

Factors determining intra-regional fiscal decentralization in Russia and the US

Michael Alexeev^{a,b,*}, Arseny Mamedov^{b,c}

^a *Indiana University, Bloomington, Indiana, USA*

^b *Russian Academy of National Economy and Public Administration, Moscow, Russia*

^c *Gaidar Institute for Economic Policy, Moscow, Russia*

Abstract

We use panel data for Russia's regions (2005–2013) and the US states (1997–2013) and several different econometric specifications to estimate and compare the determinants of fiscal decentralization in the two countries. We find that while the factors of decentralization in the US states largely conform to existing theoretical predictions, this is not so for Russia, where almost no factors are consistently associated with intraregional fiscal decentralization. Moreover, our results for Russia differ from prior results based on earlier data. We conjecture that the recent weakening of the effects of conventional fiscal decentralization determinants in Russia is due to the decline of democratic institutions in Russia's regions and overall political and economic centralization in the country.

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1. Introduction

The effects of fiscal decentralization have been the subject of fast growing literature in economics and political science.¹ This literature typically treats fiscal decentralization as exogenous. This approach could lead to misleading results if the factors that determine the degree of fiscal decentralization also affect its presumed effects, such as institutional quality or economic growth. For this reason, it is important to understand what factors determine the degree of fiscal decentrali-

* Corresponding author, *E-mail address:* malexeev@indiana.edu

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¹ See Martinez-Vazquez et al. (2016) for a recent survey of the economic and political effects of fiscal decentralization. Another useful recent reference is Ahmad and Brosio (2015).

zation. Unfortunately, there has been little recent research on this topic. In fact, we are aware of only four papers on the determinants of fiscal decentralization published in the last 12 years (Canavire-Bacarreza et al., 2016; Freinkman and Plekhanov, 2009; Letelier, 2005; Arzaghi and Henderson, 2005).² More research on this issue was conducted in the 1980s and 1990s, but much of it used arguably inadequate empirical techniques.

Perhaps more important for our purposes, the overwhelming majority of the empirical work on the determinants of fiscal decentralization both recently and in the 1980s–1990s used country-level data. Two notable exceptions are Wallis and Oates (1988; hereafter W&O) and Freinkman and Plekhanov (2009; hereafter F&P) who studied the determinants of fiscal decentralization in the US states and Russian regions, respectively. Although there are certain advantages of working at the country level due to generally better data availability, there are also significant disadvantages. First, countries generally differ in difficult to measure ways, which cannot always be accounted for using country fixed effects because some of these differences vary over time. Second, budgetary accounting systems and general government responsibilities may vary from one country to another in ways that undermine the validity of comparing decentralization measures across countries. Third, countries' reporting of budgetary data to international organizations, whose data are typically used in country-level research, is sometimes inconsistent. For example, there are non-trivial discrepancies between the World Bank and OECD data on the subnational government share of expenditures.³

All of these problems can be alleviated or even eliminated by studying the determinants of fiscal decentralization at the intraregional level, that is, looking at the fiscal arrangements between provincial (regional in Russia and state in the US) and municipal government levels. This is the focus of our paper. More specifically, we aim to extend and improve upon W&O and F&P's work on the factors of regional fiscal decentralization by employing more sophisticated and, in our view, more appropriate econometric approaches as well as more recent and comprehensive data.

In terms of econometric techniques, W&O used a random effects specification in their main regressions. However, the Hausman test rejects random effects for our data. F&P present only between-effects results, arguing that a fixed effects specification would not work because, "most indicators do not have meaningful time-series variation within short periods of time" (Freinkman and Plekhanov, 2009, p. 508) and because they focus on long-term trends. Although we agree that a between-effects specification is a useful technique for the problem at hand (and we present between-effects results), it also has significant disadvantages relative to fixed effects approaches. In particular, a between-effects estimation is likely to suffer from an omit-

² Jametti and Joanis (2016) also addressed the determinants of fiscal decentralization, but they focused almost exclusively on electoral competition and other political variables without including several other potentially important factors common in this literature, such as a measure of ethnic diversity within the population or dependence on natural resource rents.

³ According to the World Bank's data, the shares of subnational government expenditures in general government expenditures in Belgium, Finland, France, and Greece in 2011 were, respectively, 33.06%, 35.02%, 18.67%, and 5.53%. Meanwhile, the respective numbers from the OECD database are 37.75%, 40.73%, 20.02%, and 5.58%. Moreover, the differences do not remain stable over time. Thus, the World Bank reports a 5.10% share for Greece for 2010 while the OECD number is 7.16%. These numbers are taken from World Bank (2014) and OECD (2017).

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