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Center for Advanced Study in the Social Sciences (CEACS)

A political theory of decentralization dynamics

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Date 2009

Type Working Paper

Series Estudios = Working papers / Instituto Juan March de Estudios e Investigaciones,
Centro de Estudios Avanzados en Ciencias Sociales 2009/248

City: Madrid

Publisher: Centro de Estudios Avanzados en Ciencias Sociales

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Center for Advanced Study in the Social Sciences

WORKING PAPERS

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DECENTRALIZATION DYNAMICS

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Abstract

The literature on decentralization has traditionally focused on the study of its origins and consequences, leaving the analysis of its dynamics much further behind. We aim to fill this gap by creating a new theoretical framework in which the evolution of decentralization is contingent upon national incumbent's strategies of political survival. Our argument conceives decentralization as a national incumbent's choice that results from the interaction between national and subnational politicians' relative powers and goals. Two dimensions define it: the degree of vertical integration of statewide parties (intraparty competition) and the blackmail role played by regional parties (interparty competition). We claim that, apart from structural factors, decentralization happens when it helps the national politician to survive in office. In our framework, the decision to implement further decentralization depends on, first, the degree of vertical integration of statewide parties - defined by the level of electoral independence between national and subnational copartisans and the degree of autonomy of regional branches within the organization. This will determine subnational incentives to push for a downward transfer of power and resources and national incumbent's capacity to oppose it. Secondly, the existence of regional parties with strong presence in national legislatures will determine the extent to which national incumbent is willing to surrender power in exchange for regional parties' parliamentary support. The national incumbent faces a "Faustian" dilemma when decentralizing serves to preserve his power today but ties his future reelection down to additional surrenders of power.

INTRODUCTION

Empirical evidence reveals that decentralization operates in waves. The long-term tendency since the 19th century was one of centralization whereas, starting in the 1970s, the downward transfer of powers became an extended phenomenon in the world, adopting a multiplicity of forms.¹ However, it seems that recent decentralizing waves have come to stay. Cross-country data indicate that the evolution of intergovernmental arrangements in the last decades are more resilient, since they exhibit a bias towards either increasing decentralization or stability, being centralization a much less common trend.

Why the dynamic of intergovernmental arrangements over time vary across countries? And why changes are biased towards increasing decentralization? These questions are still unresolved in the literature and represent a pending issue in the research agenda. Scholars have generally paid little attention to the dynamics of decentralization, as they have traditionally focused on the study of its origins and consequences. As a result, there is a shortage of cross-country evidence on the malleable nature of fiscal and political intergovernmental arrangements, as well as on the explanatory factors of their evolution over time. This paper aims at filling this theoretical gap by exploring the dynamics of decentralization and creating a formal model that accounts for self-reinforcing decentralization.²

Following the approach of Second Generation Fiscal Federalism theories,³ we assume decentralization is a strategic choice made by self-interested politicians, and that political incentives and electoral goals play a crucial role in explaining the design of

intergovernmental arrangements. Our claim is that decentralization dynamics are crucially driven by the relative power of national vs. subnational elites, which is defined by the structure of the party system. Every time national and subnational political elites agree on a new intergovernmental contract, the distribution of power and resources across levels of government changes, as new competences are transferred downwards. The resulting configuration of power has an impact on two dimensions of the party system. On the one hand, it modifies intra-party competition within state-wide parties by enhancing subnational copartisans' resources and control over their electoral fates. On the other hand, it strengthens the role of regional parties in the national legislature. These changes give rise to a new bargaining scenario among national and subnational politicians, which results in the ongoing transfers of powers towards the subnational level, that is, in a self-reinforcing dynamic of decentralization.

This paper makes a contribution to the existing literature by providing a new theoretical framework that bridges the literature on the relationship between party systems and decentralization. We do it by creating a theoretical model where the evolution of intergovernmental arrangements is endogenous to the nature of the party system and party competition. This model presents two important innovations. First, it departs from previous analyses in that it clearly distinguishes two dimensions of the party system (intra-party and interparty) and acknowledges the interaction among them. Second, we go beyond the literature that studies separately the causes and consequences of decentralization by analyzing how decentralization and party competition influence each other in a mutually reinforcing process. We address the common endogeneity concerns by specifying the micro-logic that leads to the self-reinforcing dynamic of decentralization.

The paper is organized as follows. In section two we account for the current theories of decentralization and its dynamics and how our model improves them. The argument of the paper is

¹ For instance, Faletti (2005) distinguishes between three forms of decentralization: political, fiscal, and administrative.

² We conceive decentralization as the process that involves the downward transfers of revenue sources and expenditure authority from higher to lower levels of government. This requires the previous existence of subnational democratically elected governments.

³ See, for instance, Rodden and Rose-Ackerman (1997); Rodden and Wibbels (2002).

presented in section three, where we propose a theory to analyze decentralization dynamics in relation to the characteristics of the party system. Section four provides a workhorse model based on this theory. Finally, section five concludes.

DECENTRALIZATION DYNAMICS

Although the literature on the origins and consequences of decentralization is large, the analysis of the dynamics of decentralization lags further behind. The literature gap is particularly astonishing considering that changes in the distribution of revenue and expenditure powers across levels of government is rarely stable. Countries' modern history can be described as different episodes of both decentralization and re-centralization trends (Weingast, 1995), and empirical evidence shows that the worldwide trend in the last decades has been one of decentralization. For instance, Rodden and Garret (2007) analyze the evolution of regional and local share of total government expenditure from 1982 until 1997 in 42 countries with data from the Governance Finance Statistics. They show that in 22 countries the average share of decentralized expenditure in the second period (1990-1997) increased or remained the same with respect to the former period (1982-1989); whereas in 20 countries, the decentralization of expenditure has decreased across periods (they have therefore experienced a recentralizing trend).⁴ However, if we analyze the magnitudes, countries that have decentralized have done it to a larger extent than those that recentralized. Moreover, the decentralization processes in many countries have followed a reinforcing path. In fact, even in those federations where the constitution has tried to limit the domain of federal bargaining (as the German one), the evidence shows that there is always room for ambiguity and interpretation that encourages negotiation and renegotiation of intergovernmental arrangements.⁵ Hence,

⁴ Further empirical evidence of the predominance of decentralizing trends is found in Hooghe et al (2008).

