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Reforms and Decentralization: Friends or Foes?

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Résumé

Des préoccupations d'ordre systémique concernant les marchés, le capitalisme et le rôle de l'Etat dans l'économie sont de nouveau d'actualité. Certains aspects de la façon dont les sociétés sont organisées dans le domaine économique et social pourraient faire l'objet de réformes assez amples. D'après l'expérience, ce genre de réformes est parfois accompagné de changements importants en matière de décentralisation. Pour explorer la question des relations entre réforme économique et décentralisation politique, on observera qu'une réforme comporte deux dimensions: l'une s'exprimant en termes de conception ou d'architecture, l'autre en termes de processus. Le document est organisé autour de cette distinction. Pour les économistes, il semble naturel de raisonner en termes de conception ou d'architecture, c'est-à-dire de percevoir une réforme comme le remplacement d'un état par un autre, supposé meilleur. Même si cette perspective, qui occupe une place dominante dans la réflexion économique, se révèle finalement un peu décevante, certains de ses aspects sont discutés dans la première partie. La deuxième partie est consacrée à la perspective exprimée en termes de processus. Elle aussi a inspiré un nombre non négligeable de travaux sur les réformes, mais en général sans référence à la décentralisation. Il est montré dans cette seconde partie qu'il peut être intéressant d'intégrer la décentralisation dans une analyse des réformes comme processus.

Mots-clés

Décentralisation, systèmes économiques, réformes, économie politique, concurrence par comparaison

Abstract

Systemic concerns about markets, capitalism and the role of the state in the economy are salient again. Relatively large-scale reforms of economic and social arrangements are seriously considered. Historical experience suggests that reforms of that kind are sometimes associated with important changes in institutional arrangements pertaining to political decentralization. To explore the relationship between economic reforms and decentralization, the paper argues that a reform has two dimensions. It is a process and it is a design. The organization of the paper is inspired by that distinction. For economists, it seems natural to reason in terms of design -- that is, to perceive reform as the replacement of one state by another, presumably better. The first part of the paper discusses some aspects of that design perspective, which, although it is dominant in the literature, proves in the end somewhat disappointing. The second part is devoted to the process perspective, which has also inspired a relatively large body of work on economic reforms, albeit most of it unconcerned with decentralization. It is suggested in that second part that integrating decentralization in an analysis of reforms as processes may be worthwhile....

Keywords

Decentralization, economic systems, reforms, public choice, yardstick competition ...

Classification JEL : D72, H10, H70

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I. Introduction

Systemic concerns about markets, capitalism and the role of the state in the economy are salient again. Relatively large-scale reforms of economic and/or social arrangements are seriously considered and some (in the financial sector in particular) are undertaken or may be imminent. Historical experience suggests that reforms of that kind are sometimes associated with changes in the “architecture of government” – to borrow the title of a recent book on political decentralization (Treisman 2007). Inspired in part by historical experience, discussions about economic systems or about “national models” of economic governance now often give a role to the relationship between national and sub-national governments. A case in point is the political economy literature on China. In that literature, an influential view is that the economic performance of China is related to the way it has organized the relations between central and regional and local authorities, both in its official institutions and within its ruling party. Decentralization is also an object of attention in discussions about the economic conditions of countries such as Argentina, Brazil, India, Nigeria and Russia. From the perspective of an international organization such as the World Bank, two positive worldwide evolutions occurred over the last decades, liberalization of markets and political decentralization, and a relation between the two seemed plausible even if difficult to establish empirically.

In the case of Europe, the relation between the governmental and the economic systems is relevant mainly at the level of the European Union (EU). The policy-making capacity left to the member states interacts in a somewhat conflicting way with the ambitiously strict features adopted as a binding norm or ideal for the “internal” market. There is a parallel between the way that interaction is evolving and the experience of the United States, more precisely the way in which, in that country, entrenched political convictions about state autonomy and the role of the federal government interacted with the mainly economic concerns embodied in the Commerce Clause.

If it is difficult to deny the possibility of an important link between economic systems and the “architecture of government”, or between reforms of the first and changes in the second, it must be acknowledged that the literature explicitly addressing that question in general terms is limited -- Weingast (1995, 2009 e.g.) being one of the exceptions, albeit from a particular standpoint. It must be stressed also that the relation is far from being unambiguous. To fight the Great Depression, the New Deal led to an increased centralization of the American governmental system. Conversely, but under the same logic, to preserve or foster markets Ronald Reagan in the United States and the Communist Party in China favoured decentralization. However, for the same purpose, the Conservative government in Britain under Margaret Thatcher and her successor favoured centralization both in Britain and, ironically, at the level of the EU. And, in France, François Mitterrand was elected in 1981 on the basis of a platform focussed on large-scale economic and social reforms increasing considerably the involvement of government in the economy. Yet, a major legacy of his presidency was the relatively extensive political decentralization enacted in 1982.

