

Decentralization and Governance

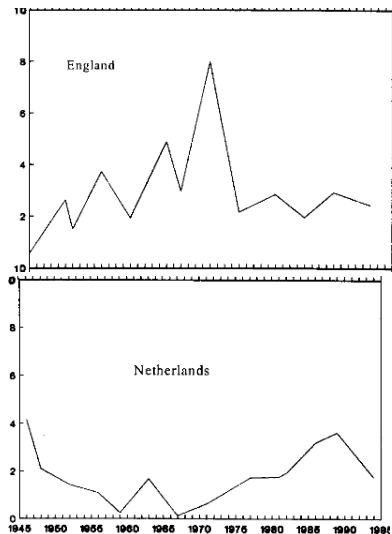
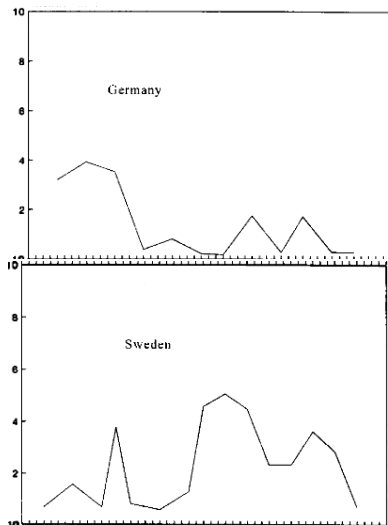
Overview and Recent Evidence

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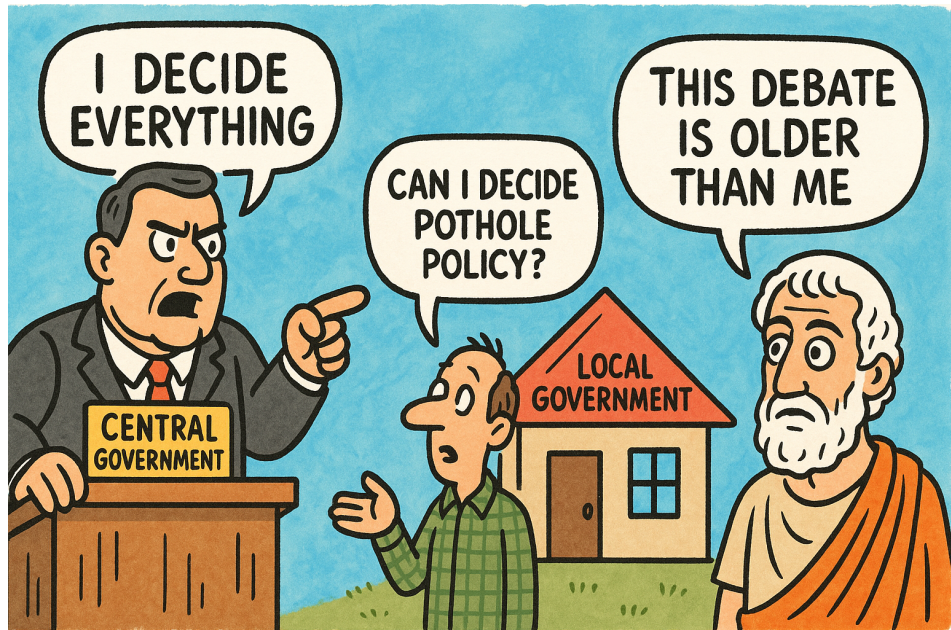
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- ▶ **How should government be organized?** How to allocate authority? How to tax and redistribute?
 - ▶ These are *old questions* intersecting with almost all of economics and politics.
 - ▶ Since Aristotle, Cicero, Tocqueville, Mill, Rousseau, Madison, Hamilton, Hayek...
- ▶ In this lecture I will focus on one subset of questions pertaining to *decentralization*.
 - ▶ How many tiers to have? What size should government units have? What responsibilities should be held by what level?
 - ▶ How does this impact state capacity and public goods provision?
- ▶ Unsurprisingly, the literature about these questions is immense.
 - ▶ But interest in the topic is cyclical.

Interest in decentralization is cyclical in parties' manifestos (De Vries, 2000)



- ▶ A recent wave of papers in Economics and Politics has re-examined the impacts of decentralization with modern techniques. We will discuss two of them later.
- ▶ But first, I will take a step back and briefly **overview the topic of federalism and decentralization**.
 - ▶ Following closely Treisman (2007) “The Architecture of Government”
 - ▶ I will avoid almost all math.
- ▶ **Spoiler alert:** There is no set of arguments that is logically correct and general to clearly favor decentralization.
 - ▶ “To choose to decentralize, in most settings, requires a leap of faith rather than the application of science.” (Treisman, 2007)
 - ▶ But I will have more to say.



Outline

Defining decentralization

Some of the arguments

Cross-country evidence

Unpacking administrative efficiency

Recent empirical micro evidence

Avenues of future research

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- ▶ A **jurisdiction** is a subset of the territory consisting of contiguous points.
- ▶ Territories are partitioned into **multi-tier** jurisdictions.
 - ▶ Each citizen lives within one jurisdiction at each tier.
- ▶ Each jurisdiction is associated with at least one **governmental body**: officials + politicians implementing policies.
- ▶ *Centralized regime*: single jurisdiction, single government, chooses all policies.
 - ▶ **Decentralization**: deviations from this extreme case.

▶ **Administrative decentralization**

- ▶ Agents at lower tiers are appointed by and subordinate to the central government.
- ▶ The agent has no right to overrule the central government's instructions or appeal them to some other body.
- ▶ At least one policy issue defined by these agents at lower tiers.

- ▶ **Decision-making decentralization:** if at least one subnational tier of government has exclusive authority to make decisions on at least one policy issue.
- ▶ **Appointment decentralization:** if government officials at least one subnational tier are selected and appointed by residents of that government's jurisdiction, independent of higher-level governments
- ▶ **Federalism** = certain combination of decision-making and appointment decentralization, with >1 tier (Riker, 1964; Dahl, 1986).