⁵ As Filippov *et al.* state (2004:35) "*however well crafted, arguments can be made for nearly any allocation of responsibility, and all levels of*

two research questions emerge from the empirical evidence: Why does the distribution of powers and authority across levels of government change over time? And why in some cases changes are strongly biased towards increasing decentralization?

Current theories of decentralization lack a clear standpoint on why a country follows a specific decentralization path. In fact, in the majority of the cases, theories conceive decentralization as a one shot decision. There are some functionalist arguments in the literature that predict that decentralization happens when economic or military benefits offset the costs of an eventual disruption of the federation.⁶ As long as these benefits still overcome the costs, the arrangements between subnational units and the federal government remain stable. Only external shocks that suddenly change the balance between benefits and costs can make the decentralization arrangements vary in one or another direction. Hence, stability is the expected outcome, while no actors come into play in the explanation.

A similar perspective underlies in the political sociology literature. This literature claims that when popular demands for decentralization have enough support because they represent a wide cleavage, a regionalized party system emerges (De Winter and Tursan 1998) and decentralization tends to be enhanced (Keating 1998, Van Houten 2000). Countries with entrenched ethnic conflict can implement a more decentralized democracy at the first stage to mitigate the risk of secession (Laitin 1995). Again, this

government can lay claim to the right to oversee any specific public (or private) activity (...) Even explicitly stated bargains at this (constitutional) level are vulnerable".

⁶ In the literature on federalism, two different views on the origin and stability of federations have prevailed. The first one regards federalism as a cooperative system since it makes all participants better off by allowing them to achieve a common and desirable end more effectively (Elazar 1994). The second perspective regards federalism as a mechanism to endow public policy with economic efficiency (Tiebout 1956; Oates 1972).

functionalist perspective leads us to expect stability.

We contend that we need something else than a functionalist argument (“the federal contract prevails because of the realization of its benefits”) to understand the evolution of intergovernmental arrangements, because there is no reason to think that political elites will always safeguard the benefits of federalism. The tensions between centralization and decentralization that are inherent in every devolved system can only be solved by bringing the focus of the analysis to national and subnational political elites and to the specifics of their self-interest.

In other words, political actors are the ones empowered to disrupt, change or maintain the federal contract, so any explanation aimed at explaining a modification of intergovernmental arrangements must provide a good account of their incentives and goals and how they evolve according to different configurations of relative power between national and subnational elites. As a recent critical strand of the literature on decentralization points out, politicians are not benevolent planners⁷ and their actions are not always efficiency-oriented. Actually, the fact that normative theories on decentralization overlook politicians’ electoral goals and incentives is used to account for the mismatch between the expectations and benefits ascribed to decentralization and what actually takes place after decentralization is implemented.⁸

⁷ For instance, decentralization, far from generating public sector efficiency as fiscal federalism models would predict, increase national budgetary deficits and undermine macro-economic stability (Rodden and Rose-Ackermann 1997; Rodden and Wibbels 2002; Rodden 2006).

⁸ As Bednar *et al.* point out (1999: 9) “*Although political-economic theories of decentralization show how improvement over centralized regimes is conceivable as well as beneficial, they ignore a central practical difficulty with constructing and maintaining regimes of this sort. That is, the constituted agents of a decentralized regime, the national and subnational governments will have strong incentives and many opportunities to cheat on the arrangement*”.

However, recent studies are not the first to note the importance of political factors to account for the evolution of decentralization. In his seminal work, Riker (1964) already pointed out that parties were the key factor to understanding the extent to which a federation is centralized or decentralized.⁹ Riker suggested that US federalist institutions have no significant impact on the stability of the federal bargain, but it is the structure of political parties that encourages or discourages the maintenance of the federal bargain. In particular, partisan harmony and party discipline are the two crucial variables in understanding the evolution of the federation. Stemming from Riker’s perspective, there are two different approaches in the literature that studies the relationship between the evolution of decentralization and the party system: one of them considers the former the explanatory variable of the latter, and the other proposes the opposite causal relation.

In the first approach, the decentralization structure of the state is presented as an exogenous variable that affects the nature of the party system. Higher levels of decentralization make subnational party elites more autonomous. And vice versa, a shift of competences from the regions to the centre is expected to strengthen vertical integration of the party system. This perspective, where decentralization precedes changes in the party system, has been adopted by some scholars.

Chibber and Kollman’s (2004) basic hypothesis is that different levels of party aggregation will occur depending on the level of government where decisions are made. Hence, periods of centralization will be followed by a higher level of party aggregation and periods of decentralization will be followed by a lower level of party aggregation. In their study, centralized/decentralized allocations of

⁹ When dealing with cross-country variation in the level of federalism Riker states: “(...) *the proximate cause of variations in the degree of centralization (or peripheralization) in the constitutional structure of federalism is the variation in degree of party centralization.*” (1964: 129).

authority work independently of the party system. Brancati (2006) shows that political decentralization (defined as a division of political authority among multiple levels of government in which each level is democratically elected) has a positive and significant effect upon the strength of regional parties. Finally, Harbers (2009) focus on Latin American countries and shows that both fiscal and political decentralization have a detrimental effect on the level of nationalization of the party system.

