

# Political Economy of Reforms

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# Overview

- My comments focus on reform of the federal system and the role of decentralization.
- Federalism is a key policy issue in many countries, including the United States and India.
- I will touch on two key issues in the debate over the design of federal systems:
  - the optimal assignment of responsibilities
  - the intergovernmental grant system

# *Economic approach to federalism*

## Advantages of centralization

- 1) Internalizing externalities
- 2) Greater ability to redistribute income
- 3) Economies of scale
- 4) Insurance against regional business cycles

## Disadvantages of centralization

- 1) Lack of experimentation
- 2) No Tiebout competition
- 3) Policy uniformity

# *A political economy approach*

- Instead of assuming policy uniformity, a political economy approach accounts for bargaining between jurisdictions under centralization.
- In this view, the chief drawback of centralization is the common pool problem, which follows from three features of legislatures:
  - 1) Locally elected representatives
  - 2) National taxation
  - 3) Localized spending
- Political misallocations may result. Under decentralization, by contrast, jurisdictions fully internalize such costs.

# *Evidence on common pool problems*

- Do legislators respond to these incentives? The opposing view is that political institutions, such as parties, internalize these fiscal externalities.
- In “Parochial Interests and the Centralized Provision of Local Public Goods”, I examine voting in Congress over a package of earmarks.
- I find that legislators respond to this common pool problem. Support for the package of projects is increasing in own-district spending but is decreasing in the overall tax burden.

# *Conflict between jurisdictions*

- This common pool problem creates a conflict between regions, which is often resolved in favor of jurisdictions with political power in legislatures.
- This may lead to a political misallocation with over-spending in politically powerful jurisdictions and under-spending in weak jurisdictions.
- I have theoretically and empirically investigated two sources of this political power:
  - 1) agenda control
  - 2) over-representation

# *The role of agenda control*

- In “Estimating the Value of Proposal Power”, I investigate the role of agenda control.
- In the U.S. Congress, committees have considerable control over legislative proposals.
- This agenda control leads to a spending distortion. In particular, districts represented on the transportation committee command a disproportionate share of highway projects.