To account for these differences and to explore the relationship between economic reforms and political decentralization, the paper argues that a reform has two dimensions, at least potentially. It is a process and it is a design. This is true whether the reform concerns the economic system or is about decentralization (or centralization). The organization of the paper is inspired by this distinction. For economists, it seems natural to reason in terms of design -- that is, to perceive reform as the replacement of one state by another, presumably better in some sense, at least better in the eyes of the promoters of the reform. This is in agreement with the method of comparative statics, in which one compares an equilibrium position or situation with another. Given our focus on the interaction between reforms of the economic system and political decentralization, this approach suggests a discussion in terms of complementarities -- that is, a discussion of how a set of characteristics of the economic system and some features or the relationship between levels of government do or do not match up. Regarding reforms, should the present combination be replaced by another? To return to the cases mentioned above, should a more market-friendly type of economic system be associated with a more decentralized system of government, and, conversely a more interventionist and redistributive economic system with more political centralization? The New Deal, the platform of Reagan and perhaps the contemporary Chinese experience suggest this kind of association. But other experiences -- Thatcher's, or possibly Mitterrand's -- suggest opposite complementarities. The first part of the paper is based on this design perspective, which, although it is dominant in the literature, proves in the end somewhat disappointing. The second part is devoted to the process perspective, which has also inspired a relatively large body of work on economic reforms albeit most of it unconcerned with decentralization. We argue in the second part that integrating decentralization in an analysis of reforms as processes seems promising. But only an exploration of some of the possibilities will be attempted.

II. The institutional design perspective

In this section, we remain on a broad level and concentrate on the question of how views on the relations between economic systems and economic performance, on the one hand, and political decentralization or centralization, on the other, have been associated with views about government and about competitive markets. This will allow us to address the puzzle created by the fact that Reaganism and Thatcherism, two apparently close ideologies, have adopted contrasting positions regarding political decentralization.

2.1. Decentralization and views on government

Even among liberal (*i.e.*, pro-market) economists, journalists and politicians, the views held on the state are not identical on the two sides of the Atlantic. The difference is reflected at the intellectual level in the observation that Public Choice, as a subfield of economics and of political science, has

not had in the United Kingdom the success it has had in the United States.¹ The difference also explains in part the opposite approaches to decentralization adopted by Reaganism and Thatcherism.

Distrust of the state in general and of its bureaucracy in particular was one of the sources of inspiration of Public Choice. Welfare economics and, to a lesser extent, public economics used to focus on market failures and to discuss the policies a government, supposedly benevolent if not also omniscient, should adopt to deal with them. The field now known as Public Choice flourished in part as an elaborate critique of that approach. Throwing analytical light on governmental or public sector failures succeeded in undermining many cases made too hastily for public intervention or in showing the naivety of many economists' specifications of intervention tools. By performing this critical task, Public Choice certainly contributed to improving the quality of the debate among economists on policy issues.

Some authors have gone further and discussed the implications of a more encompassing perspective of governments. They portray them as predatory, at least potentially, or likely to become the prey of interest groups, including their own bureaucracies. As a consequence, it is urgent in their opinion to investigate, and if need be promote, mechanisms that can constrain government – that can “tame the Leviathan” (Brennan and Buchanan 1980). The two main classes of mechanisms stressed in this literature are, on the one hand, constitutional constraints, which *inter alia* protect individual rights and limit the power of a simple majority to exploit the minority, and, on the other hand, federalism or decentralization, which allows interjurisdictional competition for mobile individuals and capital to limit over-regulation and the exploitation of tax payers (yardstick competition, an effect of federalism or decentralization which is emerging intellectually as a second channel of competition, will be discussed later). To have a sufficient impact, it may be advisable that both kinds of constraints operate together.

This is the case in the system advocated by Barry Weingast (1993, 1995) under the name of “market-preserving federalism”. In it, “the authority to regulate markets is not vested with the highest political government in the hierarchy” and “the lower governments are prevented from using their regulatory authority to erect trade barriers against the goods and services from other political units”. According to him, this was more or less the system adopted in the United States in the nineteenth century and, in that case, it was constitutionally entrenched and enforced by the Supreme Court. The basic underlying mechanism, in Weingast's contributions of that period, is that of mobility-based competition, more or less as in Brennan and Buchanan (1980). Its virtues were presented as follows by Yingyi Qian and Weingast in an article published in 1997 (cited by Daniel Treisman 2007, p. 74):

¹ The case of Public Choice in Britain is relatively straightforward. Few economists or political scientists associate themselves with Public Choice or political economy in that country, and they were even fewer at the time of Thatcher, which is the time period relevant for the claim formulated in the text. Consequently, to support that claim, it is unnecessary, in the case of Britain, to discuss the nature of the association of individual scholars with Public Choice. Extending the comparison to other European countries (Germany, Italy and Switzerland in particular), in which Public Choice seems to have been more successful, would require taking into account not only the number of scholars associated in some sense with Public Choice but also the content of their work.

“Just as market competition pressures firm managers to reflect the interests of shareholders, competition among local governments helps to limit government’s predatory behaviour. Mobile resources can quickly leave jurisdictions with inappropriate behaviour. Competition for mobile sources of revenue prevents local political leaders from imposing debilitating taxes or regulation”.²

The relationship between assessments of what would be the best system of economic governance and attitudes toward reform depends on whether or not the institutional status quo is deemed satisfactory. If it is, there will be a tendency to oppose reforms implying institutional changes. If it is not, the link with reforms as designs will be direct. Moving from the status quo toward the new system will be advocated by economists and others and may be undertaken by politicians. Distrust of “big government” was a major inspiration of the Reagan administration, which also held the view that decentralization would be a good way to curb government’s size, powers and financial resources. The widely cited assertion that government “is not the solution to our problems,... government is the problem” was pronounced in 1981 by Reagan in his Inauguration Address. Then (in his State of the Union address), Reagan announced a New Federalism scheme. In particular, a number of programmes would be transferred by the federal government to the states (see Pierson 1994). It seemed clear to all observers that the programmes would then be downsized as a result of mobility-based competition among the states.³