In the second approach, scholars have analyzed the reverse causal relation, where the type of party system drives changes in the decentralization of the state. Caramani (2004) states that the increasing importance of the regional level in Western countries is the result of the regionalization of voting. This viewpoint is also consistent with the work of Willis, Garman and Haggard (1999), as they assume that there is a unidirectional effect that goes from the internal organization of political parties to the fiscal structure of the state. The reasons to believe that a regionalized party system will hence make decentralization more likely are twofold. First, in a direct way by forcing national alliances in which they trade political survival for decentralization (Sebenius, 1983, Heller 2002). Secondly, because the existence of a regionalized party system gives incentives to national parties to adopt a more regionalized discourse (Roller and Van Houten 2003).

An interesting work consistent with this viewpoint is the historical analysis of Bednar, Eskridge and Ferejohn (1999). Bednar *et al's* is one of the few studies that have studied the evolution of a federal state from a dynamic point of view. They contend that the evolution of Great Britain from a *de facto* federal state to a unitary country in the XIXth century had to do with changes in the party system. The growth of organized and disciplined parties in the nineteenth century made the British federal system collapse.¹⁰ In other words,

federalism was self-enforcing as long as national authority remained highly fragmented (between the Crown, the Parliament and the House of Lords) and parties were disorganized. The stability of the federation was grounded on locally oriented MPs that reinforced local authority, resulting in a largely fragmented Parliament which had very difficult to ground legislation in a national political project.

We intend to build on previous research by integrating the two unidirectional perspectives (decentralization affects the party system or the party system affects decentralization) into a single framework where party system and decentralization reinforce each other. Our argument is that decentralization modifies the distribution of powers between national and subnational actors by triggering changes in the structure of the party system. Characteristics of the party system, such as the way in which parties organize and compete in statewide and regional elections, are crucial to explain the configuration of national and subnational politicians' relative power. For instance, according to Thorlakson (2009), in a party system where statewide parties are of a *split* or *confederal* type, regional branches are more powerful against their national counterparts, since they have a high degree of autonomy and the extent of vertical integration remains relatively low. So any change in the party system will affect actors' relative powers, which in turn will have an impact in the maintenance or modification of intergovernmental arrangements.

In summary, scholars have tended to focus in one of the directions of causality between decentralization and party systems, although reverse causation can never be ruled out and stands as an unresolved shortcoming in the analysis. To study

government from overawing local jurisdictions. Local elites could impose most taxes and regulations without interference from Westminster and were actively competing with one another for commercial advantage. They controlled parliamentary seats and were eager to give political support to the Crown or to those who aspired to hold parliamentary office in exchange for the financing of local projects.

¹⁰ Britain became a *de facto* federal state after the 1688 Glorious Revolution (Weingast 1995) and until the nineteenth century the fragmentation of power between the King and the Parliament prevented the national

decentralization dynamics we need to figure out a more complex theoretical framework that provides an adequate account of the reciprocal causation between changes in intergovernmental arrangements and changes in the party system. And, crucially, the party system needs to be analysed as having two distinct dimensions –the one of inter-party competition and the one of intra-party competition. We tackle this theoretical challenge in the remaining sections of the paper.

A POLITICAL THEORY OF DECENTRALIZATION DYNAMICS

The Logic of Political Bargaining and Intergovernmental Arrangements

We conceive intergovernmental arrangements as contracts that specify the authority of the national level and the authority of subnational units. So when national and subnational political elites agree on a new intergovernmental contract, the distribution of powers and resources across levels of government changes. The resulting configuration of power will be self-enforcing as long as the maintenance of the contract is compatible with politicians' incentives. If not, intergovernmental arrangements may enter an unstable dynamic.

We assume that national and subnational politicians are actors driven by their self-interest. Politicians are office-maximizers, that is, their goal is political survival. They have intertemporal concerns, meaning that they are aware of the impact of their present decisions in their future political survival. We assume politicians have two means to survive in power: (i) by controlling resources and formulating policies with which they appeal to voters' support, or (ii) by forging alliances with different political groups. In principle, politicians prefer to control a large share of resources, as it makes their electoral fate more dependent on how successfully they use them. However, they might not always be able to ground political survival exclusively on the formulation of policies, but need to ally with other political groups. When bargaining and alliances involve subnational political elites, these will be willing to support the central government

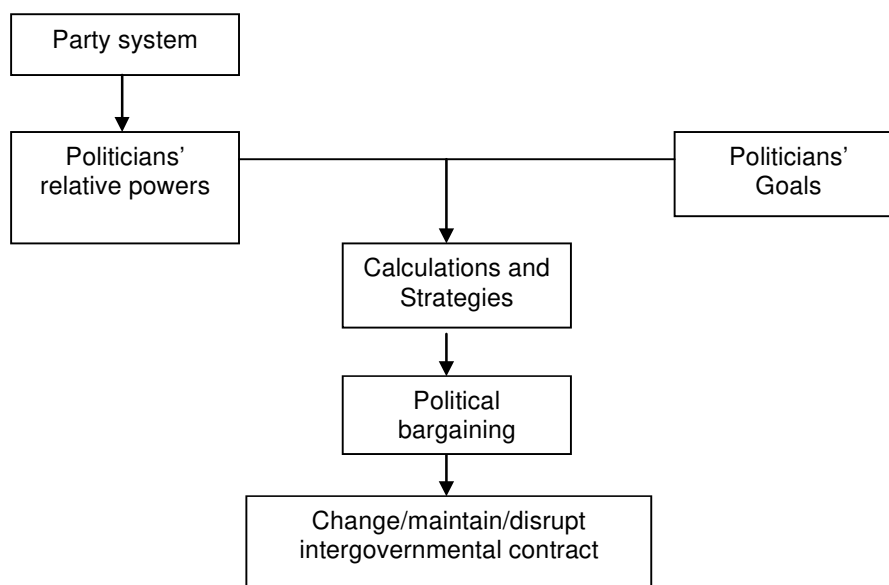
incumbent (allowing her to survive in office) in exchange for decentralization (that is, a downward transfer of resources). In sum, central government's actions are aimed, first and foremost, at winning elections and controlling a large portfolio of competences, expenditures and revenue sources. However, under certain circumstances, politicians may decide to surrender power to subnational politicians in order to survive in office.

