

Incentives of bureaucrats and politicians in a federation

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This proposal draws heavily on Zhuravskaya (2006)

One of the grand debates political economics and development literatures is about workings of federalism in developing and transition countries. In this debate, one strand of the literature argues that decentralization helps to create efficient incentives for local public officials through inter-jurisdictional competition and fiscal incentives. Chinese system of fiscal intergovernmental relations is commonly used by this strand of literature as the main example of the beneficial effect of decentralization on growth. The other strand of the literature argues that decentralization leads to inefficient local policies because of local capture and incentives to pursue regionalist policies. Russian transition is often used to demonstrate the pitfalls of decentralization.¹ Overall, it has been shown that in China, local governments fostered growth of small business by maintaining benign regulatory environment and providing growth-enhancing public goods; while in Russia, local governments impeded growth by excessive regulations, corruption, low public goods provision, and regionalist policies.

There have been a few attempts to reconcile the outcomes of Russian and Chinese federalism. Most of them focus on formulating conditions for the system of intergovernmental fiscal relations which need to be satisfied for federalism to function well. For example, such features as the clarity of the division of expenditure responsibilities and revenue sources between levels of government and the size and predictability of marginal remittance rates affect incentives of sub-national governments to foster business growth and to provide public goods efficiently (Roland 2000). Indeed, there is some evidence of important differences in the fiscal intergovernmental relations between China and Russia (Jin, Qian, and Weingast 2005 and Zhuravskaya 2000). Yet, there is a fundamental question of why one of the two countries was able to institute and enforce efficient rules while the other was not; this question was not addressed in these papers.

Blanchard and Shleifer (2001) shed some new light on this debate by focusing on another major difference between Russia and China. They use the China-Russia comparison to argue that for federalism to function, it needs to come with political centralization. This argument was first developed by William Riker (1964) who reasoned that only those local politicians, who have strong career concerns about promotion to the national politics, can resist local special interests and internalize effects of own local policies on other jurisdictions in the country. Blanchard and Shleifer highlight differences in career concerns of local politicians in the two countries: On the one hand, Chinese Communist party plays a crucial role in creating “national” career concerns for (fiscally autonomous) local public officials. In particular, it systematically promotes governors whose regions performed well to the central government, and dismisses governors whose regions performed poorly. In contrast, in the 1990s in Russia, fiscal decentralization occurred along with massive political decentralization, so that the central government was left without political or administrative means to discipline governors.

Generally, there are two distinct ways to achieve political centralization: first, to have strong national political parties present in local elections; and second, to have administrative subordination, i.e., to appoint rather than elect local officials. There is an important difference in the positions of Blanchard and Shleifer, on the one hand, and Riker, on the other, about the effect of these two methods. Blanchard and Shleifer stress the importance of administrative centralization in China, although, they highlight the possible costs in the form of toppled

¹ The first side of the debate is represented by Tiebout 1956; Qian and Roland 1998; Maskin, Qian, and Xu 2000; Montinola, Qian, and Weingast 1995; Qian and Weingast 1996; while the second side by Musgrave 1969; Oates 1972; Prud'homme 1995; Tanzi 1996; Bardhan 2000; Cai and Treisman 2004.

democracy. The Riker's view was that in most cases administrative subordination is ineffective in disciplining local politicians – unlike strong national parties – because it may undermine potential benefits of federalism (such as better information about preferences of population at the local level) in the first place. The reason for this is that appointed officials may stop caring for preferences of local population even though they may know them better than central politicians. In contrast, strong national political parties in presence of local elections strike a balance in incentives of local politicians between caring for preferences of the national party and of local population. Using cross-section and panel data for up to 75 developing and transition countries for 25 years, Enikolopov and Zhuravskaya (2006) confirm Riker's view. They show that strength of national political parties significantly improves such outcomes of fiscal decentralization as economic growth, quality of government, and public goods provision; while appointing rather than electing local governments does not have a significant effect on the results of fiscal decentralization.