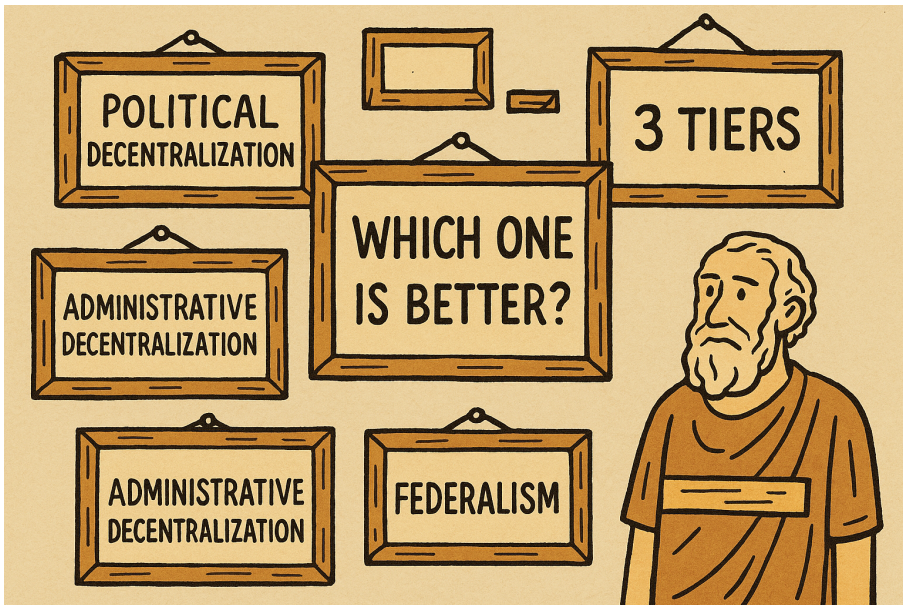
Fiscal decentralization

1. Decision-making decentralization on questions of taxation or expenditure.
 - ▶ A more fiscally decentralized state, in this sense, is one in which lower tier governments have greater autonomy to define their own tax bases, set their own tax rates, and determine their own public spending.
2. *Ex post* division of tax revenues – or expenditures – between levels of government, regardless of whose decisions led to this division.
 - ▶ In this sense, a state in which subnational governments receive a larger share of total tax revenues – or account for a larger share of total state expenditures – is more fiscally decentralized.
 - ▶ This is essentially the indicator of decentralization chosen by Lijphart (1984,p.177).

- ▶ Vertical decentralization
 - ▶ Changing decision-making responsibilities across tiers
- ▶ Horizontal decentralization
 - ▶ Creation of new units within tier \implies people governed by smaller units (on average)

Comparing systems?

- ▶ Which one is more decentralized?
 - ▶ Is a system in which local governments make education policy and central government makes health policy more or less decentralized than one in which the assignments are reversed?
- ▶ Which one is “better”?
 - ▶ Two three-tier systems, A and B, when in A one-third of the issues are assigned to each of the tiers, while in B 90 percent of issues are assigned to the middle tier and 5 percent each to the top and bottom tiers?



Outline

Defining decentralization

Some of the arguments

- Administrative efficiency

- Local competition

- Fiscal incentives

- Democracy

- Checks, balances, and liberty

- Veto players and change

- Local information and policy innovation

- Ethnic conflicts

Cross-country evidence

Unpacking administrative efficiency

- ▶ **Argument** Multi-tier government makes it possible to satisfy citizens' demands for public goods and services more precisely and cost-effectively. If it is most efficient to provide some public outputs in small units and others in large ones, or if tastes for some outputs vary geographically, provision in a multi-tier structure can be tailored to these cost and demand conditions. (See Oates 1972)
- ▶ **Critique**
 1. An all-powerful central government could achieve the same efficiencies.
 2. Multi-tier structure also makes worse outcomes possible (e.g. services at “wrong scale”).
 3. Given that increasing the number of tiers and governments is costly, this argument establishes only that some administrative decentralization may be beneficial, not how much.

- ▶ **Argument** Competition among local governments to attract mobile residents or investment induces them to be more honest, efficient, and responsive. Such competitive pressures are weaker among nation-states. Therefore, one should give more responsibilities to local governments. (See Hayek 1939, Tiebout 1956.)
- ▶ **Critique**
 1. The conditions for vigorous competition among local governments are so restrictive they will rarely be met even approximately in real countries.
 2. If, however, the conditions are met, competition may for many reasons be perverse, leading to less efficient or less desirable outcomes.
 3. An all-powerful central government could achieve similar outcomes with appointed field agents.

- ▶ **Argument** Increasing local governments' share in a shared tax should increase their motivation to support local economic activity, resulting in better performance nationwide.
- ▶ **Critique**
 1. Increasing local governments' share means decreasing the shares of other levels of government.
 2. If local governments become more motivated to support economic performance, the other levels of government will become less motivated.
 3. All levels of government can influence economic performance, so the resulting net effect on performance is indeterminate.

- ▶ **Argument** Decentralization, by reducing the scale of government, increases citizen participation and cultivates civic virtue. It also enhances electoral accountability because voters have better information about local than about central government performance, because dividing responsibilities up among multiple levels makes it easier for voters to attribute credit or blame among them, and because voters in small groups can coordinate better on a voting strategy. (See Tocqueville 1969 [1835], Mill 1991 [1861], Jefferson 1999 [1774–1826].)
- ▶ **Critique**
 1. In all but the tiniest communities, only a small fraction of citizens can participate directly in local government.
 2. As for electoral accountability, it is not clear why voters would be better informed about local than central government performance. (One can observe whether the Central Bank is keeping inflation low as directly as one can observe whether a local school board is managing schools well.)
 3. Multiple tiers may make it harder, not easier, to attribute credit and blame.