The Conservatives in Britain shared with the Republicans in the United States a desire to privatize a number of organizations and programmes, implying some downsizing of government. But the British government did not hesitate to increase taxes, at least those collected by the central government, and to reduce the powers and autonomy of the subcentral authorities. The difference is often ascribed to partisan considerations, local governments and other authorities (those in charge of housing in particular) being in their majority strongholds of the Labour Party. It is also often explained by the fact that the concentration of powers in the hands of the central government normally facilitates the implementation of the decisions of that government. If the United States had not been a federal country with many powers and competencies of the states entrenched in the Constitution and protected by the Senate and the Supreme Court, it is conceivable that the central government could have obtained a reduction of the financial capacity of the subcentral governments by the use of authority, as happened in Britain, rather than by relying on the erosion effects of mobility-based competition, as it planned to do. But that avenue was not constitutionally open to the Reagan administration. Finally, the authoritarian personality of Thatcher may also have played a role.⁴ Without denying the relevance of these reasons, I think that a cause that I have already

² This comparison turns out to be a little unhappy in the light of what we have discovered recently about financial markets and the remuneration of managers.

³ An estimate of the diminution that could result was provided by Gramlich (1982).

⁴ Cf. Judt (2005), pp. 540-541: “What Thatcherism stood for more than anything else was ‘the smack of firm government’... Indeed, and for all her talk of the individual and the market, Margaret Thatcher presided over a remarkable and somewhat disconcerting revival of the British state. In administration she was an instinctive centralizer. To ensure that her writ carried throughout the land, she reduces the powers and budgets of local government (the 1986 Local Government Act dismantled Britain’s metropolitan authorities, taking their powers back to London, just as the rest

alluded to goes deeper. Whereas economic conservatism in the United States includes many views also held in Public Choice, in particular the centrality of distrust of government, this is not the case of economic conservatism or liberalism in Britain, which is more traditional and more narrowly economic. It stresses free trade, competitive markets, sound public finance and sound monetary policy. Downsizing government and reducing its revenues may be the consequence of the pursuit of other objectives but they have no priority. If the pursuit of these other objectives requires political centralization rather than decentralization -- and (to reduce the public deficit, for instance) increases rather than decreases in taxation -- this is more acceptable for economic conservatives or liberals in Britain than it would be for their counterparts in the American context.

The foregoing comparison between Reaganism and Thatcherism is logically incomplete. With regard to the British Conservatives, what has been argued so far is only that their views on government *allowed* – that is, were no obstacle to -- political centralization. It was different on the other side of the Atlantic, where, in themselves, the views held on government by the Republicans were not only an obstacle to centralisation but constituted even an *inducement* to promote decentralization. We turn now to differences in the views of what is required for a market to be truly competitive. We will see that the conception held by Thatcherism provided a positive inducement to increase centralization whereas the conception held by the Republicans allowed – that is, was no obstacle to -- a decentralization to be pursued for other reasons.

2.2. Decentralization and views on competitive markets

The starting point of the discussion must be the too often unheeded fact that genuine political decentralization fragments markets and distorts competition among firms (Breton and Salmon 2001). This is necessarily so whenever subcentral governments, whether regional or local, are given significant powers and autonomy, and in particular are encouraged to undertake innovative policies. Some differences in regulation among regions are a consequence, at any point in time, of the freedom to innovate. Others are related to local conditions, including the nature of the political equilibrium. Whatever their causes, many regional differences regarding regulation will generate non-tariff impediments to the exchange of goods and especially services across regional borders. Competition among sub-central governments to attract people or investments takes the form of state aids, tax holidays and various forms of in kind support. All have in common the consequence, at least as a side effect, of distorting competition among firms – and thus of precluding the maintenance or establishment of a perfectly “level-playing field.” The observation of decentralized

of Europe was engaged in a large-scale decentralization of power). The direction of educational policy and regional economic planning reverted to central government departments under direct political control.”

federations such as Canada and Switzerland confirms these facts.⁵ And so does, to a lesser degree, the observation of the United States.

Of course, there are limits to the tolerance of impediments to exchange and of distortions of competition. The three countries just mentioned have policies that aim at keeping them under control. In Canada and Switzerland procedures exist whose explicit aim is to complete the “common” or “internal” market. These procedures rely in part on federal institutions, including the courts, but also, interestingly, on negotiations among sub-national governments akin to international negotiations among sovereign states.⁶ In the United States, where no such inter-regional negotiation takes place, the federal institutions -- *i.e.*, the Congress, the President, the Supreme Court, and some federal agencies – act to safeguard what is considered in that country as a healthy competitive internal market. Under Reagan, the result was not very different from what it was under other administrations: a combination of tolerance of many impediments or distortions (for instance, state aids) and the ruling out of others, thus limiting but not suppressing the discretion enjoyed by state governments. It must also be noted that, in practice, contrarily to its electoral platform and proclaimed ideology, the Reagan administration did increase centralization in many domains (Rodden and Rose-Ackerman 1997). However, this may only reflect the constraints to which platforms and ideologies must adjust in the real world. From a doctrinal point of view, which is what counts for our purpose in this section, the essential point is that the ideology underlying Reaganism had no problem in favouring political decentralization because it included a conception of competitive markets that was flexible or broad enough to accommodate the side effects of that decentralization.

Many economists and, perhaps inspired by them, many politicians and journalists have a conception of market competition which is far more demanding. Their support for free trade is uncompromising and entails a demand for eliminating all impediments to exchange, whether based on border tariffs or on regulations, and whether truly inspired by protectionism or only consequent on the side effects of unrelated policies. Similarly, they have no patience with the distortions of competition generated by state aids, tax holidays, etc. and are thus defending the enactment and enforcement of rules that will ban these instruments typically used by subcentral authorities.⁷ This, in a sense traditional, conception of competitive markets implies that very little leeway may be left to politically decentralized government.

