

Political Centralization and Government Accountability¹

How far shall we go in the process of European integration? What determines if power should be centralised or decentralised? How many layers of governments should there be?

Traditional economic analysis of fiscal federalism has emphasised the importance of differences across regions as a major determinant of the choice between centralising and decentralising political power. It has reached the conclusion that different people need different governments. Centralisation – the argument goes – works well in an area that is internally homogeneous, while it is doomed to fail in a territory that is internally heterogeneous.

However, evidence from both national and local governments suggests that in fact internally homogeneous territories at times perform very poorly.

Based on the result of the theoretical model that we developed, we argue that the extent and the nature of across regions differences play a key – yet subtle – role in answering those questions. Indeed, the conclusion that different people need different government crucially depends on the nature of the differences across the areas that would constitute the unitary state. It holds when regions differ in preferences; for instance, they vary in their preferred level of redistribution, or of government spending. Then, starker differences imply that power should be optimally devolved to local governments, better able to match local preferences. To the contrary, however,

the conclusion is reversed when regions differ mainly in their ability to hold the politicians governing them accountable and responsive; broadly speaking, when they differ in institutional quality, but share the same preferences. In this case, power should be left in the hands of a central government.

Differences in accountability and in institutional quality are a crucial and widespread phenomenon. Remarkably, heterogeneity in institutional quality appears to be very persistent as well. We adopt a standard political agency setting, with self-interested politicians whose rent-seeking behaviour is constrained by their electoral discipline. Regions may differ in two dimensions: preferences and institutional quality. The ultimate determinant of a region's institutional quality is voters' information on the activity of politicians. Only informed voters are able to monitor their politicians and to effectively discipline them: higher institutional quality regions are characterised by a higher percentage of informed voters.

The model shows that, while voter information always improves political accountability, the link between the two is subject to decreasing returns. The more informed the citizens, the better the government, but the smaller the additional improvement that a further rise in voter knowledge would entail. Therefore, when regions differ mostly in terms of voters' information, centralisation improves government performance.

When difference across regions is mostly about preferences, rather than about infor-

mation, therefore, social welfare maximisation requires different governments for different regions.

Suppose now that regions differ both in information and in preferences, but that the differences in preferences concern some of the public goods. The traditional fiscal federalism literature suggests that there should be many layers of government, having the central government in charge of the public goods that all the regions homogeneously like. Yet, some recent empirical studies failed to support such theories.