- ▶ **Argument** In decentralized orders, strong local governments will check central government abuses and protect individual freedoms. (See Tocqueville 1969 [1835], Weingast 1995, Madison 1999 [1772–1836], Hamilton 2001 [1769–1804].)
- ▶ **Critique**
 1. Local governments can usually defeat a central government only if they coordinate. They will often fail to coordinate, and their attempts to do so can easily be undermined by central “divide-and-conquer” strategies.

- ▶ **Argument** By making policy changes depend on more actors, decentralization tends to increase policy stability. (See Proudhon 1979 [1863], Hume 1994 [1752], Tsebelis 2002.)
- ▶ **Critique**
 1. When the claim does hold, there are no general normative implications. Policy stability is good when the policies entrenched are good, but bad when the policies entrenched are bad, however one defines “good” and “bad.”

- ▶ **Argument** Local governments are better able to elicit and make use of local information, or are more motivated to do so. Decentralization should increase policy experimentation. (See Turgot 1775, Brandeis 1932, J.S. Mill 1991 [1861].)
- ▶ **Critique**
 1. On examination, it is not clear why local governments would be better able to extract local information, or more motivated to do so.
 2. As for policy innovation, central governments in centralized systems can also introduce local policy experiments, and electoral pressures will usually make them more motivated to do so than local governments in decentralized systems.
 - ▶ A central government has more to gain from local discoveries (which it can use to increase its support in other regions), and it has less to lose electorally if an experiment in one region goes wrong than the government of that region.

- ▶ **Argument** Political decentralization defuses ethnic conflicts by satisfying limited demands for autonomy, splitting the prizes and lowering the stakes of politics, creating checks on the central government, socializing ethnic politicians into cooperative behavior, and refocusing party development onto very small ethnic groups.
- ▶ **Critique**
 1. Decentralization can help only geographically concentrated minorities. It may create new ethnic minorities within smaller units.
 2. The central government is sometimes the solution, not the problem. If decentralization prevents central government interventions, it will prevent both abusive interventions and humanitarian actions to stop one local ethnic group from massacring another.
 3. Small ethnic groups may feel more threatened than larger ones.
 4. In sum, all the effects can go both ways.

- ▶ **Bottom-line:** it is very difficult to make general arguments about decentralization being good or bad.
- ▶ Empirical evidence until relatively recently has been cross-country or case studies.
- ▶ Before we dive into more recent quasi-experimental papers, let's discuss some cross-country evidence.
 - ▶ Data from IMF (86 countries), World Bank, V-DEM

