

Explanatory Factors of Fiscal Decentralization

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1. Introduction

Decentralization is in vogue. It has become a central concern around the world. Over the second half of the XXth century most Western European national governments undertook a process of institutional change which resulted in new arrangements regarding to the territorial distribution of power. As a consequence of this, new regional elected governments with executive and sometimes legislative powers have emerged (UK, Spain, Italy, France, Belgium, Portugal¹) or local governments (either in the county level or in municipalities) have been strengthened, in particular in the Scandinavian countries (Engel and Ginderachter 1993; Sharpe 1993; Wright 1984). But also other central governments around the world are decentralizing fiscal, political and/or administrative responsibilities. In developing countries we have the example of Moldova (IMF 1999 WP/99/176) which is currently undergoing a reform of its system of intergovernmental fiscal relations with decentralization to the local government; Uganda (Livingstone and Charlton 2001); Indonesia (Brodjonegoro and Asanuma; 2000); Philippines (Eaton 2001); in transition economies such as the Czech Republic and Slovakia (Bryson and Cornia 2000); and in South Africa (Ahmad, 1998). The creation or reinforcement of subnational levels of government took place together with a process of political and fiscal decentralization whose pace and depth have followed different patterns across countries. As far as fiscal relations is concerned, governments in countries traditionally highly centralized have undertaken reforms of its intergovernmental fiscal relations to a greater or lesser extent, depending upon the nature and the strength of the forces which lie behind the demands for increased decentralization (Bird, 2001).

It is important to note the term decentralization is not easily defined because this label encompasses a wide variety of institutional rearrangements. “*Decentralization seems often to mean whatever the person using the term wants it to mean*” (Bird; 1993: 208). Decentralization is a political reality worldwide that varies greatly among and within countries. For this reason, before making any assumption about this overwhelming process of institutional change it is important to distinguish about the different forms of

¹ Açores and Madeira have the statute of Autonomous Regions and their own power of taxation since 1976.

decentralization. This is especially important whether we want to account for the consequences of decentralization or we focus on its causal mechanisms.

According to Mills (1994), a first way of distinction about the different forms of decentralization is related to the characteristics of the units to which the power is transferred. *Internal* decentralization takes place when the units are part of the public sector while when power is transferred to institutions which are regulated by private law it is defined as an *external* decentralization. It is widely assumed there are basically four forms of decentralization (Eaton 2001; Bird 1998; Bird and Vaillancourt 1998). Within the internal decentralization category and according to the degree of local autonomy we find two types. First, the term ***deconcentration*** is applied to the transfer of some administrative responsibilities to lower units within the public sector hierarchy. It implies a very low level of local autonomy since the local units are accountable to higher levels. On the other hand, we use the term ***devolution*** when there is a major transference of political power (autonomy) to subnational units with respect to a defined set of functions. It usually implies the transfer of political and financial responsibility. The autonomy of these units is strengthened by the fact that the line of accountability is to the electorate. As far as external decentralization is concerned, ***delegation*** implies the transfer of managerial and administrative responsibilities to organizations and agencies that have a flexible link with the structure of the public administration so that central control is exercised indirectly. It may be identified with a principal-agent relationship. This form of decentralization has been often used to avoid the public administration regulations and bureaucracy as a way to increase efficacy. Finally, the most controversial form of decentralization is the transfer of a set of functions from the public sector to the private one. The most frequent form of this type of decentralization within the health care sector is the *contracting-out* of public services to private for-profit or non-for-profit organizations. When contracting-out also includes the selling of public centres and services to private enterprises, it is called *privatization*. When the public sector contracts-out some services neither juridical-administrative nor democratic controls are applicable so that accountability is exercised only according to the contract terms. A *corporatist structure* may also be considered as an external form of decentralization due to the involvement of organized interests in the policy

making process to the extent that it may replace parliamentary decision making with respect to some policies.

