Elected or appointed? How the nomination scheme of the city manager influences the effects of government fragmentation

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ABSTRACT

Empirical research on the causal effect of government fragmentation derives diverse results. One reason for this diversity might be that studies are typically settled in a variety of institutional environments. To assess the extent to which the local political system might shape the effects of fragmentation, this study measures the causal effect of a change in the nomination scheme of the city manager on the council size effect. I combine a regression discontinuity design with a difference-in-differences approach in a large panel dataset of German municipalities. The study finds that when the manager is appointed by council, there is no significant council size effect, but that there is a negative effect when the manager is elected by voters for those expenditure categories over which the manager has the most discretion. These findings suggest that the nature of the political system does indeed matter.

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1. Introduction

Government fragmentation—which refers to the number of decision-makers in government, such as the number of legislators—is often considered an important determinant of government size (Weingast et al., 1981; Schaltegger and Feld, 2009). Despite massive attention paid to it in the empirical literature,[1] however, no definitive conclusion has yet emerged regarding the causal effect of fragmentation on policy. Strikingly, Egger and Köthenbürger (2010) and Pettersson-Lidbom (2012) even applied the same identification strategy to different datasets and derived completely different results. A main characteristic of the existing literature is that it measured the effect of fragmentation in completely different (local) political systems.

The current study asks whether underlying heterogeneity in local political systems can explain these mixed results. Specifically, using a large panel dataset of 426 municipalities in the German state of Hesse in the 1985–2000 period, I compare the effect of the number of legislators on spending (i.e., the council size effect) in two distinct local political systems. In the first setting, the city manager—who in Hesse is the head of public administration—is appointed by the municipal council. In the second setting, he is elected by voters.[2] To establish causality, I combine a regression discontinuity design (RDD) with a difference-in-differences (DiD) approach. The RDD uses that council size in Hesse is a discontinuous function of population size. The DiD approach exploits that the timing of the switch from appointment to election differed across

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[1] The following is an incomplete list of papers. In the literature, there exist various measures of government fragmentation. Besides the number of legislators (as used in this study), the number of ministers and the number of parties in government are sometimes used (Roubini and Sachs, 1989; Perotti and Kontopoulos, 2002; Schaltegger and Feld, 2009). However, the number of legislators seems to be the most frequently used measure of fragmentation (Gilligan and Matsusaka, 1995; Bradbury and Crain, 2001; Baqir, 2002; MacDonald, 2008; Egger and Köthenbürger, 2010; Pettersson-Lidbom, 2012).

[2] An important predecessor of this study is Baqir (2002). He compares government fragmentation effects in mayor–council and council–manager systems among US cities and finds that mayor–council systems break the relationship between fragmentation and spending. However, in his setting, political units might self-select into specific forms of local governments, such that it is questionable whether the estimated effects can be considered causal.

municipalities, given the new system's quasi-random phase-in period.

I find that fragmentation effects indeed differ between these two political systems. When the manager is appointed by the council, there is no relationship between council size and spending. However, when the manager is elected by voters, there is a highly significant negative council size effect, i.e. the larger the size of the council is, the smaller the government size.

Theoretical findings regarding the relationship between fragmentation and policy are as diverse as the existing empirical results. In a seminal contribution, Weingast et al. (1981) argued that fragmentation leads to inefficiently high spending, because each legislator tries to benefit his constituencies through pork-barrel spending while internalizing only a fraction of the associated costs. Primo and Snyder (2008), however, show that the model of Weingast et al. (1981) can even predict inefficiently low spending. Recently, Pettersson-Lidbom (2012) argued that agency problems between the council and a budget-maximizing public administration can be better solved with more legislators, thus creating a negative relationship between fragmentation and spending.

Pinpointing the specific mechanism behind the effects of fragmentation on policy is important to understanding the welfare consequences of fragmentation. In pork-barrel type models—such as those of Weingast et al. (1981) and Primo and Snyder (2008)—more fragmentation leads to inefficiency. In contrast, if agency problems exist, more fragmentation can curb inefficiently high spending.