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Some of the arguments

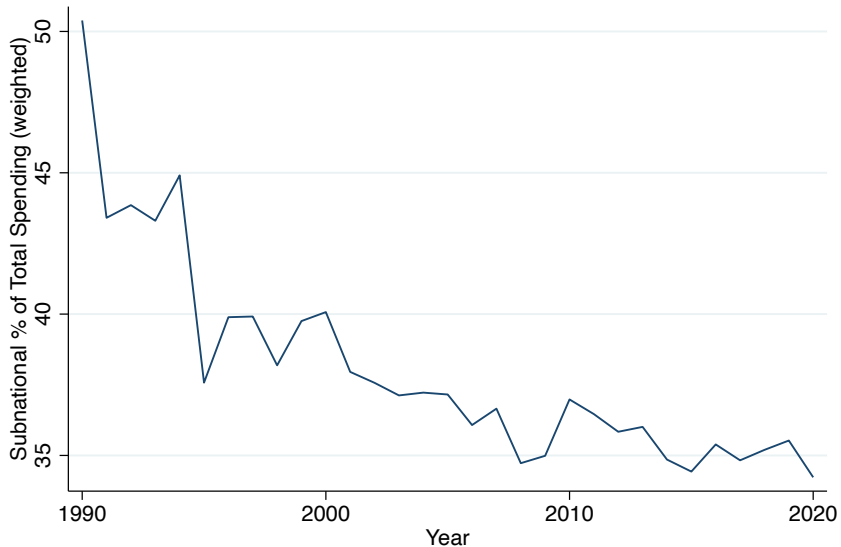
Cross-country evidence

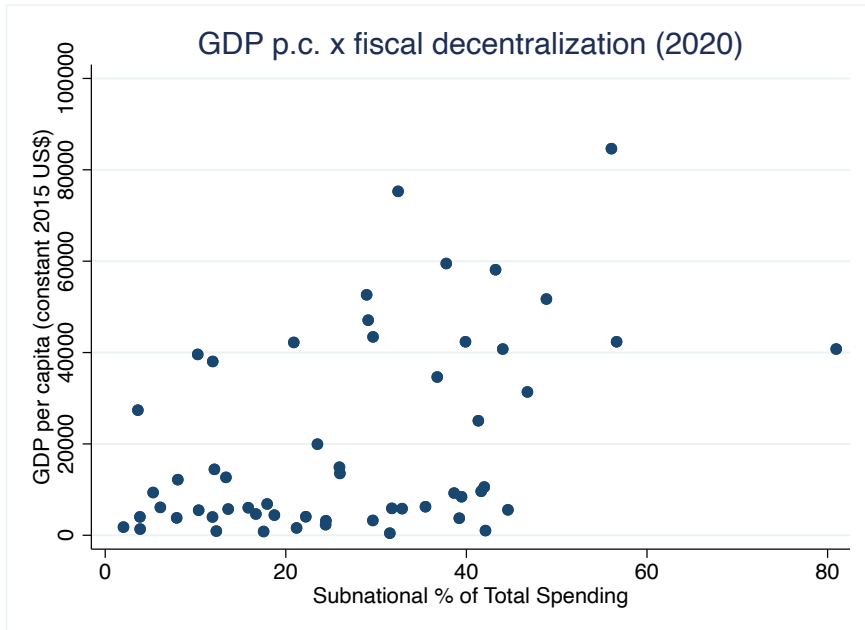
Unpacking administrative efficiency

Recent empirical micro evidence

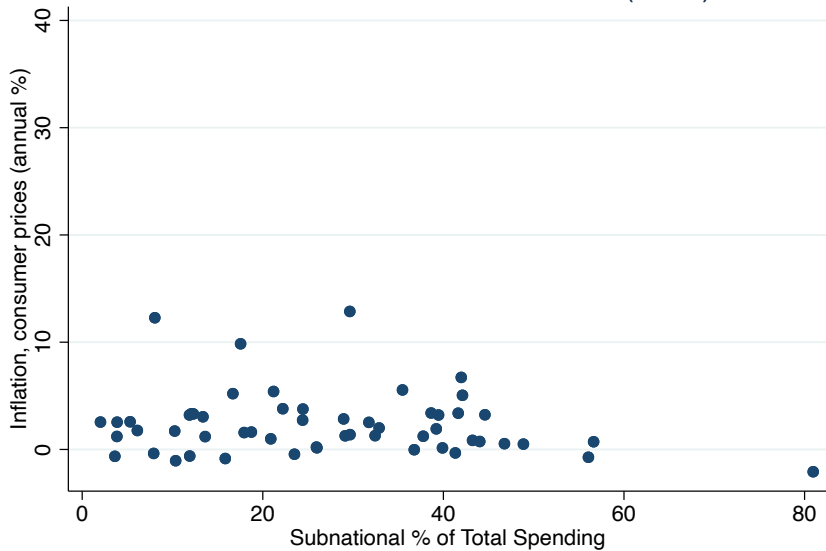
Avenues of future research

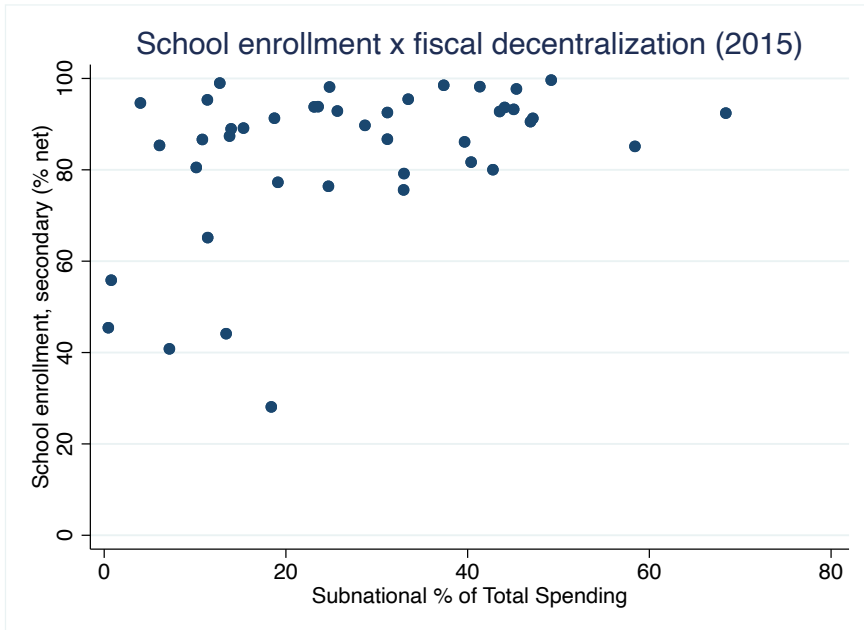
Fiscal decentralization over time



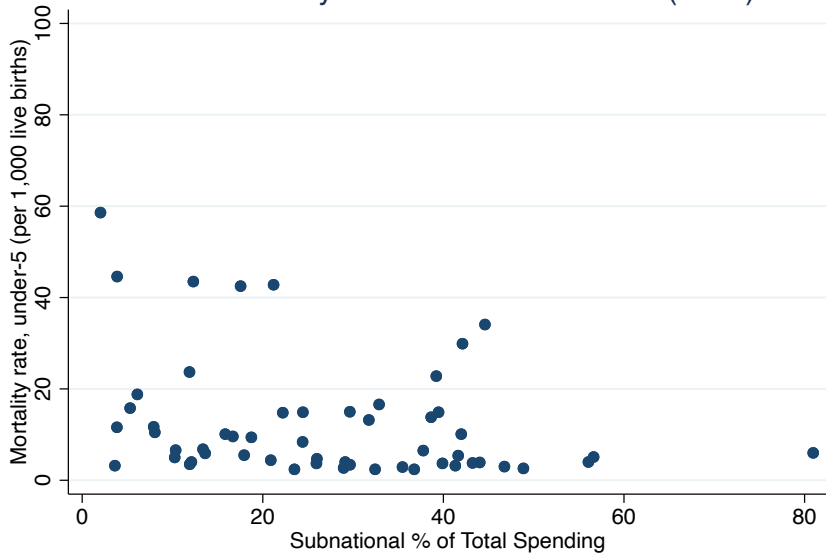


Inflation x fiscal decentralization (2020)