The outcome of the bargaining between national and subnational politicians will result from the combination of politicians' goals and the limits and conditions of the institutional setting where they make decisions. Among all the institutional variables, we focus on the party system and its impact on national and subnational politicians' relative power¹¹. Politicians' strategies in the bargaining process will stem from the interaction between their goals and the limits imposed by the configuration of their relative power. Put in other words, the incentives of both national and subnational politicians to maintain, change or disrupt the intergovernmental contract will be contingent on the interaction between their preferences and their relative power.

Thus, in our theoretical framework politicians' strategies are contingent upon their relative power, which in turn is determined by the structure of the party system. Two dimensions of political competition define the nature of the party system: intra-party competition and inter-party competition. Intra-party competition is associated to the vertical distribution of power within state-wide parties. More specifically, it has to do with the level of electoral independence between national and subnational copartisans and the degree

¹¹ Institutions may also act as the lens through which the impact of incentives are filtered and may therefore operate to curb a further deepening of decentralization or to spur it. For instance, institutions that hinder the regionalization of interparty competition will make the strategy of decentralizing less risky for central incumbents. We take here those institutions as given.

FIGURE 1. The Logic of Political Bargaining and Decentralization



of autonomy of regional branches within the organization.¹² On the other hand, interparty competition is related to the blackmail role played by regional parties in national legislatures. In the next section, we delve into the causal mechanisms that connect decentralization, the nature of political competition and an unstable allocation of powers across levels of government.

The Nature of Party Competition and Self-Reinforcing Decentralization

Decentralization becomes self-reinforcing when political bargaining over the federal contract repeatedly results in a further transfer of powers towards the subnational level. Following the logic of bargaining presented in Figure 1, this will occur if both national and subnational politicians face incentives to change the intergovernmental contract. This happens when, given the configuration of their relative power, national politicians find that the best strategy to maximize political survival is to transfer downward some authority and

resources; whereas subnational politicians find that the best way to survive in office is to maximize the control of resources by demanding to central government higher transfers of resources and authority.

However, this is not a simple one-shot decision. The intergovernmental process becomes dynamic because the type of party system is not exogenous, but contingent upon the scope of decentralization of the state (Figure 2). The idea is that the level of decentralization is not neutral to the future decisions and the relative bargaining power with which actors face them. Hence, the structure of the party system triggers a self-reinforcing dynamic of decentralization. This will occur when intra-party and inter-party competition strengthens powers of subnational elites to an extent that makes the national incumbent unable to oppose his demands. Then the intergovernmental contract becomes instable, as bargaining among political results in ongoing transfers of powers towards the subnational level.

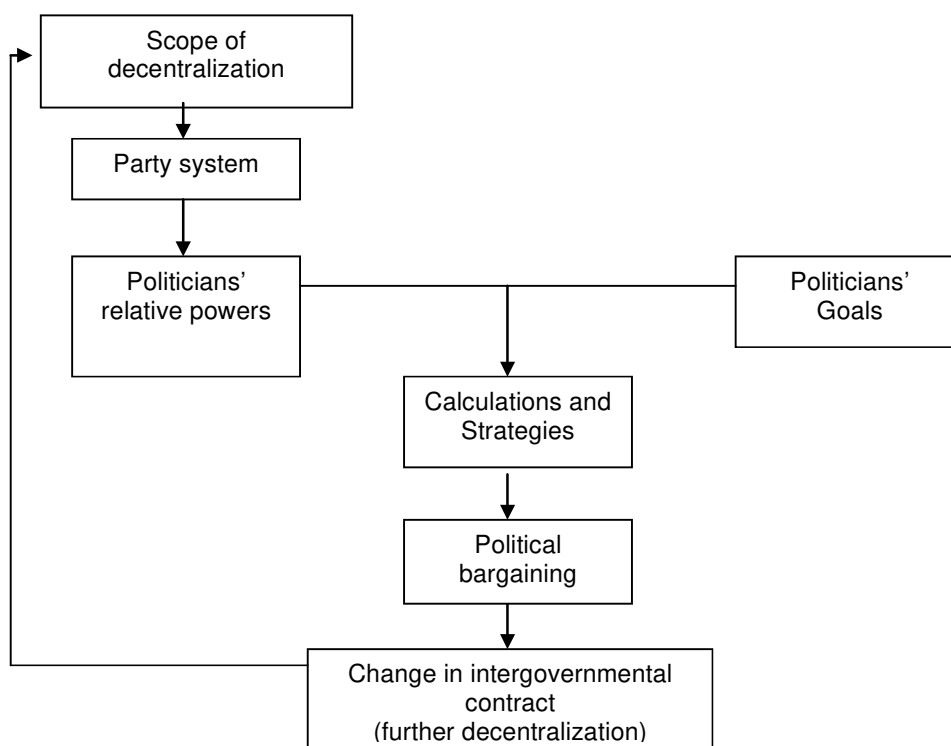
National incumbent's decision to surrender power may seem an irrational choice, given that decentralization strengthens subnational powers and, therefore, further tightens the national incumbent's hands for the future. However, we contend that a rational of political survival is what underlies the national

¹² Electoral externalities across levels of government exist when the electoral fates of national politicians are correlated with those of their local and regional counterparts (see Rodden 2001).

incumbent's choice. Decentralization represents a strategy of political survival for the national incumbent. It is an endogenous choice that results from the relative power of national and subnational elites, which is defined by the structure of the party system. As the nature of the party system is also endogenous to the type of decentralization of the state, in our model there is a feedback

loop from decentralization to the party system and back to decentralization. And due to the evolving nature of the configuration of relative power our model predicts instability in the intergovernmental arrangements even when other factors like inter-regional income inequality remain stable over time.

