

**3d Winter School on Inequality and Collective Welfare
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**FISCAL FEDERALISM AND INTERGOVERNMENTAL
RELATIONSHIPS**

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OUTLINE

Main purpose: offer ideas for research in the field to PhD students.

1. Introduction

2. General overview of the field

3. Topics for research

4. Some selected examples (my own research)

1. Introduction

*Fiscal federalism: not the same of local finance. Examples: the European Union, international organization, secession/formation of countries/ federations

*Local finance: not the same of fiscal federalism. Data on local governments, important base for testing theories in political economics, public economics, welfare economics, ect...Examples to follow.

*Policy relevant field. State and governments boundaries continuously changing: decentralization process inside countries, centralization process across countries...

*Relevant for welfare economics too. Devolution of the welfare state to local governments (Education, Health, Labor Market policies...)

2. General overview

2.1 Traditional models (first generation)

Theory

* Oates's decentralization "theorem"

Better representation of local preferences;

More accountability of local politicians;

* Oates's "recipe":

trade-off between spill-over effects & heterogeneity of preferences;

* Tiebout's "voting by feet" theorem;

Exit option even in the government context;

No mobility costs- efficiency;

Implications

* Normative assignment of competences (allocative) to different levels of govts., resources (tax revenue, tariffs...), size of governments, ect.

* Trade-off between efficiency-equity; Tiebout's conditions generally violated, fiscally induced mobility, hence role force central grants (block grants – redistribution motive; Pigovian transfers to correct spillover);

*theory of secession /integration of countries;

A contrary view

*Buchanan & Tullock's Leviathan model;

⇒ decentralization leads to tax competition and tax competition

protects citizens

*still purely normative model, but with opposing predictions;

2.2 *Second generation models*

Theory

- political economy models;
- asymmetric information models;

⇒ makes more sense of Oates' ideas;

- Better representation of local interests?

Seabright (1996), Tabellini & Persson (2000); Lockwood (2001), Besley and Coate (2001); A central politician needs not to please voters in all districts; local politicians need to please local voters;

- More accountability of local politicians? Agency model a la Besley; Lockwood and Hindricks (2006);

⇒ further ideas on why decentralization could be accountability

increasing:

Yardstick competition (Salmon, 1987 Besley and Case, 1995; Besley and Smart, 2006; Besley, 2007), Bordignon (2007); Bordignon, Cerniglia and Revelli (2003, 2004).

⇒ derives the optimal structure of fiscal rules (e.g.

intergovernmental grants) under asymmetric information;

- Bordignon, Manasse and Tabellini (2001); etc.

..But unclear on why local governments more informed..

⇒ Explores the rationality of some fundamental assumption of

Oates' theorem

* the uniformity assumption

⇒ case-study Market preserving fiscal federalism

Weingstadt and Quian,

Qian and Roland, 2000

⇒ Vertical externalities

Keen

⇒ literature is turning empirics

Fiscal federalism and growth

3. Topics for further research

3.1 Links between fiscal federalism & accountability

Modern literature generally confirms Oates' intuition; but counterexamples... (lack of accountability generated by decentralization)

1. Lobbying, corruption and decentralization

Prud'homme "decentralization increases the role of local interest groups on policy"

Bardham and others... theoretically and empirically... many reasons to go in a direction and to go in the opposite one..

Bordignon, Colombo, Galmarini (2007) " depends on how the interests of local lobbies are positioned with respect to the function to be centralized / decentralized"

2. Soft budget constraint problems

Central government provides fiscal insurance to local governments, but fiscal insurance may turn out in a moral hazard problem

⇒ which distortions in grants? Which distortions in local expenditure? Which effects on fiscal stability? What can be done?

Rodden et als., 2003;.. Von Hagen & Rattzo, lots of literature, Bordignon (2000), Bordignon and Turati (2005), Bordignon (2006)..

3. Partial decentralization

World Bank: Leaving aside Anglosaxon types of local governments, decentralization is generally only partial; overlapping of competences remain on the expenditure side, and local govts. financed by discretionary grants:

⇒ less not more accountability because of decentralization;

⇒ more inefficiency at local level;

⇒ more influence of local interests groups;

See below...

3.2 Fiscal federalism and international organizations

Theory of secessions

Alesina and Spolare (1997), Bolton and Roland (1997), Alesina and Spolaore (2004), Bordignon and Brusco (2001); Lebreton...

More should be done in using theory to understand the working of international organization..

*When secession rules are optimal? How should they be organized?

Internal workings of international organizations

* How should the internal working of an international union be organized? What our theory says?

⇒the European Union, more than a Union, less than a unitary state;

Lot of game – theoretical literature on international agreements, very little which comes to term with how international organization actually works;

Bordignon and Brusco (2006) on enhanced cooperation in the EU; stumbling blocks or building blocks?

3.3 Fiscal federalism and equity

Is fiscal federalism inequitable? What does equity mean in a federal context? What horizontal equity means?

Bordignon, Fontana, Peragine (2006);

How should intergovernmental grants be organized to be equitable?

Literature on the equality of opportunity (circumstances and effort) could be useful?

4. Some selected examples

4.1 Bordignon (2006)

Tax competition versus Yardstick competition; do they work together?

4.2 Bordignon & Piazza (2007)

The partial decentralization issue. Studying the introduction of the PIT surcharge rate in 1999 in a agency model of policy; derive theoretical implications and put them to data.

4.3 Bordignon & Tabellini (2006)

Using local finance to test competing theories. Exploit a “natural experiment” in the Italian context; Mayors in Municipalities below 15,000 inhabitants elected at the first ballot; Mayors in Municipalities below 15,000 inhabitants elected with a dual ballot mechanism. Formulate theories and put them to data.