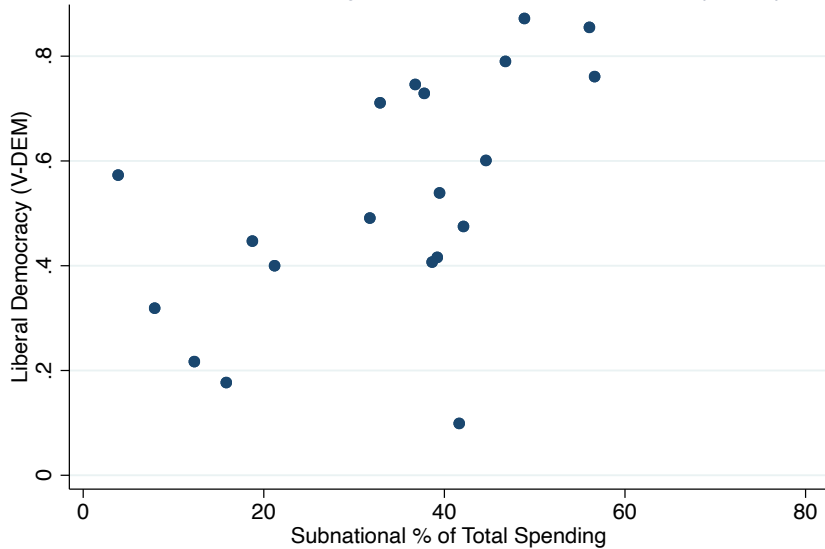




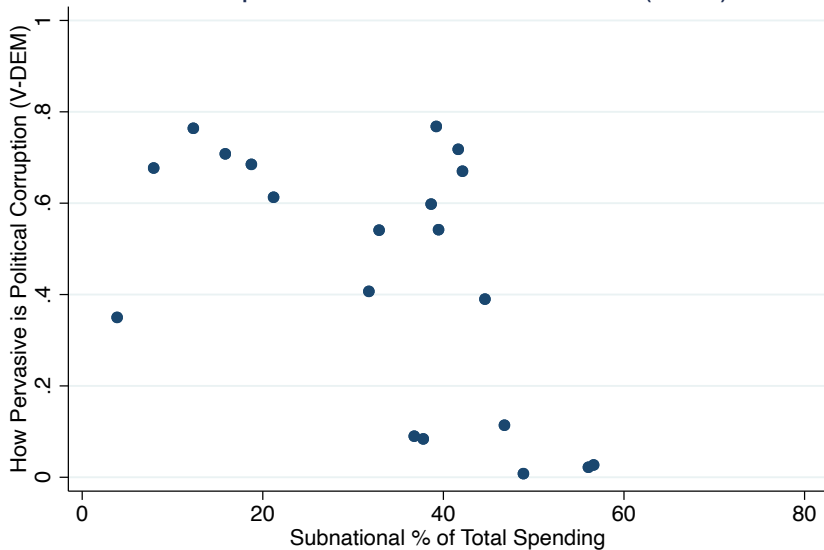
Child mortality x fiscal decentralization (2020)



Liberal democracy x fiscal decentralization (2020)



Corruption x fiscal decentralization (2020)



Determinants of fiscal decentralization

VARIABLES	(1)	(2)	(3)	(4)
ln(GDP p.c.)	8.19*** (0.64)	7.82*** (0.68)	10.80*** (1.22)	16.81*** (2.66)
ln(Population)	2.29*** (0.39)	2.56*** (0.40)	-0.09 (0.80)	-2.45 (5.77)
Liberal Democracy (V-DEM)	22.79*** (5.25)	22.06*** (5.46)	2.25 (5.86)	-14.03*** (4.80)
Judicial Constraints on the Executive (V-DEM)	-6.82* (3.78)	-5.81 (4.00)	-5.89 (4.77)	16.89*** (4.02)
Observations	368	368	368	367
R-squared	0.70	0.72	0.81	0.98
Year FE	-	✓	✓	✓
Continent FE	-	-	✓	-
Country FE	-	-	-	✓
Unique countries	24	24	24	23
Mean	36.10	36.10	36.10	36.17
SD	18.24	18.24	18.24	18.22

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Administrative efficiency

- ▶ Let's suppose all political authority is at the central level. How should a government should implement its policies?
 - ▶ Should it keep all its officers close at hand in bureaus in the nation's capital?
 - ▶ Should it assign agents to local districts, stationing them throughout the territory?
 - ▶ Should it use tiers?
- ▶ **Principle:** A rational central government will administer via locally based agents so long as the marginal cost of supervising and communicating with these agents is lower than the marginal cost of providing the same services using agents based in the capital. And it will choose the number of tiers and dimensions of jurisdictions to minimize such costs.
- ▶ This can vary by type of public service.
 - ▶ Internalize externalities at higher levels, such as national defense (Oates, 1972)

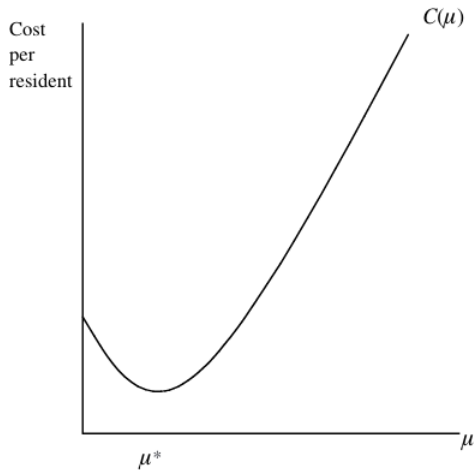


Figure 3.1. Cost per resident of providing g units of a local public good to μ residents

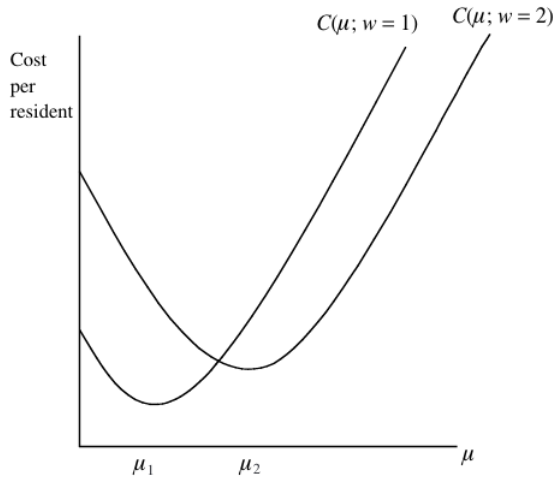


Figure 3.2. Cost per resident of providing g units of local public good $w = \{1, 2\}$ to μ residents

Heterogeneous tastes

- ▶ Another argument for administrative decentralization is that it permits differentiation of policies among heterogeneous local communities.
- ▶ Alesina and Spolaore (2003): both the size of countries and the degree of centralization within them are determined by a basic tradeoff between economies of scale (which favor large size or central provision) and heterogeneity (which favors small size or decentralized provision).
- ▶ Still, not a necessity. In principle central governments can also differentiate policies.