FIGURE 2. The Dynamic Logic of Political Bargaining and Decentralization



The Intra-Party Competition Dimension and Decentralization Dynamics. Our argument is that decentralization strengthens the position of subnational elites within the party structure, which makes more likely that national and subnational politicians' strategies converge into an ongoing renegotiation of the intergovernmental contract. Decentralization involves an increase in the scope of competences and resources of subnational governments, which modifies the nature of intra-party competition in two ways.

First, it decreases electoral externalities between party copartisans at different levels of government. If voters use the party label of the national executive to reward or punish subnational politicians in a retrospective way, then the electoral fate of subnational politicians becomes linked to that of their copartisans at the national level. Then the electoral spillovers or externalities of national elections upon the subnational level are high.¹³ As subnational

¹³ As Rodden states “the self-interested activities of a prominent politician at one level produce positive or negative externalities that

party elites are endowed with capital-intensive policies such as health, social services and education, their reelection chances become increasingly more related to the quality of the services they provide than to the value of their national party label. Issues at stake in subnational electoral contests gradually become more connected to local issues than to national matters. Subnational representatives increasingly ground their electoral platforms and pledges on local terms, which results in increasing divergence in campaign strategies.

Second, increasing electoral independence is associated to the formation of differentiated constituencies for the subnational branches of state-wide parties, which reinforces subnational leaders' status within the party organization. Subnational copartisans increasingly put their level of authority within the organization on the level with their assigned expenditure and revenue responsibilities in subnational jurisdictions. The structure of state-wide parties undergoes a process of *centrifugation* as subnational leaders gain influence within the party structure to select the candidates that run for national and subnational elections and to shape the party's political agenda (León-Alfonso 2007).

However, these two mechanisms do not limit their effect to the short term, but they set in motion a self-enforcing process. If we observe them in a dynamic way, decentralization makes subnational party elites more independent in electoral terms and, as a result, more powerful within the party organization. Subnational copartisans, like their national counterparts, are authority-maximizers. As subnational elites become more powerful, they face fewer incentives to cooperate with the national branch of the party. Instead, they have more incentives to fight for higher levels of resources and authority from their national counterparts, even at the expense of entering into conflict with them. This is so

affect the reelection changes of politicians with the same party label competing at the other level" (2006: 126). This is particularly so in a context where revenue collection and authority over policy areas is largely centralized.

because, as they gain power within the party and their electoral success becomes gradually independent from that of their national copartisans, the potential political costs associated to a further demand of transferences diminish. In other words, a strategy based on the maximization of authority does not risk subnational politicians' chances of winning or maintaining office (their foremost goal).

Consider a situation where 1) party leaders (party brokers) from the national party's headquarters control nominations for both subnational executive offices and national legislative offices, and 2) electoral externalities between national and subnational elections are high. In this context, subnational politicians face high political costs by pursuing a bickering strategy. Costs have to do, firstly, with the worsening of their within-party careers (it is the punishment that the national party apparatus will impose on those who challenge them). Secondly, assuming that voters dislike parties that exhibit internal tensions or are divided, the electoral prospects of the national branch of the party may be worsened, which may have a negative impact on subnational branches' electoral results through electoral externalities.

On the other hand, subnational leaders face lower costs of pursuing an authority-maximizing strategy if party brokers come from party subnational branches or if electoral externalities are low. In this context, national party co-partisans will not have incentives to punish those leaders if they depend on them for career promotion within the party. Neither will they if they depend on the mobilization of subnational constituencies to win national elections. Finally, lower electoral externalities mean that that any electoral cost to the national party label that stems from within-party divisions and confrontation will not eventually have a negative spillover on subnational electoral prospects. In sum, decentralization enhances, in the first term, more autonomy of subnational leaders of state-wide parties from their national copartisans. This generates the conditions for these subnational leaders to support further decentralization demands.

The Inter-Party Competition Dimension and Decentralization Dynamics. We claim that the decentralization of resources changes the nature of inter-party competition, fostering a regionalization of the party system. We conceive a regionalized party system as one where there is low party linkage across districts (Cox 1997). That is, party systems where parties are not uniformly successful in winning votes across districts.¹⁴ Several arguments justify the positive impact of decentralization on the regionalization of the party system. First, a very straightforward argument is developed by Chibber and Kollman (2004), Brancati (2008) and Harbers (2009). In a centralized scenario there are no incentives for politicians to belong to a party that has no leverage at the national level, so it is expected that elites will coordinate and run under the label of a single national party. However, once resources are decentralized, regional elites will have an interest in sacrificing power in the national legislature to be more autonomous in the control of the political agenda at the regional level.

Decentralization modifies regional elites' career paths, as well. As decentralization increases, their career aspirations turn towards the subnational level. In a centralized scenario, regional elites use the regional tiers of authority as a springboard to a place in the national arena. This represents an instrument in the hands of national parties to control them. However, in a decentralized scenario, regional elites have fewer aspirations to enter the national arena because the subnational level becomes more appealing in terms of the level autonomy and resources they can maximize.