2. Research Question

Among the different forms of decentralization, devolution is the one that responds to the most complex causes since it implies a major modification of the *status-quo*. It is the most extensive form of decentralization since the (central) government transfers authority for decisionmaking, finance and management to quasi-autonomous units of local government (Bird 1998 WB: 7; Eaton 2001: 103). This study will focus on this form of decentralization because it involves the use of fiscal instruments to shift the responsibility among tiers of government. The political decision to devolve powers usually implies the transfer of fiscal capacities to subnational governments that are elected through democratic elections, that is, fiscal decentralization. The modification of the financial intertwining between different tiers of government means a change in *who sets and collects what taxes, who undertakes which expenditures and how vertical imbalances² are rectified* (Bird 1998: 7). Fiscal decentralization seems to be the most salient federal institution (Jan-Erik Lane and Svante Ersson), that is, according to these authors it is the most differentiating institutional arrangement between unitary and federal states. In addition, the importance of fiscal decentralization comes from a very intuitive argument: money matters because how it is raised, distributed and spent will be crucial to enforce political autonomy and to consequences with respect to its consequences on macroeconomic and equity issues.

Decentralization faces the problem of accounting for the complex rationale behind this process. The causal factors that explain decentralization are as varied as the decentralization design that stems from them and the way different decentralization dimensions interact may have an impact. The complex set of causal mechanisms that account for any form of decentralization exemplifies the problematic character of it and this complexity mainly comes from the context-specific nature and the multiple dimensions of decentralization. Its effects do not depend on decentralization *per se* but on the institutional

² Vertical imbalance is the difference between regional autonomy on revenues and expenditures. The higher the difference, the higher the vertical imbalance.

setting in which it takes place, which also affects the design of decentralization. As I already mentioned, it is very difficult to establish causal factors of so many institutional arrangements that the label “decentralization” encompasses. However, I specify a particular form of decentralization (devolution) with respect to a very specific set of responsibilities (fiscal responsibilities).

The main purpose of my research is to make a contribution to the understanding of the processes that lead to the establishment of new institutional arrangements, in particular it aims at explaining the rationale of devolution of fiscal policies. I would like to find out what explanatory variables lie behind an institutional change such as the establishment of new arrangements in territorial distribution of power over revenues and expenditures. Which are the causal mechanisms that account for devolution?. In particular, which are the explanatory factors that account for a modification in who sets and collects what taxes, who expends and how intergovernmental grants are established?. At first the process of devolution of power may be regarded as an irrational or non-intuitive process since it decreases the influence of national politicians over expenditures and revenues while subnational actors are endowed with independent authority over revenues and expenditures. In addition, as devolution implies the transfer of power to subnational actors that are independently elected, these have different political incentives than national politicians. They respond to different constituencies. After devolution it follows a period of uncertainty about the political and economic consequences of devolution, what makes the national policy-makers’ decision to devolve powers more puzzling. Why do politicians surrender power, then?.

The term fiscal decentralization also requires further definition. An intergovernmental fiscal system is usually described through the following questions (based on Bird and Vaillancourt): *Who expends the money?* (expenditure assignment) *Who levies what taxes?* (revenue assignment) *How is the imbalance between revenues and expenditures of subnational governments?* (the so-called vertical imbalance which is usually rectified with intergovernmental transfers) and *How fiscal institutions equilibrate for the difference in*

needs and capacities among government units at the same level of government? (the so-called horizontal imbalance which is usually rectified through interterritorial compensation funds i.e. the *Fondo de Compensación Interterritorial* in Spain or the National Solidarity Fund in Italy). Most authors refer to fiscal decentralization as the percentage of total government expenditure executed by subnational governments (considering the size and character of transfers); or the level of tax autonomy of subnational governments or both. The borrowing capacity of subnational government is also taken into account in some studies as a variable of fiscal decentralization.

3. Determinants of institutional change

The main purpose of this section is to present the different theories that account for institutional change. I am not so interested in the typology of theories but in the role of actors and forces that each one includes in the process of institutional change. This may give me some initial hints about the role of each participant in an institutional change. Since the mid-1980s, the literature that has dealt with institutions has been dominated by the “*new institutionalism*” approach. As Hall and Taylor (1996: 2) point out, the new institutionalist approach was a reaction to the behavioural perspectives to politics that had been prominent in political science during the 1960s and 1970s. The behavioural approach regarded political outcomes as the consequences derived of the characteristics shared by a group of individuals (social, cultural or psychological). In contrast, the new institutionalist perspective aimed at bringing the institutions back in. The two issues fundamental to any institutional analysis may be formulated through the following two questions: *how do institutions affect the behaviour of individuals?*. *And how institutions originate and change?*. For the purpose of this research project, I am interested in the theories developed with respect to the second question so that from here on I will mainly refer to the postulates of the schools of the new institutionalist though with respect to how institutions are created and modified, as this may help me to understand decentralization of fiscal powers.