Costs of organization

- ▶ Decentralizing public goods provision can have **costs** too.
- ▶ (Fixed) costs of operating government offices.
 - ▶ See Dahis and Szerman (2025), coming soon.
- ▶ Communication costs
- ▶ Agency costs and loss of control

- ▶ What is the most efficient size and shape for a government? Most economists would view the search for a precise, general answer to these questions as misguided.
- ▶ It depends on so many factors: production technology, demand conditions, communication costs, incentives in the tax and financial systems, etc.
- ▶ And beyond administrative efficiency, what about politics?
 - ▶ Are there advantages to letting local communities choose their own political leaders and policies?
 - ▶ (competition between governments, common pools, participation, accountability, ...)

What about the modern evidence?

- ▶ Recent empirical evidence has adopted the spirit of the *credibility revolution* (Angrist and Pischke, 2010) and applied quasi-experimental methods with rich microdata to evaluate reforms.
- ▶ **Two caveats**
 1. The recent evidence is of reforms that usually *bundle various changes at once*.
 2. They are *relative changes*, it's hard to say in absolute and in general what maximizes welfare.
- ▶ Let's briefly discuss two recent papers as examples
 1. Dahis and Szerman (R&R AEJ:Applied, 2025)
 2. Weaver and Narasimhan (AER, 2024)

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Dahis and Szerman (2025)

Weaver and Narasimhan (2024)

Avenues of future research

- ▶ **Classic tension in fiscal federalism:** large administrative units may not serve all its constituent parts equally well, but the parts worse off may not have the scale or resources to self-finance a secession.
- ▶ A country may decide to *subsidize voluntary splits* with federal transfers to weaken that trade-off.
 - ▶ But doing so introduces a *new trade-off*: new units receive concentrated benefits at the diffused expense of the rest of the country.
- ▶ To what extent such a policy is beneficial is an open empirical question.

Study *one side* of this trade-off: **How do administrative splits impact local development in the areas seceding?**

- ▶ Identification: restrict attention to areas applying to split, then compare trajectories between those that split and *almost* split.
- ▶ Setting: Brazil.
 - ▶ By law, municipalities have:
 1. Administrative, fiscal and political decision-making power
 2. Standardized horizontal structure.
 - ▶ Rapid growth in number of units during 8-year window of time.
- ▶ Rich contextual information and data to explore mechanisms.

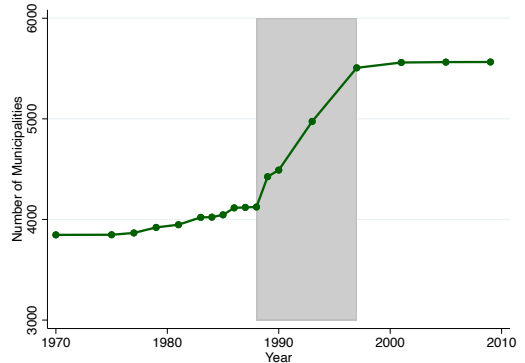
Background

- ▶ Three tiers of government: federal (L0), states (L1) and municipalities (L2).
 - ▶ Municipality > district.
 - ▶ Attributions: education up to 9th grade, basic health, sanitation, security.
 - ▶ Revenues mainly from: local taxation, federal transfers (and matching grants).
 - ▶ For small municipalities, federal transfers amount to up to 90%. Figures
- ▶ Too few municipalities?
 - ▶ In 1988, only 4,214 municipalities in a country of almost 150 million people.
 - ▶ Average size: 2,017 km².
 - ▶ Italian comuni: 38 km². US county: 2,577 km². Indian district: 4,078 km².
 - ▶ In Brazil there is no lower-level unit of government.
- ▶ New Constitution in 1988: facilitated and de facto subsidized splits.
 1. Low requirements: state legislation, \approx 5k people, unilateral referendum vote.
 2. Formalized a federal transfers scheme (FPM).
 - ▶ Guarantees a revenue floor to municipalities.
 - ▶ Step-wise population formula. Coefficients
 - ▶ Zero-sum within state.
 - ▶ New municipality \implies others in state lose a bit.

Background

- ▶ Effectively led to a large increase in number of municipalities.
 - ▶ ↑ 23%, in two waves: 1992 and 1996.
 - ▶ In our data, out of those allowed, 39% of districts applied to split.
- ▶ In 1996, Congress votes almost unanimously and passes amendment halting splits.
 - ▶ Impression of inefficiency and patronage.

Figure: Number of Municipalities



A new government is set up

- Investment spikes. Bureaucracy grows by $\approx 40\%$.

Figure: $\ln(\text{Capital Exp.})$

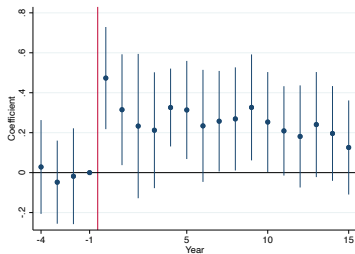


Figure: $\ln(\text{Current Exp.})$

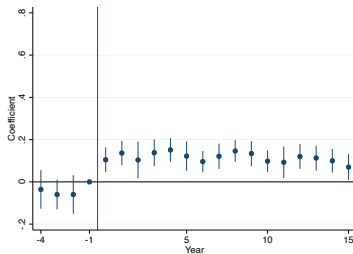
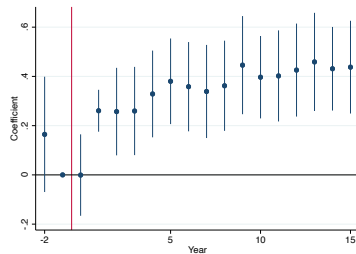


Figure: $\ln(\text{Public Jobs})$



By Function

By Sphere

Wages

Effects on Education Provision (by age)