Hence, decentralization gives incentives and increases the ability of subnational leaders of state-wide parties to reinforce their regional constituencies. Moreover, the introduction of subnational elections and the decentralization of policy-making may

¹⁴ Several measures of nationalization of the party system have been developed in the literature. See Jones and Mainwaring (2003), Chibber and Kollman (2004) and Kasuya and Moenius (2004). Kasuya and Moenius' measure, most interestingly, is district-focused.

give way to the rise of territorial cleavages that are masked when centralization is the pattern (Bardi and Mair 2008). Therefore, new regionalist parties will arise supported by them.¹⁵

As a result, decentralization will enhance the regionalization of the party system, but also we expect that this will end up leading to more decentralization. Regional parties will demand higher decentralization because they are authority- and revenue-maximizers and will prefer to have more power to less. They know higher levels of authority and resources will make them more capable of controlling and widening regional constituencies.¹⁶ Their demand for increasing transfers of powers from central government will become one of the most important claims and a device for political bargaining. This means they will be willing to provide parliamentary support in the national legislature in exchange for further decentralization. As decentralization strengthens regional parties' electoral support, the probability they play a pivotal role in the national legislature increases. In consequence, regional parties will become more capable of using decentralization as a bargaining device in the national legislature. As Heller (2002) explains, they will keep on trading policy stability and, with it, national incumbent's survival, for further decentralization.

In the line with this argument, Rodden and Wilkinson (2004) state that the switch from unitary executives towards coalition governments in India the last decade is an important break with implications with

¹⁵ An example of how decentralization regionalizes the party system can be found in the Spanish case. In 1982 the ruling centre-right party, UCD, lost the elections and collapsed. Many of its regional elites, instead of joining the other national right party, AP (and even when decentralization was mainly political and not of resources) founded their own regional parties.

¹⁶ This is the case, for instance, of the agrarian parties in Scandinavian countries. As these parties' electoral support is concentrated in some jurisdictions, they are interested in pushing for more decentralization to gain control of policy and resources in areas that represent their electoral strongholds.

respect to inter-regional redistribution and decentralization outcomes. When the incumbent is either in a coalition or in parliamentary minority, and needs the support of other parties -which in decentralized countries are likely to be regional parties-, decentralization outcomes are likely to be the result of legislative bargaining within the ruling coalition.

Cross-Reinforcing Dynamics

There are cross-reinforcing effects between the dimensions of intra-party and inter-party competition. If decentralization is fostered by inter-party and intra-party competition, we expect that increases in decentralization implemented due to restrictions to the central government incumbent in one dimension, will also have effects on the other. This would explain why decentralization can eventually fall into a spiral process, generating the conditions for the irreversibility of decentralization, provided that institutional variables remain stable. We expect this to happen particularly when decentralization is already high.

On the one hand, regionalization of national arenas can affect intra-party centrifugation as a side-effect of competition in subnational elections. In the short term, as Roller and Van Houten (2003) stress, subnational elections, by giving way to the emergence of regional parties, make statewide parties aware of the necessity of formulating political strategies that adjust to the different regional arenas. Given that subnational elections will revolve around local issues, regional parties have a comparative advantage in the competition with their local based proposals. As a best response, national parties will then be willing of sacrificing some level of control of their regional copartisans in order to allow them to adjust their political strategy to the environment.

Statewide parties' electoral platforms in subnational elections become increasingly differentiated as they adjust them to the different subnational electoral arenas. Subnational copartisans become more autonomous in the definition of their electoral pledges and their electoral fates less dependent on their national copartisans.

This process may give rise to the emergence of separate constituencies for national and subnational copartisans that are capable of distinguishing their electoral platforms of statewide parties and voting accordingly. As a result, electoral externalities between national and subnational copartisans decrease. Given the decrease of electoral externalities, in regions where statewide parties compete with strong regional parties that base their electoral claims in decentralization demands, subnational copartisans will have more incentives to introduce decentralization claims in the discourse. In other words, the regionalization of the party system can change the rules of the game in such a way that subnational branches have greater incentives to follow their own agenda and challenge their national copartisans.

On the other hand, intra-party centrifugation may foster the regionalization of the national arena, by the fragmentation of national parties and the emergence of new regionalist parties. Regional and national elites have incentives to coordinate around a single label when both sides have something to win. However, when the electoral constituencies are very differentiated, regional elites might lose the interest of running under the same label. Examples of this are the CSU in Germany or the PSC in Spain (Roller and van Houten 2003). Although they run in the national elections in an alliance with national parties, they remain as differentiated regionalist parties. The centrifugal dynamics within a party can eventually lead to intra-party conflict and the disruption of it. Subnational leaders seeking for room of manoeuvre to manage subnational resources, can end up abandoning the national party and creating a regional label to compete themselves in the elections.

THE FAUSTIAN DILEMMA OF THE NATIONAL INCUMBENT: A MODEL

To explain this reinforcing dynamic we use an endogenous model of decentralization based in a *Faustian* paradox (Bai and Lagunoff 2008). We claim that both intra-

party centrifugation and regionalization of the party system are dynamically related with decentralization in a self-reinforcing process. These two elements represent two different dimensions of party competition: inter-party and intra-party. At every moment in time, we can collapse both in a single measure of political power configuration (w_t in the formal model we present below) that gives us an idea of the decentralization pressures the central government is exposed to. The dynamic problem lies in that this political power restriction increases also in time with decentralization. Therefore, central government incumbents have a choice dilemma. Like Faust, they have to choose between something positive today that ties their hands in the future, namely, to decentralize at the cost of increasing the political power restrictions in the future.

The paradox comes from the fact that the national government ends up implementing decentralization although his most preferred policy choice would be to keep power and resources in his hands. The national incumbent faces a policy choice dilemma: if she chooses his preferred policy (not to decentralize), she then sacrifices his capacity for political survival; but if she wants to survive office, she must surrender power, knowing that she will tight his hand in the future. By implementing his undesired policy (decentralizing) the national incumbent can achieve its short term objective of keeping office, but at the cost of strengthening subnational actors, which increases the likelihood they ask for further decentralization in the future.

In other words, given the state of the world - that is, the nature of inter-party and intra-party competition-, if the national incumbent does not decentralize at time t she risks its political survival. But she knows decentralization changes political power in a way that ultimately triggers further demands of decentralization at $t+1$. Decentralization changes the configuration of power across levels of government, because it empowers subnational governments while weakening the national ruler. Subnational governments bring about further demands for a downward transfer of power and the national incumbent faces again the dilemma: to choose his most

preferred policy by sacrificing political power, or to implement further decentralization in order to be more capable to stay in power at $t+2$.