⁵ Richard Bird and François Vaillancourt (2005, p. 36) note: “It should be understood that Canada is not, and never has been, a full internal common market. There has been a long tradition of accepting that provinces not only may have their own economic policies but can and do sometimes implement them in ways that reduce national economic efficiency.” And (p. 37): “Regulatory federalism in Canada... does not easily fit the Weingast (1995) conception of “market-preserving federalism”. The “competitive” sub-national governments envisaged in that framework may have a substantial regulatory role, but they are assumed to exercise that role within a common market enforced by the federal government to ensure nation-wide free markets and full mobility of factors, goods and services. In many fields,..., Canada’s federal government either cannot exercise such a role or has chosen not to do so.”

⁶ In Canada, negotiations of that kind, addressing only a subset of impediments to trade and distortions of competition, led to the “Internal Agreement on Trade” signed by the provinces and territories in 1995.

⁷ See Mueller (2000) for a more sympathetic political economy analysis of State aids.

Thatcherism displayed this logic within the United Kingdom. It increased the political centralization of an already centralized country. But the logic is illustrated more strikingly at the level of the EU. Although highly suspicious of any step toward more integration, their conception of a competitive market led Thatcher herself and her successor, John Major, to accept and even favour, as far as the internal market was concerned, increased powers at the Brussels level. Because most policies have a bearing on the internal market, this has allowed more centralization at the Brussels level than one would have expected from the position of Thatcherism on European integration in general (Salmon 2003).

2.3. Discussion

Over time, it turns out that the New Federalism of Reagan brought no major change. In a sense, it achieved less than the initially less ambitious New Federalism of Richard Nixon (see Pierson 1994). Similarly, political centralization in Britain under Thatcher was only a modest accentuation of a system of government already centralized. Some substantial retrenchment of the state did obtain in the United States but this had little to do with decentralization. The most durable consequences of the views of British Conservatives on the question of markets were observed in Europe, where, especially with the Single Act, they contributed to increased centralisation in Brussels.

Weingast illustrated “market preserving federalism” with the experience of the United States in the nineteenth century but also with the system currently in place in Communist China. But it is interesting to note that, later, there has been a shift in his arguments. In his more recent writings (e.g., Jin, Qian and Weingast 2005, Weingast 2009), pro-market policies are no more in the fore. They are subsumed under pro-growth policies. Decentralization is claimed to be an essential component in the economic success of the Chinese system because, in that system, subcentral governments are given a large share of the surplus generated by growth. Given the observed growth, this distribution of the surplus may be claimed to provide sub-central governments with a financial incentive to adopt pro-market policies if one thinks that pro-market policies are mainly responsible for economic growth. If one has a more qualified or hesitant opinion, the incentives given to these governments by the distribution of the growth surplus may still be deemed important by inducing them to adopt the policies that they think best for growth, whether or not these policies are pro-market.⁸ The argument does, however, reflect a continuing distrust of central government. As noted by Treisman (2007), the implication of a larger share of the surplus given to the subcentral jurisdictions is a smaller share retained by the central government, whose incentives to adopt pro-growth policies are, following the logic, diminished as a consequence.⁹

⁸ As Weingast (2009) writes: “Whatever the goals of subnational officials, greater revenue relaxes their budget constraint, allowing them to further their goals.”

⁹ If there is no reason to distrust the central government more than the subcentral ones, one may interpret Weingast’s financial incentives approach as relevant not for the justification of political decentralization but for the way financial resources should be shared in an already existing decentralized system.

The literature relating the degree of political decentralization or centralization to economic systems and their performance, in particular economic growth, is not limited to the authors cited. There is a significant volume of empirical work, whose conclusions are not, however, very illuminating. A question which has recently emerged, with a tribute to the early contribution of William Riker (1964), is the possibility that the political party system – in particular whether it is itself centralized, as in China, or decentralized, as in Russia before but not since Putin -- may play a role in the comparative performance of institutionally decentralized systems (Blanchard and Shleifer 2001, Enikolopov and Zhuravskaya 2007). This could be related to the distinction, central in Treisman (2007), between administrative decentralization and political decentralization. But the meaning of political decentralization or centralization under dictatorships or authoritarian regimes needs more thought than it has been given so far.

The literature stressing the benefits of mobility-based competition may be called *a-democratic* in the sense that, in most of it, votes -- or, more generally, consent (Breton 1996) -- do not play a very significant or very explicit role. The question of whether governments at the different levels are democratic is implicitly treated as secondary. Glossing over the distinction between democracies and dictatorships may be convenient inasmuch as it increases the scope or applicability of the analysis, especially when its main concern is development. But, in particular with regard to the effects of decentralization in the rich, industrialized countries, the neglect of democratic mechanisms constitutes a weakness of the approach -- a serious one in the case of the earlier literature, a more easily rectifiable one in the more recent work. As has been often noted, not only “bad” policies may be eroded by mobility-based competition, but also “good” ones (the “race to the bottom” possibility). But this is a normative or prescriptive argument. From a positive economics standpoint, what counts is that, in democracies, mobility-based competition may potentially erode or endanger policies to which the population is strongly attached -- and this whether we, as observers, choose to deem these policies “good” or “bad”. As a consequence, some forms of decentralization may be politically unsustainable. The *a-democratic* characteristic just noted leads to the neglect of this essential point.¹⁰