Figure: School Attendance

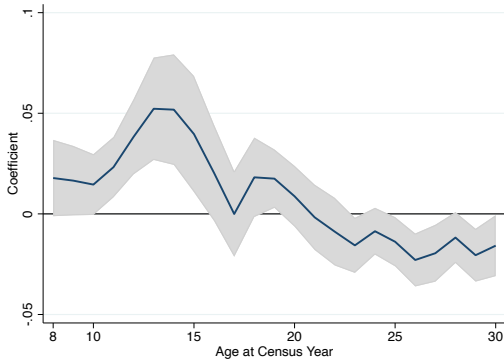
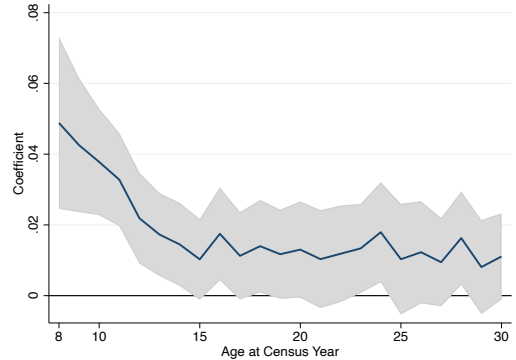


Figure: Literacy



Specification

Munic. Level

Other Services

A Summary Measure: $\ln(\text{Nighttime Luminosity})$

Figure: Municipality level

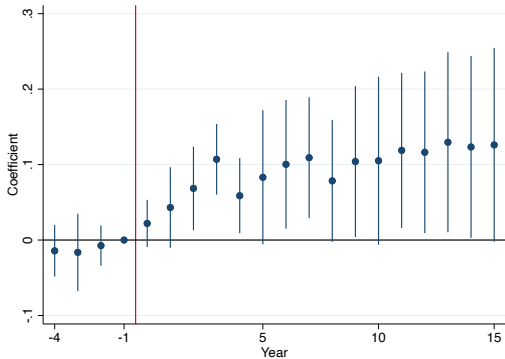
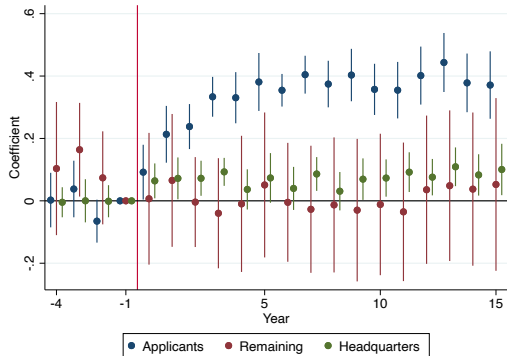


Figure: District level [$\uparrow 34\%$]



Specification

Table

- ▶ More details in the paper.
- ▶ Results shed a *broadly positive light* on this type of decentralization reform.
 - ▶ No clear evidence of binding negative scale effects.
 - ▶ Net effects potentially positive.

- ▶ Study the state of Uttar Pradesh in India (241 million people)
- ▶ Village \in gram panchayat (GP)
- ▶ The GP is an elected body that oversees the provision of local public goods such as water and sanitation. They are also the primary implementer of a large workfare program, the National Rural Employment Guarantee Scheme (NREGS), and play a role in identifying beneficiaries for government welfare programs.
- ▶ **Empirical design:** villages with a population exceeding 1,000 in the last decadal census should be split into their own GP.
 - \implies Regression Discontinuity (RD)

Figure 1: First stage of village population on gram panchayat population in Uttar Pradesh

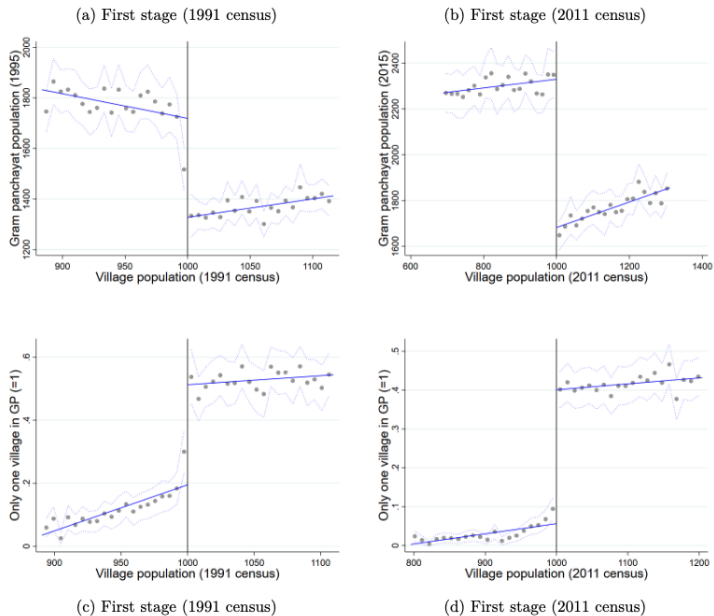


Figure 2: Effects on village-level amenities (1991 discontinuity)

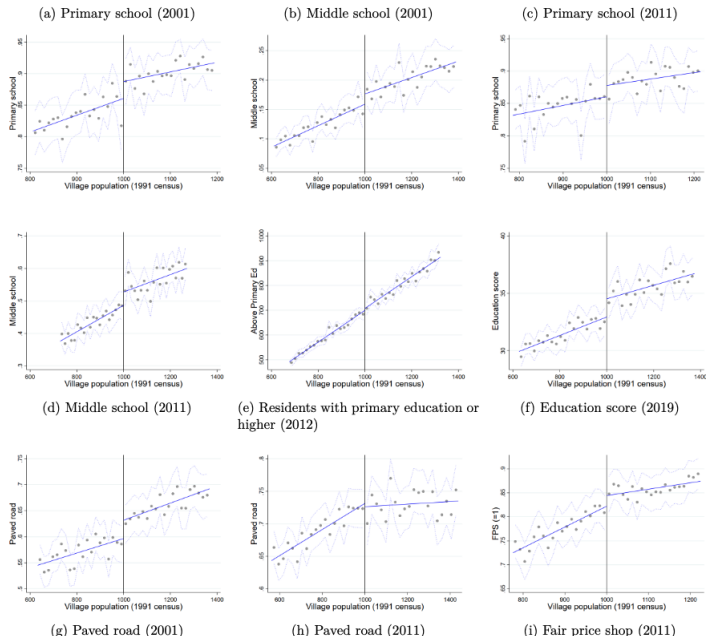
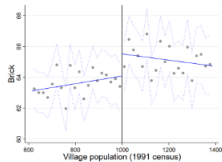
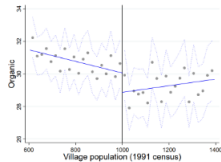