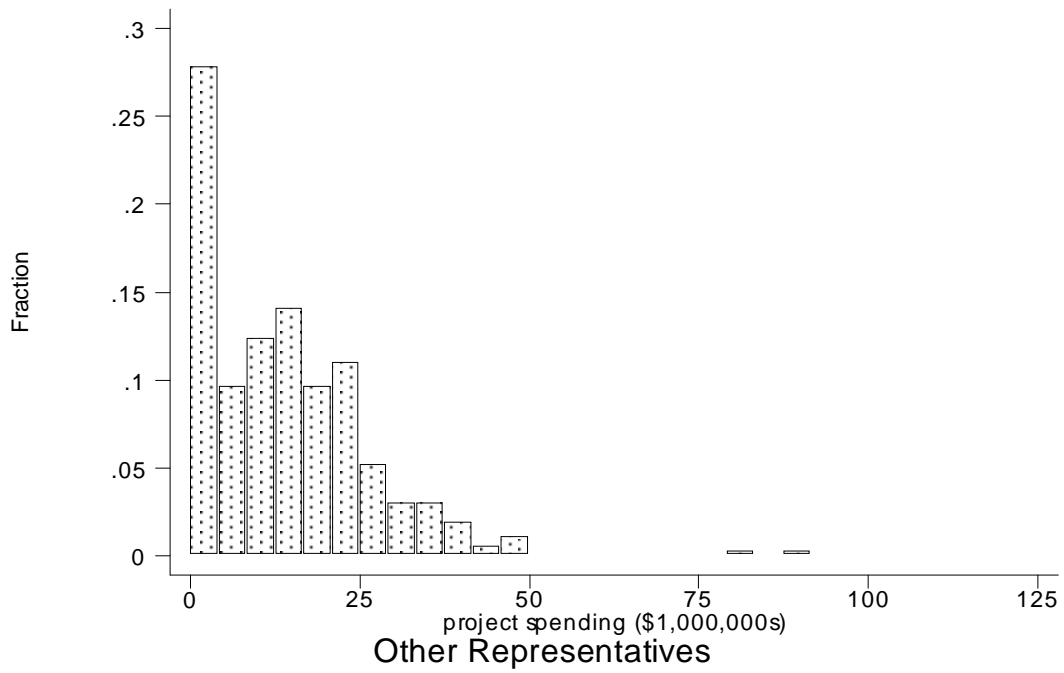
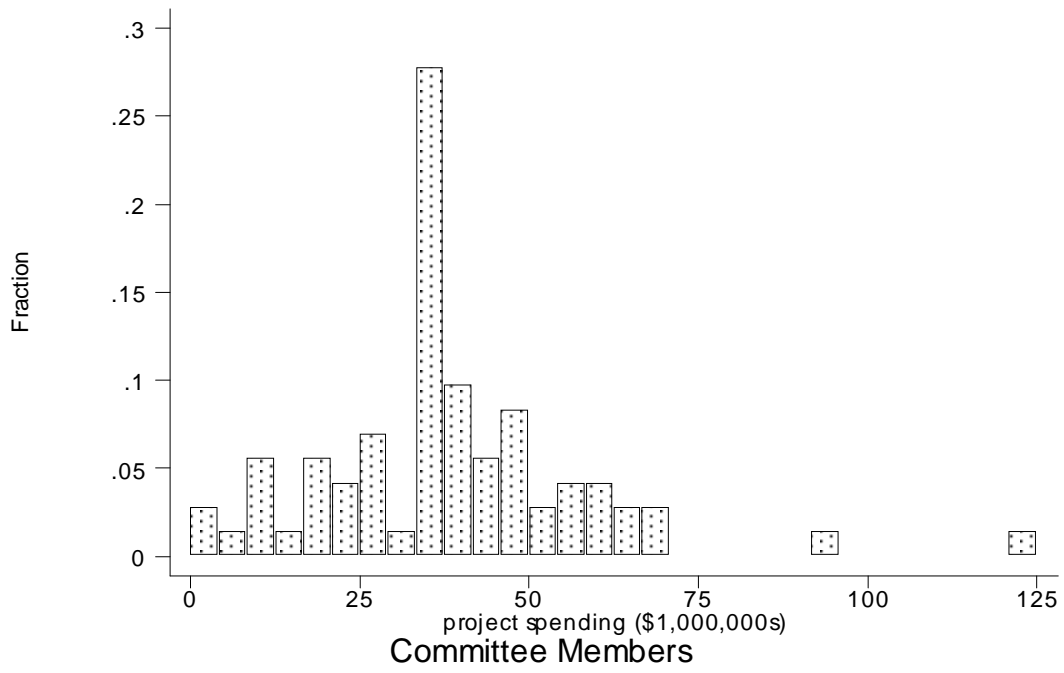