In the developed countries, democratic mechanisms interact with the necessity, less constraining in the American context than in the British one but operative nonetheless, of limiting the magnitude of non-tariff barriers and spatial distortions of competition. The democratic setting implies that, if they are given the power to do so, subcentral governments will respond to the demands of the population by adopting policies whose side-effects may cause such impediments and

¹⁰ The point is relevant also, to some extent, to non-democratic settings (provided they are not of an extreme variety as is the case currently of North Korea). In all political regimes, office-holders typically seek some consent from the population. Consequently, if decentralization in China is considered to have played a large role in the performance of that country this may be, in part at least, because the way it has been implemented has ensured that governments or authorities at all levels have received some consent on the part of the population. This argument is not incompatible with the stress put on the distribution of the growth surplus because it is possible that part of this surplus is used to gain the consent of the local population – which may compensate for some popular policies being eroded by mobility-based competition. For this to be investigated, an explicit acknowledgement of the relevance of democratic or quasi-democratic mechanisms would be needed however.

distortions. Admittedly, mobility-based competition will make some of these policies impossible or costly, or will limit their magnitude. The courts may also restrict some policies. But other policies, demanded by the population or a segment thereof, will remain legally accessible to the subcentral governments and will be implemented by them in disregard of the side effects. To respond to the public's demand and at the same time avoid the side effects, the only solution will be the adoption of the policies by the central government itself.¹¹

There is no incompatibility between taking into account the democratic dimension of governance and sharing the view -- essential to Public Choice -- that voters are at a disadvantage because of information asymmetry. To assess many kinds of public policies, voters do not have all the information that office-holders detain and they cannot rely completely on what they are told (not only by incumbents and other candidates, but also by interest groups). In a world exposed to rapid historical change and various kinds of shocks, the obstacles voters encounter in many policy areas to assess the performance of government are substantial. The fact that some information is available to voters from outside the jurisdiction makes a difference, however. No such possibility is taken into account in the world implicitly assumed by much of the Public Choice literature. This is one of the two major reasons why that literature displays such scepticism with regard to the democratic dimension (the other reason being the logic of voters' rational ignorance, whose significance in practice tends to be exaggerated). In a political universe supposed closed to information from outside, office-holders transact with interest groups and/or keep some resources for their own discretionary uses. General interest objectives such as economic growth are sacrificed. Once informational openness is acknowledged, things change. As argued in Salmon (1987), comparisons by voters between what obtains in their jurisdiction and what happens in others may reduce information asymmetry. In turn, the fact that office-holders are aware of the existence or possibility of these comparisons affects their decisions. If pressed by electoral competition, they want to be judged as performing comparatively well. This is the basis of what has been called "yardstick competition" among governments, which, under favourable circumstances, may strengthen the right kind of incentives in governments (not only the politicians in office, but also, indirectly, the bureaucracy, the legislature, the courts, the political parties, etc.). For these comparisons to be at all possible, the simultaneous existence of several governments is necessary. Federalism and political decentralization imply such simultaneous existence and consequently offer a way to make office-holders more accountable.

If, because of yardstick competition in particular, voters are better informed and office-holders are more accountable to voters, there will be less possibility of discretionary behaviour, and thus

¹¹ As Susan Rose-Ackerman wrote in a book published in 1991 (cited in Breton and Salmon 2001), the response of the Reagan administration "to the growth of state regulatory activity was to propose preemptive regulations in such areas as nuclear power, trucking, state workfare, drug labeling, products liability, coastal zone management, taxicab licensing, affirmative action, the minimum drinking age, and the transport of hazardous waste." She adds: "According to one study, ninety-one explicit federal preemption statutes were enacted during the two Reagan administrations. These statutes represented 25 percent of all federal preemption laws enacted since the founding of the republic. This seems an odd outcome to emerge from an administration supposedly committed to the "new federalism" of increased state authority".

less governmental or bureaucratic slack and more alignment of public policies with what voters want. Do such effects of yardstick competition when it works well (not always the case) have a bearing on economic governance or systems? The fact that distrust in government is less justified does not by itself mean that markets must be less trusted. Only if distrust of government was an essential ingredient in the case for markets would the improvement in accountability of government have an effect on the economic system in the direction of less reliance on markets. On the whole we can consider analyses based on competition among governments of the yardstick competition variety as neutral with regard to the economic system. Decentralization, by allowing yardstick competition, may improve governance but this can affect the degree of reliance on markets in any direction.

What complicates the matter is that yardstick competition among governments may also play a role at the international level. The comparative performance involved in the mechanism may concern countries rather than sub-national jurisdictions. Suppose for a moment that accountability concerns only one variable or dimension. Inasmuch as international yardstick competition improves the accountability of office-holders and thus the quality of economic governance in a country, this makes it less likely that decentralization in that country and the yardstick competition among subcentral governments that ensues will be as accountability-enhancing as it would have been if the country had been closed to international flows of information. This means, in this single dimension case, that yardstick competition processes at the different levels are largely substitutes. As already argued in Salmon (1991), a small informationally open economy will typically not gain very much in terms of accountability of its office-holders by adopting a federal and decentralized political system. In a large, relatively closed economy with regard to information from outside, such adoption may improve accountability more significantly. If, more realistically, we assume that the governmental performance is assessed along many dimensions, there is a role for yardstick competition to play in a complementary way on several governmental tiers as well as internationally. This may in particular mitigate the consequences of the problems of measurement raised by multi-tasking. Urban policies are likely to be central in the comparative assessment of local authorities by voters, whereas economic growth performance is a particularly suitable object of international comparisons. Comparisons of growth rates or income per head will give central governments an incentive to ensure that the national economy does not fall behind, whether or not the governmental system is decentralized.