There are three schools of thought within the hardly unified body of thought known as “*new institutionalism*” (Hall and Taylor 1994, 1996; Richard Scott 1995; Steinmo 1993; Rico 1998): *the historical institutionalism*; *the rational choice institutionalism* and *the sociological institutionalism*. The new institutionalism in economics is considered by some authors as an independent school of thought but in fact it overlaps with the rational choice school, as we will analyse further on. These schools of thought may be divided along two theoretical approaches: the *calculus approach* and the *cultural approach* (Hall and Taylor 1996:7). The first one establishes that the starting point from which institutions are created is the so-called Nash equilibrium. The same explanation is used to account for institutional persistence over time: individuals have no incentive to deviate from such institutional setting because it would make them worse off. I will further analyse this approach in the next section. In contrast, the cultural approach regards institutions not as the product of individual choice but as a collective construction that represents cultural symbols that are socially shared.

The historical institutionalism has traditionally been an eclectic school of thought since it has used both approaches to account for the two fundamental issues on institutions while the sociological institutionalism has been identified with the cultural approach. As Rico (1998: 72) points out “*The narrow association between institutional structures and national cultures is the main characteristic of new institutionalist theories that emerged at the end of the 1980s in the sociological field*”. Regarding institutional origins and change, both schools insist that new institutions are created or adopted within an already established institutional setting that influences the design of new institutions. From the historical perspective the role of power and in particular of asymmetrical relations of power are fundamental to account for the distribution of power among social groups over the creation of new institutions. In addition, the adoption of new institutions will take place within an earlier institutional structure that not only distributes power among actors but also limits the range of options for institutional change. The process through which earlier institutions shape/condition the development of new ones is known as “*path dependence*”. On the contrary, rational choice theorists account for institutional origin by reference to the value that actors attach to functions carried out by institutions that affect them. So institutional

arrangements are regarded as the product of a voluntary agreement between equal and independent actors that allows them to overcome a problem of collective action. The institution persists over time because it rests on an equilibrium out of which at least one actor would become worse off. The new economic institutionalism uses a very similar approach to the origins of institutions. Actors agree on new institutional arrangements (such as the establishment of property rights) whose functions are highly valued by them, in particular the decrease of transaction costs. From the sociological institutionalist perspective, a particular institution may be chosen out of efficiency considerations but taking into account the role of more irrational values, symbols and practices associated with culture. Unlike the rational choice approach, when an organization adopts or creates new institutions these may not be related to the specific functions of the organization itself (Hall and Taylor 1994:11) but might be adopted because they reflect a symbolic value that is culturally constructed and valued. For instance, as Soysal points out *“policies toward immigrants adopted by many states were pursued, not because they were most functional for the state, but because the evolving conceptions of human rights promulgated by international regimes made such policies seem appropriate and others illegitimate in the eyes of national authorities”* (Soysal 1994). A very important contribution of sociological institutionalism is it ends up with the traditional separation between institutions and culture as it defines institutions in a much broader sense than political scientists (Marcus and Olsen 1989). Institutions are not only formal rules and procedures that define the organizational relations but also they encompass symbol systems, cognitive scripts and moral templates that are socially constructed. In addition, sociological institutionalism arose as a reaction to the traditional separation between explanations about the social world based on a means-end rationality and those related to culture. For that reason sociologists of new institutionalism argue that while rational choice theorists might regard individual actions as the expression of an instrumental rationality; those actions are socially constituted through the use of shared attitudes or values.