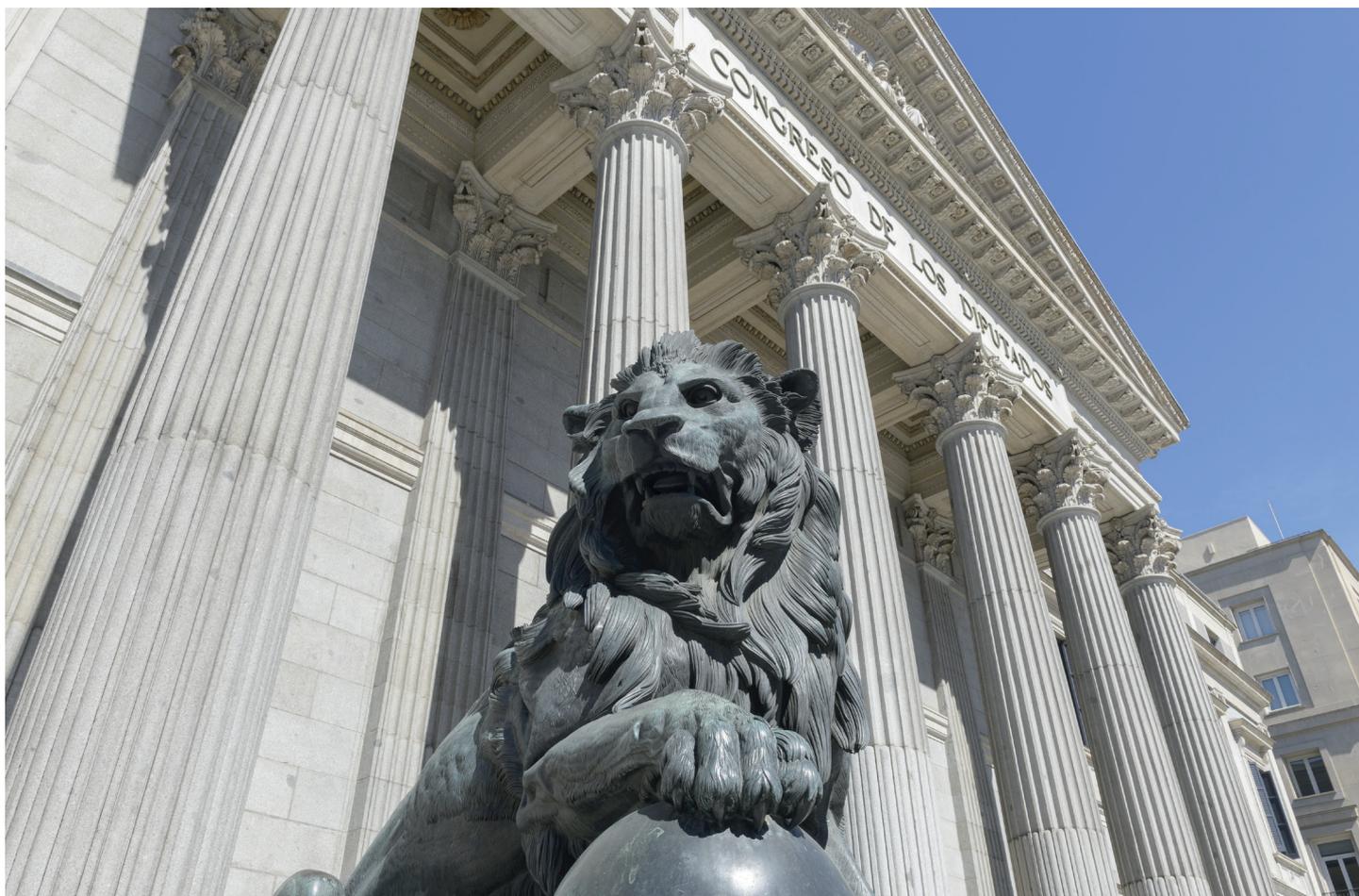
Our theory suggests that there are endogenous economies of scope in government accountability. Politicians with little power have low-powered incentives. They control a smaller budget, so they have a lower

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¹ This Info IEB is based on the content of the paper “Political Centralization and Government Accountability”, by F. Boffa (IEB Associate Researcher), A. Piolatto (IEB Researcher) and G. Ponzetto. The paper was published in the *Quarterly Journal of Economics* (2016), 131. The QJE is considered one of the five most reputed journals in Economics.



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value of holding office. Moreover, their reelection is more likely to be determined by factors other than their performance. As a result, career concerns are weaker. Hence, most of the time multiple layers of govern-

ment tend to reduce efficiency and increase budget dissipation.

To conclude, we argue that multiplying government tiers in general reduces the quality of government. However, we find that differences in the ability of voters to monitor politicians and to hold them accountable push towards centralisation, which is shown to provide a superior quality of government with respect to distinct regional governments. Differences in preferences, instead, pull towards decentralisation and the devolution of power to distinct regional governments, as local politicians are better able to match local preference. The ideal state is internally homogeneous in terms

of citizens’ preferences, but its constituent regions are heterogeneous in their ability to monitor their politicians.

Therefore, government decentralisation is not always the right answer to differences across regions. Scottish voters, who rejected independence in the 2014 referendum, may not have been that unwise. When evaluating whether different people need different government, one should first understand where heterogeneity comes from.

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