To conclude this section, the design perspective, although it is adopted by many scholars, does not seem particularly fruitful for the purpose of relating degrees or forms of political centralisation or decentralization, on the one hand, and economic systems or systems of economic governance, on the other. There is a temptation to elevate the Chinese experience of decentralization-cum-centralization into a model or blueprint which could be provided to all developing countries. The large differences between the choices made by Reaganism and Thatcherism, or by India and China (Singh and Srinivasan 2006, Singh 2007), suggest that no

model or experience endowed with some generality is available. The variables considered so far stand in relations of complementarity with many particular characteristics of countries, many of them of a non-economic kind. Does this mean that nothing a little general can be said, and that in each country the idea of some inspiration stemming from the observation or analysis of arrangements adopted abroad is meaningless? The process perspective, to which I now turn, may offer a relatively less discomfoting answer to these questions.

III. The process perspective

After some general remarks on the process approach to reforms, and then on how decentralization may be integrated into it, I explore in a third subsection the possibility of explaining variations in decentralization as open-ended reform processes.

3.1. General remarks on reforms as processes.

The process dimension of economic reforms has been an object of serious study in economics for a long time now.¹² Although political processes are discussed as central elements in most of the contributions, the authors of these contributions are seldom public choice scholars in a strict sense. Their interest in reform typically stemmed from an interest in economic development, international economics or the conversion to capitalism and market economy of the former Communist countries. Whatever its merits, the work done by these economists over the last decades is no substitute for the contributions made, over a longer period of time, by political scientists, sociologists and historians. The remarks that follow concern the whole literature, not only the part which can be ascribed to economists.

A first remark is that the degree to which the process perspective departs from the design one is variable. In the case of many contributions, the reasoning supposes that the end state of the process is well known. The question studied may concern the mechanisms which delay or prevent the passage from the status quo to a state deemed preferable. Or it may be about how to organize the transition from one state to another. In particular, should the transition take the form of one big, encompassing, “jump” or should it consist of a sequence of piecemeal reforms? The design perspective may be relevant also to characterize the process itself, for instance to specify the sequence of decisions which will ultimately lead to the end-state. However, with some authors -- Gerard Roland (2000), *e.g.* -- transition is understood in a way that gives less room to design and a greater role to uncertainty and experimentation.

¹² A volume including many seminal contributions is Sturzenegger and Tommasi (1998). See also Rodrik (1996).

A second remark is that economic systems are always evolving. Thus many reforms are relatively small-sized, with a limited scope, concerning only a segment or single characteristic of the overall economic and social system.¹³ They often prove more successful and durable in the end than more visible and ambitious ones. The New Deal, the reforms undertaken by Reagan and Thatcher, or by Mitterrand in 1981 are large-scale reforms (if obviously less large-scale than the reforms implemented in the former collectivist systems). In democratic settings, this type of reforms usually requires an “authorization” by voters (Keeler 1993). Some typical characteristics of these authorizations are worth noting:

- they are conceded to national governments rather than to regional or local ones;
- they follow a sentiment of crisis, a growing awareness of serious underperformance and/or general acquiescence to the inevitability of yielding to external constraints (to obtain financial support, e.g.);
- they are particularly powerful when reforms are expected to follow rapidly a clear-cut electoral victory and had been properly announced before the election.

Franklin Roosevelt, Thatcher, Reagan and Mitterrand clearly got authorizations of that kind. A counter-example is Jacques Chirac in 1995. Once elected, he attempted reforms that were almost the exact opposite of what he had announced and he lost the legislative election of 1997 largely as a consequence.

3.2 Introducing decentralization

Decentralization and federalism occupy a relatively secondary place in the literature on reforms as processes. A question which has not lacked attention, however, is: does existing decentralization or federalist features of the political system make the process of reform slower and more difficult? The immediate answer to the question is that they do (Treisman 2007). In the language of Tsebelis (2002), decentralization and *a fortiori* federalism increase the number of “veto players”. This may occur at the level of the subcentral governments if their acquiescence or cooperation is needed, either to enact the reform or to implement it once enacted. It may also occur at the central level inasmuch as the subcentral governments are represented there. This representation may be official as is the case with the Bundesrat in Germany (as was also the case of the Senate of the United States until 1909) and, if we extend our reasoning to the EU, with the Economic Council and the Council of Ministers in Brussels. But the representation and veto powers may also be *de facto*, as is the case with the senates in many countries (the United States after 1909, Switzerland or France, for instance.). A particular mechanism is the “cumul des mandats” in France: most members of the two houses of parliament and many ministers are also elected officials in subcentral governments

¹³ An interesting collection of case studies of such reforms and a convincing systematisation inspired by them are offered in the volume produced by Boeri *et al.* (2005) for the Rodolfo DeBenedetti Foundation.

(mayors of large cities or presidents of regional or “general” councils, in particular). This gives these governments a *de facto* representation in the central institutions and a degree of veto power, particularly likely to be employed whenever they are concerned in one way or another by a planned reform.