There are some critics to the rational choice perspective on how institutions originate and change. First, as one may conclude from the explanation set above, they provide us a functionalist explanation. Rational individuals choose institutions according to the value

they attach to the effects that follow from the existence of that institution. In addition, with this functionalist argument they pretend to explain both origins and institutional persistence over time while there are reasons to believe they respond to different causal mechanisms. As Hall and Taylor point out “*because unintended consequences are ubiquitous in the social world, one cannot safely deduce origins (of institutions) from consequences*” (1996:19). In addition, the rational choice perspective assumes that the institutional creation process is under the control of equal and independent rational actors that are capable of predicting correctly the effects derived from the establishment of an institution. This approach overlooks many inefficiencies that institutions display and does not take into account the asymmetries of power that may exist among actors. Finally, if the starting point of a institution is an equilibrium similar to a Nash equilibrium it is difficult to derive any possibility of change.

To sum up, in order to account for the origin and change of institutions we could state that:

- institutional setting in which it takes places will have an effect over the process of institutional creation and modification. For instance, the earlier institutional structure may allocate asymmetrical power to the different actors so that it conditions the influence each one may exert in the process of institutional change.
- In the process of institutional change we can consider that actors' actions are goal-oriented but the range of options that actors canvass will encompass a specific set of values, symbols and interpretations that are embedded in the culture. So that the rationale of institutional change has more to do with a logic of social *appropriateness* (which takes into account the role of social legitimacy and collective processes of interpretation) than with a pure logic of instrumentality in which actor's preferences are given exogenously.

4. Literature on causes of Decentralization

So far most of the authors that have dealt with decentralization processes have treated decentralization as an independent variable so that the analysis have focused on the consequences of the territorial distribution of political and fiscal powers among subnational governments. In particular, consequences of decentralization have been fully studied with respect to macroeconomic aspects (subnational debts; deficits; government size; economic growth) or equity (regional disparities) (see West and Wong 1995). As far as macroeconomic aspects are concerned, the most-tested hypothesis has been Brennan and Buchanan's "*Leviathan hypothesis*" (see Rodden 2001; Stein 1999; Anderson and Van-den-Berg 1998; Grossman 1989; Joulfaian and Marlow 1990). Brennan and Buchanan belong to the Public Choice School and the central argument of their hypothesis is that public sector's size will be smaller the greater the extent to which taxes and expenditures are decentralized (*ceteris paribus*). As a consequence of fiscal decentralization there is tax competition among subnational units, which try to avoid the "exit" of "mobile" assets (capital) by lowering taxes³ (Rodden 2001). However, there is not neither theoretical nor empirical agreement with respect to the relation between decentralization and the size of the public sector and the same applies to the association between decentralization and the rate of economic growth. It is important to note that some theoretical arguments that focus on consequences of decentralization are also used to account for its *rationale* (causal mechanisms). For instance, one of the *expected* consequences of decentralization is to attain allocative efficiency; that is, subnational units are more capable than central governments to meet citizen's preferences and demands over public goods and services (Musgrave 1959 and Oates 1972, Tiebout 1956). However, as I will analyze in the next section, this argument is also used to account for the implementation of fiscal decentralization in some countries. What is important to stress here is that the line of division between causes and consequences of fiscal decentralization is blurred. In consequence, the analysis of causal

³ The same argument about tax competition is used by Weingast (see Garret y Rodden 2001) to link decentralization to market-friendly politics. With fiscal decentralization subnational units are forced to compete for mobile capital which prompt them to implement market-friendly policies.

mechanisms of decentralization will inevitably have to take into account decentralization outcomes in the set of explanations to account for decentralization.

Taking as a frame the general categories that Bukowski establishes in his article (Bukowski 1997: 82), next I present several explanatory factors that the existing literature identifies to account for all forms of decentralization.