The China-Russia case study taken together with evidence of country-level regressions suggests the following two points. First, just as Blanchard and Shleifer argue, political centralization does matter for how well federalism functions both in general and in Russia and China in particular. Second, the necessary condition for administrative centralization without local democracy to discipline local governments (and, therefore, to help federalism function well) seems to be efficient growth objectives of central officials. Judging by Enikolopov and Zhuravskaya (2006) results, this is not true in general. Thus, the great Chinese puzzle remains unresolved: it is still not clear why Chinese central government is well-behaved and how the Party manages to provide its officials in Beijing with incentives to act in the country's best interest. Understanding the fundamental reasons behind this is especially challenging given the 1980s experience of the Soviet Communist Party. Moreover, presence of subnational elections should have an important direct effect on country's performance not interacted with decentralization. There are alternative views on the possible sign of this effect. On the one hand, bundling of national and subnational policies at the central-level elections in absence of subnational elections leads to local capture and severe inefficiencies (Besley and Coate 2003). On the other hand, vote-buying policies at the subnational level may lead to inefficient redistribution towards pivotal interest groups (Enikolopov 2006). Moreover, elections have an important selection effect on the type of public officials (Alesina and Tabellini 2004).

All of these considerations have important implications for Russia's recent political reforms: On September 13, 2004, Putin announced a drastic political reform. First, elections of regional governors were replaced by their appointment by the president. Second, direct majoritarian elections that – prior to the reform – were held for one half of the seats in the lower chamber of the Russia's parliament were replaced by proportional representation. At the same time, the threshold share of votes needed for a party to get into the Duma was raised. The official aim of the latter change was to strengthen the national political parties. In line with Riker and Blanchard and Shleifer, Putin justified this reform by the need for "securing the unity of state power and the logical development of federalism."²

Did political reform make local governance any better in Russia and why? The project aims at addressing this question from several different angles:

What are the central government's objectives in re-appointing governors? There is room for both theoretical and empirical investigation here. First, we want to analyze whether there is a systematic difference among three groups of governors: those who raised the question of their reappointment before their term was over; those who were reappointed after their terms ended; and those who were not reappointed. Second, we want to study theoretically what are the

² <http://www.cdi.org/russia/johnson/9173-10.cfm>

conditions under which the incentives are to reappoint badly-performing governors vs. well-performing governors (there could be both political and fiscal incentives to reappoint badly-performing governors; see, for instance, Egorov and Sonin 2005). Third, it is interesting to study historical cases of incentives facing governors, such as income or successful careers (e.g., in British empire)

Both at the municipal and regional level there were jurisdictions and periods when executives (i.e., mayors and governors) were appointed throughout the 1990s. We want to use historical data to compare fiscal performance of municipalities and regions where executives were appointed and elected to test various theories about the effect of subnational elections on performance.

Another question which we aim to address is how the reform of electoral rule (for the Duma elections) might have affected the efficiency of legislature. It is too early to study this question in an empirical investigation directly because there have been no elections under the new system yet. Yet, one can study historical data on incentives to run as a single member district (SMD) candidate vs. being included in the party list. Empirical evidence (e.g., Bremzen et al 2005) suggests that deputies elected in different ways exhibit systematically different voting behavior, but little is known as to why it happens or what incentives deputies of both groups face (except for general understanding that party list deputies are more accountable to parties and SMDs are more accountable to regional voters). Both theoretical and empirical progress on this front would give us mileage towards understanding the effects of the aforementioned reform.

Individual research topics:

- Empirical investigation of who among governors is reappointed and why.
- Case study of bureaucrat accountability in the past (e.g., British, French and Spanish empires).
- Theoretical investigation of reasons to re-appoint well-performing vs. poorly-performing governors
- Empirical investigation of fiscal and growth effects of electing vs. appointing governors
- Empirical investigation of fiscal and growth effects of electing vs. appointing mayors
- Empirical investigation of the individual and party choice between listing a Member of Parliament candidate as an SMD candidate vs. as a certain position in a party list.
- Testing for systematic differences between popularity of proportional and party list deputies (for example, as measured by local media coverage).
- Cross country testing for correlation between fiscal centralization and parliamentary electoral systems (and modeling thereof).
- Theoretical investigation of the individual and party choice between listing a Member of Parliament candidate as an SMD candidate vs. as a certain position in a party list.
- Theoretical investigation of possible interrelations between repealing direct elections of governors and switching to purely proportional elections to the parliament.

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