The blocking powers of veto players should not be exaggerated, however. Their main effect is to impose negotiation, side payments and compromise. Some politicians are better than others at dealing with veto players. According to Pierson (1994), Nixon and his own brand of “New Federalism” were more successful than Reagan and his scheme because Nixon found ways to gain the acquiescence of the states. Veto powers, like the rule of unanimity where it applies, are likely to slow down decision-making, change and reforms processes but seldom to block them (see Salmon 2004 for an elaboration of that argument in the EU context). The likelihood that veto players will be unable (or unwilling) to block reform is greater when the authorizations and mandates given by the electorate are particularly clear and strong. According to Bruce Ackerman (1993-2000), “We the people” mandates occurred rarely in the history of the United States but when they did occur their strength proved overwhelming, including over veto powers related to federalism.

An additional remark is that decentralization may weaken the blocking capacity of players situated at the centre of the system, in particular the central bureaucracy and the national lobbies (we return to that in the next subsection). And another remark is that slowing change and imposing negotiation and compromise may make reforms more durable and their reversal more difficult (see Salmon 2004 in the EU context).

A second question raised by the introduction of decentralization in the discussion of reforms as processes is the role that decentralization or centralization programmes play in these processes. A distinction between the course initially planned and how things turn out may be useful at this stage. With regard to intentions and endeavours, it seems clear that centralization was instrumental to the New Deal programme, particularly in its spending and regulatory dimensions. As we saw, decentralization and centralization were also instrumental in Reagan’s and Thatcher’s programmes. In the former, decentralization seemed a good way to deregulate, reduce spending and, most importantly, curb the bureaucracy in Washington. For Thatcher, centralization was meant to facilitate privatization, especially given the local positions held by the Labour Party, and to promote a competitive market economy. In the platform put forward by Nicolas Sarkozy in 2007, it seems that the modest attention given to the matter of decentralization was inspired mainly by the central objective of reducing public spending. In these different cases, albeit to a varying degree, changing the degree or the form of decentralization is clearly an instrument to facilitate the main reforms, which have other objectives.

In other instances, the association of decentralization or centralization with economic reforms is dictated by considerations of coalition building or of getting voters’ “authorization”. The question of centralization or decentralization is, so to say, “orthogonal” to the reforms themselves. This is the

case of the Mitterrand reform of 1981. Decentralization was necessary not to implement or facilitate the main programme but to get the support of fractions of the Socialist Party led by Gaston Deferre and by Michel Rocard. In a similar way, with some differences related to the political setting, the reform programme announced by Silvio Berlusconi in 2008 had a decentralization dimension that reflected the necessity of getting the support of the federalists of the League. The matter is more subtle in the case of the centralization process at work in the EU. Centralization is required both by the logic of the change in the economic system (establishing a unified regulatory space to “complete” the internal market, especially with regard to services) and by the necessities of coalition building (Salmon 2004). Finally, decentralization may become necessary for coalition building outside any context of large-scale economic reform. Canada and Spain illustrate that possibility, which lies outside the scope of our discussion.¹⁴

When it is instrumental, has the variation in decentralization helped achieve the main objective? A brief answer is: “yes” in the case of the New Deal, notably because centralization has benefited from a “We the People” authorization; “yes” again in the case of Thatcher, because the centralization has crushed the opposition to reform of the Labour-held local authorities; and “not really” in the case of Reagan, the substantial deregulation which was achieved owing little to decentralization. Mitterrand’s overall reforms collapsed rapidly independently of the decentralization which was implemented concurrently and which did prove durable.

3.3. Variations in decentralization as open-ended reform processes: a tentative hypothesis.

Treisman (2007) concludes as follows the chapter of his book in which he reviews the empirical work published on the effects of political decentralization: “To those convinced that theory in this area implies almost no general effects, the weak, partial, and inconclusive flavor of the empirical literature is not puzzling at all. It is what one would expect”. At some level of generality, I think that we may agree with that assessment. There is no compelling reason to predict that countries that are more decentralized – or, for that matter, centralized -- will be found to have a better economic system or a higher rate of economic growth. It will all depend on many idiosyncratic characteristics of the country. In some cases decentralization will be complementary with the way the market functions, and the association of both will be efficient or growth enhancing. In other cases, centralized governance will prove more appropriate. The combination which works best in France or Japan, given the traditions of the countries, the way their elites are educated, the mentality of their citizens, etc. may be different from the combination which works best, say, in Canada or Switzerland. Consequently, it is not surprising that empirical work does not uncover robust relations

¹⁴ On the political decentralization associated with the Spanish transition to democracy and the way it was reflected in the Constitution of 1978, see Brennan and Casas Pardo (1991).

between these two sets of variables (economic performance and the state of political decentralization).

The matter is somewhat similar to the question of whether we can derive robust results from theorizing about the organization of business firms. In spite of a huge literature and much work of the highest quality, little can be said with real confidence about what structure of the firm or of organization of its management will prove, in a general way, most efficient or most favourable to profits, growth, survival, or the welfare of its various stakeholders. A conjecture may be formed, however, that a given business firm, in a competitive environment, will have some incentive to adopt the form of management and control which is the most appropriate to its particular circumstances, or at least that it will have an incentive to change the arrangements in force if they turn out to be seriously deficient or unsatisfactory along some dimension deemed essential. This will necessarily follow a trial and error pattern -- or, in the language of Karl Popper, a conjecture and refutation pattern. Of course, many *caveats* come to mind: irrationality, intellectual fads, personal interests opposed to "the interest of the firm", path dependency, and so on

In a similar vein, if we can assume that, as an effect of yardstick competition at the international level or for some other reason, national governments are not wholly inefficient, we may form the conjecture that, if they can, these governments will vary the degree or the scope of decentralization to improve the country's performance when it is found particularly deficient. They may do that in particular domains (health, education, culture, etc.) or more broadly. Again, this will follow a trial and error, or conjecture and refutation, pattern; and many *caveats* should be introduced (influence of fads, the World Bank, selfish calculations, and so on).¹⁵ Instead of the usual cross-section analysis relating states of decentralization and performance, our reasoning suggests focussing on the relation between *changes* in decentralization and either *levels* of performance or *changes* in these levels, these variables being measured in absolute or preferably comparative terms by experts. To make the suggestion somewhat more precise (at the cost of making it even more tentative), let me formulate the following hypotheses:

- H₁: some of the observed positive or negative variations in the degree of decentralization in country *j* are explained by observed (comparative) underperformance;
- H₂: some of the observed positive or negative variations in the degree of decentralization in country *j* are followed by an improvement in observed (comparative) performance.