- A societal reaction against political, administrative and economic centralism (see Aja 1999: 46 for the Spanish case⁴). This could be identified with a *bottom-up* approach (Bird 1993: 208) in which decentralization is regarded as a way to improve democracy by bringing government closer to the people and increasing their participation in the policy-making process. From this perspective decentralization is intrinsically valuable because it institutionalizes the participation of those affected by local decisions and strengthens local responsiveness and accountability. A “Northern model” may be identified in the initial steps of the devolution process in all Scandinavian countries since in all of them the principles of local democracy underlay the process of devolution, which aimed at bringing decision-making closer to people and promoting citizens’ participation at the local level. In addition, Bolton and Roland (1997) analyze in their article the regional conflict that arises from differences in regional preferences over fiscal policy. They present a “trade-off” between the efficiency a region obtains of being member of the State and the benefits associated to having a government “closer to the people”.
- Cultural, ethnic, linguistic and/or religious cleavages within the state (Van Houten; Gobetti; Sharpe 1993: 7; Lijphart 1994) seem also to be at the core of regional demands for greater political and financial autonomy. This is exemplified by the recent

⁴ “Forty years of dictatorship put to an extreme the centralization of the State so that the recuperation of democracy had necessarily to incorporate a drastic change in the territorial structure of power. During the transition to democracy, the autonomy was regarded as an essential democratic demand in Spain” (Aja 1999: 46)

devolution processes in Italy (Gobetti); Spain and South Africa (León, 2001:2); and Belgium (Van Houten).

- The expansion of the public sector and the increasing state intervention on economic and social policies give rise to new functional requirements that the structural capacity of the State is no longer able to cope with so that it has to transfer responsibilities to lower levels of government (Sharpe 1993). Decentralization is regarded as a method of improving administrative efficiency and the machinery and efficacy of economic planning. This functional perspective has mainly come from the school of *interorganizational theories* that was predominant in the literature on institutional change during the 1980s. From this approach, decentralization is the functional response of elites as a method of solving the tension between new organizational requirements and institutional capabilities. A good example of this perspective is the set of studies edited by Dente and Kjellberg (1988), who in the introduction state that “*the transformations of local authorities are clearly in relation to the increased functional scope of contemporary states, the rise – and the possible fall – of the welfare state*” (p. 15). This group of theories have been highly criticised because they take institutions as given and do not take into account relevant factors that have had a prominent role in shaping institutions such as cultural factors (values and ideas) and the role of political actors (political parties, social groups, interest organizations). They normally introduce a wide range of structural factors (distribution of formal power derived from institutions or material resources of social groups) as explanatory variables that seem isolated from individuals - who play a very secondary role in their work - as relevant actors that with their preferences and strategies promote an institutional change (Rico, 1998: 68).
- There are other arguments that associate decentralization with periods of economic crisis and cost-containment policies (the so-called “*decentralization of penury*”). As Engel and Ginderachter (1993: p.18) argue with respect to welfare state policies, during the 1980s the expansion of welfare policies came to a halt and governments had to implement cost-containment policies in order to balance public budgets. Decentralization of the public was regarded as a way to implement flexible adjustment,

