

On the incentives to experiment in federations

Christos Kotsogiannis^{a,b}, Robert Schwager^{c,*}

^a *Department of Economics, School of Business and Economics, University of Exeter,
Streatham Court, Rennes Drive, Exeter EX4 4PU, UK*

^b *Athens University of Economics and Business, Athens, Greece*

^c *Georg-August-Universität Göttingen and Zentrum für Europäische Wirtschaftsforschung Mannheim,
Platz der Göttinger Sieben 3, D-37073 Göttingen, Germany*

Received 3 October 2005; revised 19 April 2006

Available online 13 June 2006

Abstract

Conventional wisdom has it that policy innovation is better promoted in a federal rather than in a unitary system. Recent research, however, has provided theoretical evidence to the contrary: a multi-jurisdictional system is characterized—due to the existence of a horizontal information externality—by under-provision of policy innovation. This paper presents a simple model that introduces political competition for federal office and emphasizes that such competition plays an important role in shaping the incentives for experimentation. For, in this case, political actors use the innovative policies to signal ability to the electorate. This effect may offset the effect that arises from the incentive to free ride, and so a federal system may generate more innovation than a unitary one.

© 2006 Elsevier Inc. All rights reserved.

JEL classification: H77; R59

Keywords: Fiscal federalism; Policy innovation; Policy experimentation

1. Introduction

A commonly held view is that fiscal federalism promotes innovative public programs, speeds up the process of policy experimentation and its diffusion. This view has been recently expressed by the US federal government with regards to abatement technologies. The administration's chief climate negotiator, Harlan Watson, defended the US climate policy listing a variety of initiatives

* Corresponding author.

E-mail addresses: c.kotsogiannis@exeter.ac.uk (C. Kotsogiannis), rschwag@uni-goettingen.de (R. Schwager).

by states and communities. This ‘bottom-up approach’ is based on the fact that states are like ‘laboratories where new and creative ideas and methods can be applied and shared with others and inform federal policy.’¹ This view is rooted in the argument that the division of the economy into a number of independent localities gives them the opportunity to experiment with policies. With several jurisdictions experimenting, the likelihood of finding the best policy is higher than if the control of the policy choice is left to the central government.² This view is most vividly summarized in the following citation by Justice Brandeis:

‘It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory and try novel social and economic experiments without risk to the rest of the country.’³

While this statement has received widespread support, recent theoretical analysis suggests the contrary: a decentralized system is conducive to producing fewer policy innovations than a centralized one. This might be the case, for instance, either because of political risk—as in Rose-Ackerman [7]—or because of a horizontal information externality, as in Strumpf [8]. This latter contribution considers a model in which local policymakers decide on policy experiments, the outcomes of which are correlated across states. This correlation creates a learning externality and therefore an incentive for the policymakers to free-ride on each other’s innovative efforts. This incentive to free ride leads, typically, to under-experimentation relative to the social optimum that could be generated by a unitary government.⁴

An important aspect that is insightfully discussed but not formally investigated by Rose-Ackerman [7] and Strumpf [8, Section 4.3] concerns the federal political institutions and, more importantly, the *electoral incentives* faced by the state policymakers in a federal system. It is quite common observation that in federal systems regional governors run for federal office. Consider, for instance, the US experience. With the exception of George Bush senior all of America’s past five presidents previously have been state governors. The same is true, to give another example, for Germany where four out of the last six chancellors were ex-premiers of federal states. Though this does not show the innovativeness of the governors prior to the federal elections, it does show their level of political aspirations.

Undoubtedly, the implementation of new and unknown public policies is more demanding than running ‘business as usual’, since it requires imaginative leadership on the part of a governor rather than operational routine. If innovative public policies are viewed by the electorate as a signal of imaginative leadership, and hence a reasonable proxy for ability, one would expect that political aspirations are interdependent with the choice of public policies. It is so reasonable to assume that in federal contests, being innovative at the state level, positively influence the voters’ perception of the ability of a governor standing for federal office.⁵ In this paper we incorporate

¹ Herald Tribune, December 11, 2003, p. 1, ‘Warming feud: states vs. Bush team’, by A. Revkin and J. Lee. For further examples of innovative policies, see Strumpf [8].

² See, for instance, the insightful survey of Oates [5], but also Inman and Rubinfeld [1], and Kollman et al. [3]. For an early empirical analysis of the diffusion of innovations among the US states see Walker [9]. For a recent study of the diffusion of innovation among US school districts, see Rincke [6].

³ Brandeis, J. *dissenting*, New State Ice Co. v. Liebmann, 285 US. 262, 311 (1932).

⁴ This conflict, and the need for more research on this topic, between the conventional wisdom and the conclusions arrived at by the contributions of Rose-Ackerman [7] and Strumpf [8] is also emphasized in Oates [5].

⁵ This view is shared by political observers, too. In a commentary, for example, J. Podhoretz notes, ‘... although he is not a bold politician, Bush is an innovator. On all these issues [education, social security and medicare] he has fresh

Download English Version:

<https://daneshyari.com/en/article/972003>

Download Persian Version:

<https://daneshyari.com/article/972003>

[Daneshyari.com](https://daneshyari.com)