¹⁵ Although they do not refer to yardstick competition and do not focus on economic growth or performance, a fallibilist perspective in the spirit of Popper apparently underlies Bird and Vaillancourt's analysis of the vagaries of intergovernmental arrangements in Canada when they write: "'Muddling through' may not only describe how Canadian federalism has to date dealt with changing times: it may also...describe the best way in which fallible people – let alone fallible politicians – have yet developed to cope with the complex reality of managing a multi-ethnic federal country in a globalizing world." (2005, p. 39).

The hypotheses could concern macroeconomic variables like the rate of economic growth or sectional ones like education or health. All this is clearly in need of much elaboration (see Salmon 2010 for a small step in that direction). For the time being, I will limit myself to three remarks.

First, the same empirical hypotheses could be derived from a different but related mechanism, even more distant than the foregoing from any notion of design. Many years ago, Mancur Olson (1982) stressed the negative effect on economic performance of a slow process in which collective decisions are progressively captured by the increasing number of interest categories which manage (in spite of the logic of free riding) to mobilize themselves into organized pressure groups. If unchecked, this process tends to generate over time a sclerosis of the economic system. Ronald Wintrobe and Albert Breton (1986) proposed a mechanism based on the accumulation of trust that may lead to a comparable result. According to Olson, a positive side effect of major disruptions such as revolutions and wars is that of destroying the mobilization underlying the organization of the pressure groups and thus the basis of capture itself. Thanks to the disruptive events, the economy is liberated and can grow again or more rapidly. Drawing some inspiration from the story, we may form the hypothesis that governments can change the decentralization arrangements just for the sake of disaggregating networks that are a cause of persistent underperformance. For instance, if decision-making on education is concentrated at the level of the central government and is captured by a coalition of education officials located at this level and unions, transferring competencies in that area to a lower level of government may be a way to destroy the network and improve performance in education – and as a consequence, if that area is deemed important, performance of the economy as a whole. Or it may be the other way around – that is, transferring the competencies from the lower tiers of government to the higher tiers may do the job. A strategy of this kind may underlie in some cases the empirical hypotheses mentioned above. And its repetition could also account for a more extended sequence in which decentralization and recentralization are observed to alternate -- although such observation might simply reflect the trial and error pattern mentioned earlier.

A second remark is that the scepticism expressed in the last section about analytical systemic “models” of the relationship between governance and decentralization does not extend to the role of models of the same relationship in the perceptions and decisions of office-holders and voters. The Chinese experience is certainly a source of inspiration to many other countries, but the way it is interpreted and transposed to the setting of any one of these countries should be seen as part of the trial and error process mentioned above. Under a Popperian or quasi-Popperian perspective, the way conjectures are formed does not matter as much as the way they are tested and rejected if necessary. Voters and office-holders seek and find their inspiration as they want (or can), and come to their own conclusions about what works and does not. This explains that countries may remain faithful to solutions that seem initially unorthodox but prove efficient with hindsight. *Mutatis mutandis* (because it is not a democracy) a case in point is China itself.

As a last remark, I must note that the same variations in decentralization and the same relations between them and performance could be the consequence, not of a deliberate policy by the central government responding alone to underperformance, but the effect of a dynamic version of the efficiency-enhancing vertical competition among governments analyzed by Breton (1996, 2006, *e.g.*). For instance, the underperformance of the overall governmental system in some policy area, might, in a context of competition for consent, trigger a response from the regional governments, or some of them, rather than from the central government, and this may eventually bring about a durable change in the degree of decentralization in that policy area or more broadly. The federal or unitary nature of the governmental system has certainly a bearing on the relative importance of processes of that kind and on the way they are to be specified.

IV. Concluding remarks

Large-scale reforms of the economic system typically occur in political contexts in which the central governments are authorized to reshape institutional arrangements concerning their relationship with subcentral governments. Actually, in democratic and rich countries at least, large-scale reforms of the economic system do not seem to have been accompanied by durable changes in these arrangements, the main exception being the New Deal. This might be somewhat surprising given the emphasis that the recent work on fiscal federalism puts on the effects on the economy of features of the institutional and political system related to centralization or decentralization. The problem seems to be that most of the literature addresses the relation between the economy and the institutions as a matter of design, subject to the usual treatment in comparative statics. Under that perspective, not much that is general has been established (except, perhaps, the proposition that there is no general significant effect of decentralization on the economy). A perspective in which changes in the economic system and/or in the state of decentralization are treated as processes seems more promising. Even though the state of political centralization and decentralization is very dependent on idiosyncratic characteristics of the countries, most of them of a non-economic kind, under that second perspective some hypotheses may be tentatively formulated about the relationship between the performance over time of an economy, or a subset thereof, and variations in decentralization.

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