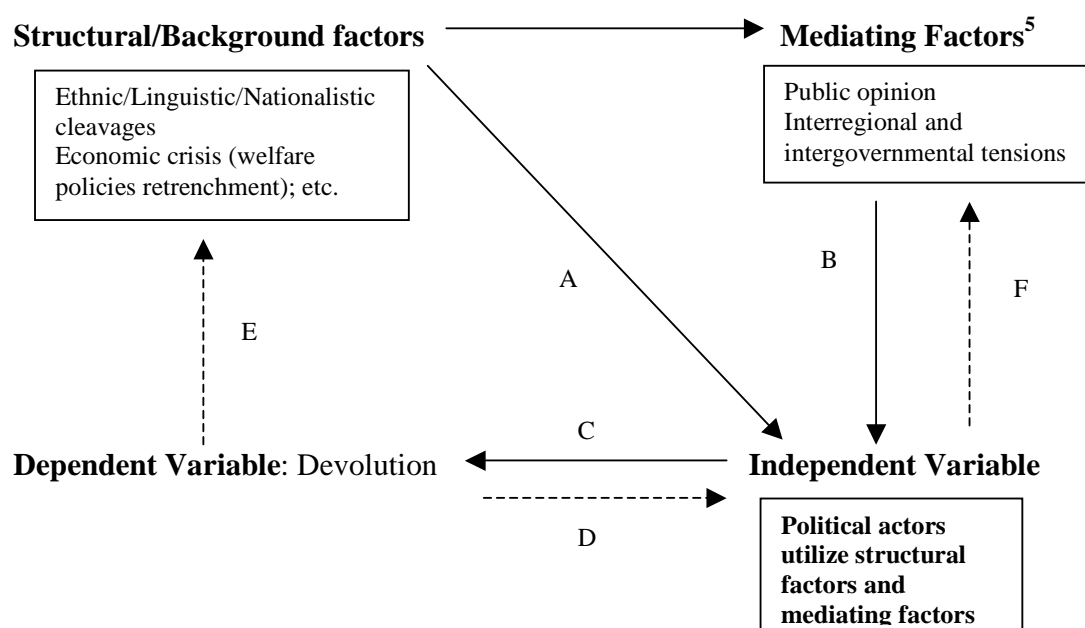
by devolving responsibilities of maintaining tight economic policy to subnational governments. For instance, Denmark and Finland represent a very good example of such policies. Hansen and Pallensen (2001 p. 618) investigate how the decentralization of the public budget in Denmark between 1982 and 1993 was used by the central to maintain economic restraint so that it could stick to a goal of zero growth in public expenditure. As for Finland, in 1993 (a period of severe economic crisis) the central government changed the basis of state subsidies from earmarked to block grants, giving municipalities more independence in using resources. At the same time the central regulation became less detailed in order to allowing for different local solutions. This devolution permitted advancing deregulation and distancing the national government from the implementation of cost-containment policies in a period of economic recession. In sum, national politicians “got rid of the burden of the accountability” (Häkkinen and Lehto 2002 :8).

In spite of this set of explanatory factors there is a lack of a coherent approach to study the phenomenon of decentralization. As Rico (1998:5) points out “*the institutional reforms of the welfare state have been investigated by the sociological and political science field (...). However, there is no an adequate explanation of the territorial decentralization of power*”. As we already pointed out, the difficulties come from the fact that neither not all those causal explanations will be relevant in any one country nor will they be equally important for all the actors that participate in a devolution process. That is to say, difficulties come from the context-specific character of decentralization. The main purpose of this study is to systematize the array of factors that are used to explain the rationale of fiscal decentralization by taking into account the role of actors, their preferences and strategies. So the approach will try to go beyond the functionalist and elitist theories that have predominated in the literature about the devolution of power and intergovernmental relations. In the next section I will present the first outline of the explanatory model for decentralization.

5. A first outline of the explanatory model

In the next figure I present a model of the interaction of explanatory factors of decentralization based on the model that Bukowski (1997: 98) constructs to account for the causal factors in the redistribution of authority (centralization and decentralization).

Figure 1. Interaction of explanatory factors of fiscal decentralization



The main purpose of my analysis of explanatory factors is to concentrate on arrows A, B and C. That is, I will focus on how the political actors at different levels include the conditions created by background factors and mediating factors in their particular political strategies that prompt subnational actors to demand fiscal autonomy and national actors to decentralize them. As I already mentioned, most of the studies that have dealt with

⁵ Mediating factors include public opinion or society reaction to structural factors. For instance, society may become highly divided due to a nationalistic cleavage (some social groups promote nationalist demands while others mobilize against them). In addition, demands of regional leaders can also rally public opinion and increase societal reaction to background factors (a reciprocal effect that is reflected in arrow F in figure 1). Another example of mediating factors is how territorially-based economic differences (a structural factor) affect the relationship between subnational governments and between them and the central government (for example, poorer regions may demand more intervention to central government policies while rich regions may demand more autonomy).

explanatory factors in the decentralization process have introduced structural factors as explanatory variables without taking into account that these factors *per se* do not prompt any institutional change. Instead, they remain as potential factors of change until political actors use the conditions created by them to make a political decision that in our case of study implies the decentralization of fiscal powers to subnational levels of government (a relationship that is represented in arrows A, B and C).