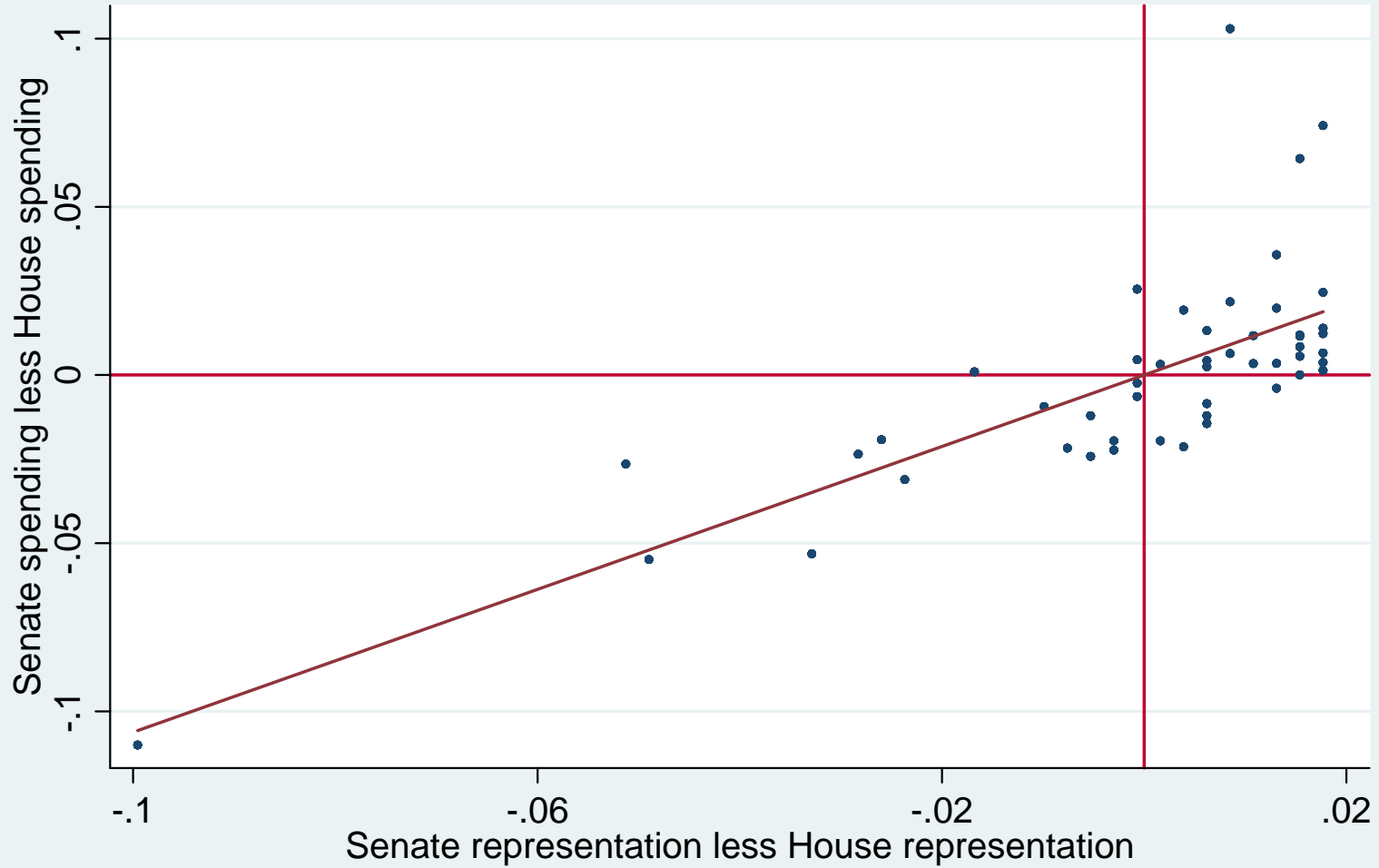
Figure 2: Distribution of Project Spending, 1998



# *The role of representation*

- How to represent jurisdictions of varying sizes in central legislatures and other organizations?
- Schemes include unit representation, such as in the U.S. Senate, and population-based representation, such as in the U.S. House.
- In “Legislative Representation and the Distribution of Federal Funds” I find that representation matters. In particular, small (relative to large) states receive more Senate (relative to House) earmarks.

Fig. 1: Representation and Public Spending



50 states averaged over time

# *Intergovernmental grant system*

- In federal systems, lower level jurisdictions often receive substantial revenues from higher levels.
- Economic models such as the median voter theorem predict that the receipt of grants should have only income effects.
- Evidence, by contrast, has shown a “flypaper effect”. That is, spending increases dollar-for-dollar with grant receipts.

# *Intergovernmental grant system*

- In “Endogenous Federal Grants and Crowd Out..”, I argue that the flypaper effect results from endogeneity problems.
- Using the power of Congressional delegation as an instrument for grant receipts, I find that federal grants crowd out state contributions to public goods.
- This suggests that central governments desiring to expand local services may need to introduce matching provisions into grant programs.