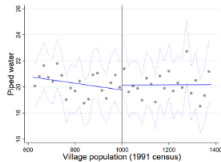
Figure 3: Effects on village-level amenities (1991 discontinuity, continued)



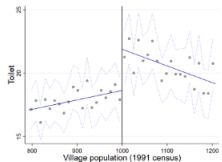
(a) Houses with brick walls (2011)



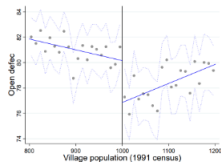
(b) Houses with walls made from organic materials (2011)



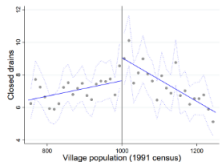
(c) In-house piped water



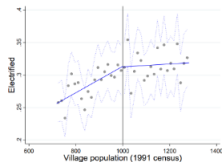
(d) Households with toilets (2011)



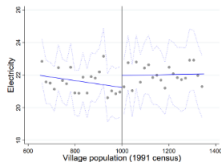
(e) Households who openly defecate



(f) Households with closed drains (2011)



(g) Electrified (2001)



(h) Households with electricity (2011)

Table 3: Effect on delivery of services

<i>Panel A: Individual-level programs</i>									
	Programs Index	BPL Card	Health insur.	Pension	Saubhagya	LPG	Housing benefits	PMMVY	Jan Dhan
RD_Estimate	0.09*** (0.033) [0.008]	5.01** (2.412) [0.038]	2.20** (1.057) [0.037]	-1.34 (1.075) [0.212]	2.58* (1.401) [0.066]	5.63** (2.450) [0.022]	5.55** (2.187) [0.011]	0.10 (0.134) [0.464]	4.98** (2.048) [0.015]
Dep var mean	0.103	109.270	25.841	39.892	50.314	106.895	45.775	2.967	76.798
Bandwidth	275	487	443	435	583	375	368	566	402
Effective Obs	12594	25358	22091	22644	29849	16844	16234	29000	17160
<i>Panel B: Workfare program implementation</i>									
	NREGS Index	Work demand	Days worked	Labor expend.	Material expend.	Total projects			
RD_Estimate	0.15*** (0.024) [0.000]	0.01*** (0.001) [0.000]	0.31*** (0.050) [0.000]	63.39*** (9.448) [0.000]	22.67*** (5.564) [0.000]	0.01*** (0.001) [0.000]			
Dep var mean	0.111	0.080	2.103	407.795	153.791	0.088			
Bandwidth	515	562	520	512	501	499			
Effective Obs	119159	131138	121607	119004	107507	117140			

Table 4: Effects on GP election outcomes

<i>Panel A: Political competition</i>						
	Voter turnout	Candidates per 1000	Eff. candidates per 1000	Candidates	Herfindahl index (votes)	Margin of victory
RD_Estimate	1.91*** (0.278) [0.000]	1.13*** (0.076) [0.000]	0.88*** (0.045) [0.000]	-0.90*** (0.091) [0.000]	0.02*** (0.003) [0.000]	0.91** (0.440) [0.038]
Dep var mean	74.773	5.263	3.034	7.534	0.299	11.322
Bandwidth	402	460	439	560	463	530
Effective Obs	37871	43010	39669	48179	42776	46429
<i>Panel B: Candidate characteristics</i>						
	Avg Educ	Avg criminal record	Avg assets (asinh)	General caste perc	Female perc	Avg age
RD_Estimate	0.01 (0.025) [0.578]	-0.02* (0.010) [0.054]	-0.01 (0.072) [0.848]	-0.01* (0.008) [0.061]	-0.02*** (0.008) [0.006]	-0.12 (0.125) [0.332]
Dep var mean	2.307	0.133	12.572	0.258	0.426	41.026
Bandwidth	561	470	492	533	478	453
Effective Obs	50914	21526	20542	49827	44847	38561

A lot more out there – Recent references

- ▶ Tricaud (AEJ:Applied, 2025): municipal cooperation in France
- ▶ Chambru et al. (AER, 2024): new local capitals in 1790's France
- ▶ Bluhm et al. (R&R AEJ:Applied): new subnational capitals worldwide
- ▶ Singhanian (WBEP, 2022) direct elections in Indonesia
- ▶ Bazzi and Gudgeon (AEJ:Applied, 2021) political divisions and ethnic conflict in Indonesia
- ▶ Pierskalla (CP, 2016) district creation in Indonesia

Outline

Defining decentralization

Some of the arguments

Cross-country evidence

Unpacking administrative efficiency

Recent empirical micro evidence

Avenues of future research

- ▶ How should government be structured is an *old* question. It's so interesting!
- ▶ Brief overview here of classic arguments and more recent evidence.
- ▶ “To choose to decentralize, in most settings, requires a leap of faith rather than the application of science.” (Treisman, 2007)
 - ▶ More research is needed.
- ▶ **Avenues of future research**
 - ▶ Unpack the effects of bundled reforms.
 - ▶ Study long term effects (50, 100 years on)
 - ▶ What is the *optimal* number of administrative units?
 - ▶ How should administrative units be *physically* shaped?

Thank you

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