Then, for now on I will focus on political actors. As a very preliminary statement in the model, I consider that the decision to devolve powers to subnational actors is the prerogative of national policy-makers. Second, I exclusively will refer to democratic governments since it is under such political regime that the process of devolution to independently elected subnational units is feasible. Third, national policy-makers will decentralize if and only if:

Benefits of decentralization > costs of decentralization

With respect to the benefits of decentralization I need to differentiate between short-term considerations and long-term considerations. At this stage of the analysis I doubt which one of them will predominate in the decision to devolve powers.

Long-term calculations – when politicians decide to cede some of their powers in the short term in order to improve their overall position in the long term. For instance, to guarantee political stability (decentralize in order to avoid regional conflict and the potential secession of some regions).

Short-term calculations - when politicians have strong incentives to discount future gains. In this case, “*politicians may treat decentralization as just another policy arena, subject to the usual exchanges and log-rolls*” (Eaton 2001: 105). For instance, to decentralize the responsibility to implement cost-containment policies in a period of economic adjustment; to guarantee the stability of the executive or the parliamentary majority with the support of regional parties; or to benefit their home districts with spending projects.

The costs of devolution for national policy-makers consist in the loss of power to command the behaviour of actors at the subnational level. The transfer of power may be for national policy-makers difficult to recuperate precisely because of the effects of devolution. Once regional governments are endowed with fiscal and political autonomy the “*decentralization feeds decentralization*” dynamic makes centralization pressures difficult to succeed. As some authors argue: “*regional elites, covered by the legitimacy from direct election will claim for greater demands*”. Broken arrows in figure one represent the fact that decentralization is a dynamic process but for the moment I will concentrate in arrows A, B and C. I will not take into account – for the moment - how devolution affect the former conditions (structural and mediating factors as well as the power of political actors).

As far as subnational governments is concerned, their calculations in making demands for decentralization will follow the same rationale than the logic followed by national decision-makers (although I insists that the decision to devolve powers lies at the central level): benefits of fiscal decentralization must be higher than its costs. Which are the benefits for subnational governments of having autonomy over their revenues and expenditures?. First, the value of autonomy *per se*. This is the value attached to decide autonomously within the regional borders. Second, it implies an improvement in the regional government’s legitimacy since it is closer to its citizens.

The cost of devolution for subnational governments is related to accountability. Once they are endowed with autonomy over revenues and expenditures voters will held them accountable for the performance of fiscal policies. There is higher visibility for the voters of subnational governments’ policies so citizens can held them accountable for the powers they exercise autonomously (unlike other forms of decentralization – delegation/deconcentration where citizens are not the *principal*. The central government remains the *principal* and the subnational governments the *agent*).

So far I have described a very preliminary set of general benefits and costs that are related to devolution policies and that affect the main political actors in the process of devolution: the central government and subnational governments. Among the most urgent pending issues that I need to introduce or develop in the model there are two that deserve special mention. First, I need to specify the utility function for each political actor and introduce other political actors that may be relevant such as state bureaucracy, national political parties, nationally organised economic actors or regional political parties. In addition (and I do not know how yet) I have to take into account the specific design of fiscal decentralization. That is, fiscal decentralization is the dependent variable in my analysis. As such, it varies. For instance, expenditures may be devolved to subnational governments but most taxes may remain at the national level. This is an example of a particular design of fiscal decentralization. Each specific design may affect in different ways the calculations of political actors. Actors will evaluate their interests and establish their strategies according to each specific design of fiscal decentralization.

Finally, I need to construct a model for the interaction process (the process of bargaining) that takes place between the central government and subnational governments when dealing with devolution policies (this interaction could be represented, for instance, as an extensive-form game with two players – the central government and subnational governments).

6. **A first outline of the structure of the thesis**

1. INTRODUCTION: Decentralization as a wide world phenomenon.
2. WHAT DO WE KNOW ABOUT DECENTRALIZATION? WHAT REMAINS UNKNOWN?
 - a) Critical review of the literature
 - Literature on institutional change
 - Literature on decentralization
 - Literature on fiscal decentralization
 - b) Research question

3. EXPLANATORY MODEL
4. EMPIRICAL EVIDENCE. Case Selection?
5. CONCLUSIONS

Currently I am working on the outline of the explanatory model. All comments about this project are welcome but I am specially interested in your opinion/suggestions about how to develop the explanatory model.

Thank you.

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