I argue that my results point to the existence of agency problems between the public administration and the council. When the manager is appointed, he is completely accountable to the council. If the manager is office-motivated, there will be a very restricted incentive, if any, to counteract the council's decisions.[3] In such cases, it is not necessary to have more legislators monitoring him. When the manager is elected by voters, his tenure in office should be less dependent on the council, and his political position should be stronger, as he does not require a parliamentary majority to stay in office. This should create (or further exacerbate) agency problems between the municipal council and the manager, compared to the case of appointment. Therefore, having a greater number of council members is helpful in monitoring the public administration more effectively. This leads to a negative relationship between council size and spending.[4]

To evaluate whether different council size effects in these two political systems might really be caused by agency problems, I undertook the analysis for different budgetary subcategories, as well as for local tax rates. Fittingly, the above conclusions hold only for expenditure categories over which the public administration has discretion. Since agency problems can exist only for those budget positions that the manager can influence, this supports the proposed mechanism.

My results have important policy implications. Knowledge of which political institutions can side-step inefficiencies that stem from either pork-barrel spending or agency problems can be useful.[5] Moreover, mayor–council systems have been found to imply council size effects other than those seen in council–manager systems (Baqir, 2002). Is this caused by the nomination scheme of the public administration? Election of the head of public administration highly correlates with the existence of a mayor–council system,[6] whereas in council–manager systems, it is more common for the city manager to be appointed by council. Therefore, disentangling the effect of the nomination scheme on the council size effect from the effect of the whole administrative system is in general difficult; however, it is possible in the present setting, as the reform changed only the former.

Additionally, the results have important implications with respect to the validity of cross-country studies within the government fragmentation literature. A council size effect that varies depending on the political system illustrates the need to use data from a homogeneous institutional setting—rather than data pulled together from different political systems, as is done particularly in cross-country studies.

More generally, the current study contributes to the literature on fiscal policy determination across different forms of local government (e.g., MacDonald, 2008; Coate and Knight, 2011; Vlaicu and Whalley, 2013). To date, causal empirical evidence on the interplay between the local executive (city manager or mayor) and the city council (as the local legislature) is scarce at best. This dearth is unsurprising, given the econometric challenge of finding at least two natural experiments. Moreover, this study relates to a growing body of literature investigating the role of public administration in government decision-making processes (e.g., Alesina and Tabellini, 2007, 2008; Ting, 2012). Third, this study relates to the literature on political economy that estimates causal effects by using variants of the RDD (e.g., Fujiwara, 2011; Gagliarducci et al., 2011; Tyrefors Hinnerich and Pettersson-Lidbom, 2014). To the best of my knowledge, this study is the first to use the RDD to measure interaction effects in separate institutions.

The remainder of this paper is structured as follows. In Section 2, I describe the institutional framework in Hesse and the dataset used. Section 3 presents the empirical strategy. In Section 4, I first present evidence of a direct effect of the change in nomination scheme on the outcome variables. Second, I present evidence that the change in nomination scheme also has effects via government fragmentation. Finally, Section 5 provides concluding remarks.

2. Institutional framework and data

2.1. Institutional framework

In Germany, municipalities are the lowest administrative unit of government; they are, however, of considerable economic importance. They are responsible for roughly one-third of the total German government spending and employ 40% of all state employees. Moreover, they are free to set three different tax rates: a tax on business profits (Gewerbesteuer), a tax on agricultural land

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[3] This is similar in spirit to the initial intent of the inventor of the city manager plan in the United States, as described by Stone et al. (1940, p.14): "By authorizing the council to hire and fire the city manager at its discretion, however, the city manager plan effectively gave the council control over administrative, as well as over legislative, policy."

[4] A question arises when considering the relationship between city manager and council as a principal-agent problem: why should manager elections make a difference, if voters can discipline him through council elections? After all, the manager is more beholden after the introduction of elections to the same people who elect the council. A key assumption for elections to make a difference is the existence of incomplete information among voters. If voters have perfect information, it should make no difference whether the manager is elected or appointed. If in this case the council appoints an incompetent manager, voters will simply punish the council through council elections; thus, councils would not hire managers that voters would not elect. If voters, however, have incomplete information about the behavior of the local political actors, this can make a difference in whether the manager is elected or appointed, as Vlaicu and Whalley (2013) show. A second explanation as to why the nomination scheme for public officials matters is that separate elections might allow for the unbundling of policy issues (Besley and Coate, 2003).

[5] This is particularly true if other types of fragmentation also create inefficiencies. Consider for example government fragmentation in the form of coalition governments. National policy-makers are not able to determine whether a municipality is governed by a single-party or coalition government, as this is the result of municipal elections. However, if there are inefficiencies resulting from one of these government types, national policy-makers might be able to mitigate these inefficiencies by simply changing the nomination scheme of the public administration.

[6] For example, Baqir (2002) reports that in his sample of US cities, 98% of the mayors in mayor–council systems are elected by voters.