Thus, the basic idea is that, given the structure of intra-party and inter-party competition at each period, national and subnational politicians' co-evolving incentives are not compatible with the stability of intergovernmental arrangements. The maintenance of intergovernmental arrangements is not in line with both national and subnational politicians' self-interest. There is no stable, fixed and self-enforcing structure of incentives that supports an equilibrium allocation of powers across levels of government. And this is exactly what explains the ongoing nature of the political bargaining processes that define the characteristics of intergovernmental arrangements.

The General Environment

The crucial characteristic of the argument is the existence of an inter-temporal trade-off. It is assumed that the central incumbent can decentralize today to increase its present capacity for political survival. However, decentralizing today will be costly in terms of the relative configuration of political power in the future. Thus, decentralization at present (time " t ") D_t is assumed to be the policy choice variable of interest. The relative configuration of political power w_t is the state variable of interest. This state variable mirrors the levels of regionalization and intra-party centrifugation that condition the extent to which national incumbent's political survival depends on subnational elites.¹⁷ The national ruler is assumed to maximize the inter-temporal capacity for political survival in a dynamic setting.

We conceive decentralization as being implemented by a national incumbent that is constrained by subnational elites. The central incumbent is limited by

¹⁷ In standard dynamic optimization problems the policy-choice variable of interest is the one that is subject to decision every period, whereas the state variable describes a dynamic process, which usually enters the optimization problem as a constraint.

decentralization pressures coming from both subnational copartisans and regional parties. The national ruler cannot simply count on her policy decisions to stay in power because she is invariably conditioned by the interaction with subnational actors' leverage and demands. From a dynamic point of view, the crucial feature of the model is that if the national ruler implements decentralization it also affects the configuration of political power not in the current period but in the following one (w_{t+1}) through the impact of decentralization on inter-party and intra-party competition.

The Evolution of Endogenous Political Power in a Decentralized Country

First we specify the dynamic evolution of the composition of political power, that is, the evolution of the state variable w_t . A Markov process of the form $w_{t+1} = Q(w_t, D_t)$ is assumed, but the novelty here is the presence of both self-enforcing and cross-reinforcing effects among the two main dimensions affecting the relative power of the national incumbent –intra party centrifugation (a_t) and regionalization (r_t). The Markov process $w_{t+1} = Q(w_t, D_t)$ for the configuration of political power is described by the following equations:

$$w_{t+1} = a_{t+1} + r_{t+1} \quad (1)$$

$$a_{t+1} = a_t + \mu_1 D_t (1 + D_t a_t \frac{r_t^2}{2}) \quad (2)$$

$$r_{t+1} = r_t + \mu_2 D_t (1 + D_t r_t \frac{a_t^2}{2}) \quad (3)$$

Note that Equation (1) states that the configuration of political power is the sum of intra-party centrifugation (a_t) and the degree of regionalization of the national arena (r_t). We assume that both components follow their own endogenous process and they add up into a single state variable. This makes the model general enough to account for different country characteristics. The parameters μ_1 and μ_2 , are assumed to be country-specific and to reflect institutional characteristics. The greater these parameters, the greater will be the impact of changes in decentralization in the future configuration of political power.

Our effort here is to specify both the self-enforcing and cross-reinforcing effects that jointly determine the evolution of the relative political power of the national incumbent.

By taking the partial derivatives with respect to D_t in equations (2) and (3) we can explore the self-enforcing effects and the cross-reinforcing effects:

$$\frac{a_{t+1}}{D_t} = \mu_1 + \mu_1 D_t a_t r_t^2 > 0 \quad \text{as long as} \quad \mu_1 > 0$$

$$\frac{r_{t+1}}{D_t} = \mu_2 + \mu_2 D_t r_t a_t^2 > 0 \quad \text{as long as} \quad \mu_2 > 0$$

The partial derivatives can be interpreted as the flow of relative political power that the national incumbent will lose in the next period. On the one hand, by decentralizing today, it increases the level of intra-party centrifugation tomorrow with a direct effect μ_1 . On the other hand, decentralizing today also increases the extent to which the national arena is regionalized in the next period via an indirect cross-reinforcing effect $\mu_2 D_t r_t a_t^2$. Note that this indirect effect is mediated by the other dimension of political power (inter-party competition). A similar logic applies with respect to the effects of decentralization on inter-party competition.

The Formalization of the Faustian Dilemma for the National Incumbent

Now we can state the general problem for the national government incumbent in terms of his utility function $v(s_t)$, which is a function of the capacity for political survival s_t in period t . The utility function is defined as the linear term $(D_t - w_t)$. It reflects that political survival is a positive function of decentralization -the policy choice variable- and a negative function of the relative configuration of political power -the state variable-. For simplicity we substitute equations (2) and (3) into (1) and formulate the optimization problem with the full Markov process but using only one restriction. Note that the national ruler maximizes inter-temporal political survival subject to the dynamic evolution of the configuration of political power.

Max $\sum_{t=1}^{\infty} \delta^{t-1} v(s_t)$ *subject to*

(i) $v(s_t) = D_t - w_t$

(ii) $w_{t+1} = a_t + \mu_1 D_t \left(1 + D_t a_t \frac{r_t^2}{2}\right) + r_t + \mu_2 D_t \left(1 + D_t r_t \frac{a_t^2}{2}\right)$

Before providing a solution to the problem it is useful to clarify the precise nature of the dilemma that the national incumbent faces. On the one hand, if the national incumbent decentralizes in period t , it increases its present capacity for political survival but decreases its capacity for survival in period $t + 1$, given that in the future it will be more constrained by intra-party centrifugation and regionalization.

