1988). This insight has inspired a vast literature, but to our best knowledge it has not been used to study the optimal degree of decentralization.

The second literature concerns normative and positive analyses of (different forms of) federalism. On the normative side, this literature highlights various costs and benefits of decentralization,<sup>5</sup> and suggests how the balance between these costs and benefits determines the optimal degree of decentralization.<sup>6</sup> Our paper introduces a new angle to this literature. We observe that career paths of politicians often start at some subnational governments and end at the national one, and hence decentralization, by affecting the distribution of

<sup>4</sup> Che et al. (2013) focuses are the bigger variations in economic performance both across autocracies and within individual autocracies vis-à-vis democracies. Che et al. (2014) focuses are incentives at the top of the government, where political career concerns are absent. Neither of them explores the interaction between decentralization and political career concerns.

<sup>5</sup> Among the costs of decentralization are: (i) externalities among subnational governments may lead to suboptimal policies (Break, 1967; Cumberland, 1981; Rivlin, 1992); and (ii) national governments may not be strong enough to protect the market (Blanchard and Shleifer, 2001; Cai and Treisman, 2004, 2005). Among the benefits of decentralization are: (i) subnational governments have informational advantage in providing local public goods (Hayek, 1945); (ii) inter-jurisdictional competition can better match citizens' heterogeneous tastes with menus of local public goods (Tiebout, 1956); (iii) inter-jurisdictional competition can provide market-preserving incentives for subnational governments (Weingast, 1995); and (iv) subnational governments, vis-à-vis national governments, may be even poorer advocates for local interests, especially in developing countries (Bardhan, 2002).

<sup>6</sup> Inman and Rubinfeld (1997) and Oates (1999) provide comprehensive surveys of this literature.

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