Note that if $D_t > 0$ then:

$$\frac{v(s_t)}{D_t} = 1 > 0$$

$$\frac{v(s_{t+1})}{D_t} = -(\mu_1 + \mu_2) - D_t(\mu_1 a_t r_t^2 + \mu_2 r_t a_t^2) < 0$$

The Rationale Behind the Model and the Optimal Path for Decentralization

By applying the Envelope Theorem (see Appendix 1) we can derive the Euler Equation that provides us the optimal path for D_t in each time period:

$$\frac{1}{B_t} = \delta \frac{A_{t+1}}{B_{t+1}}$$

We can interpret the Euler Equation as the one dictating the optimal relationship between D_t and D_{t+1} , that is, the optimal decentralization choice in each period given the choice that was made in the previous one. As we can see, if $D_t > 0$ then D_{t+1} has to be positive, as well. Therefore, whenever a central government incumbent finds optimal to decentralize in one period, she is actually condemned to decentralize in the next period. This represents a Faustian Dilemma because the inter-party and intra-party competition conditions are now relatively less favourable for the national incumbent after decentralizing. Of course, this model involves a great deal of simplification but nonetheless encapsulates the micro-logic by which it can be rational

for national incumbents to give up powers to subnational governments.

CONCLUSIONS

We contend that national incumbent's incentives to decentralize are contingent upon the nature of intra-party and inter-party competition. National incumbents decentralize to maximize political survival given their relative power vis-à-vis subnational co-partisans and non state-wide parties. Subnational co-partisans impose conditions within statewide parties whereas regional parties often impose restrictions in the legislature. Given a configuration of political power, a choice for further decentralization will arise as a result of bargaining processes between national and subnational political elites. Thus, we claim that the incentives and constraints of the political elites in decentralized countries will co-evolve over time in a way that makes decentralization a self-reinforcing process. Our main contribution is to disentangle the micro-logics of this dynamic, which may account for the cross-country variation in the evolution of decentralization. A *Faustian* dilemma is crucial to understand the micro-mechanisms that explain decentralization dynamics. National politicians implement decentralization because it is a way to preserve political power, even if by doing so they tight their hands in the future. In sum, our theoretical framework uncovers three causal mechanisms. First, the way in which party centrifugation and the regionalization of the party system leads to greater decentralization. Second, a feedback mechanism by which the level of decentralization affects the nature of intra-party and inter-party competition. And third, the cross-reinforcing effects between the regionalization of the party system and the centrifugation of state-wide parties, when decentralization levels are high enough.

This article opens several paths for future research. The first one is the analysis of the two dimensions of the party system. We claim that political competition encompasses an inter-party and intra-party dimension. Both are related, but they are not convergent. Some countries may have

high levels of regionalized inter-party competition, while keeping low levels of intra-party ones, and other countries, like the US, will have high levels of intra-party competition without having a regionalized national arena. According to our model, when both dimensions are high enough, there is a higher risk of decentralization entering a spiral dynamic. A first possible extension of our theoretical model is a more detailed exploration of the conditions under which these two dimensions reinforce each other. A second potential research path is to carry out an empirical analysis of cross-country variation of decentralization dynamics. We have cited in the paper some empirical evidence on worldwide trends in decentralization. However, further analysis of the evolution of decentralization in different countries over time is needed to provide a more qualified picture of the institutional conditions associated to different paths. Finally, the political theory on decentralization dynamics this paper provides could be tested with some country narratives that illustrate the endogenous relationship between the evolution of decentralization and the structure of the party system.

APPENDIX 1 Solving the Model and the Euler Equation

We can re-state the maximization problem for the national incumbent by using the value function and exploiting the recursive structure of the problem:

$$V(w_t) = \max_{D_t} (D_t - w_t) + \delta V(w_{t+1})$$

subject to $w_{t+1} = a_t + \mu_1 D_t \left(1 + D_t a_t \frac{r_t^2}{2}\right) + r_t + \mu_2 D_t \left(1 + D_t r_t \frac{a_t^2}{2}\right)$

To solve the problem, first we take the FOC with respect to D_t :

$$\frac{v(s_t)}{D_t} + \delta V'(w_{t+1}) \left[\frac{w_{t+1}}{D_t} \right] = 0$$

or $1 + \delta V'(w_{t+1}) [\mu_1 + \mu_2 + D_t (\mu_1 a_t r_t^2 + \mu_2 r_t a_t^2)] = 0$

And secondly, we need to substitute into the FOC an expression for $V'(w_{t+1})$. For this purpose we first look for $V'(w_t)$ and afterwards we use the recursive structure of the problem to plug this value into the FOC.

$$V'(w_t) = \frac{v(s_t)}{D_t} \frac{D_t}{w_t} + \delta V'(w_{t+1}) \left[\frac{w_{t+1}}{w_t} + \frac{w_{t+1}}{D_t} \frac{D_t}{w_t} \right]$$

By applying the Envelope Theorem and substituting into the FOC we can now derive the Euler Equation that provides us the optimal path for D_t in each time period:

$$\frac{v(s_t)}{D_t} \frac{1}{B_t} = \delta \frac{v(s_{t+1})}{D_{t+1}} \frac{A_{t+1}}{B_{t+1}}$$

Where:

$$B_t = \mu_1 + \mu_2 + D_t (\mu_1 a_t r_t^2 + \mu_2 r_t a_t^2)$$

$$A_{t+1} = \frac{1}{a_{t+1} + r_{t+1}} \left[\left(a_{t+1} + r_{t+1} + D_{t+1} \mu_1 \left(\frac{1}{2} a_{t+1} D_{t+1} r_{t+1}^2 + 1 \right) \right) + D_{t+1} \mu_2 \left(\frac{1}{2} r_{t+1} D_{t+1} a_{t+1}^2 + 1 \right) \right]$$

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