The Political economy of fiscal decentralization : bringing politics to the study of intergovernmental transfers

Author(s):	León-Alfonso, Sandra
Year:	2006
Type	Thesis (doctoral)
University:	Instituto Juan March de Estudios e Investigaciones, Centro de Estudios Avanzados en Ciencias Sociales, Universidad Autónoma de Madrid, 2006.
City:	Madrid
Number of pages:	xi, 334 p.

Abstract: El objetivo de esta tesis es explorar los factores que explican la descentralización fiscal, su diseño y su dinámica a lo largo del tiempo. La pregunta de investigación trata, por lo tanto, de las causas de los procesos de descentralización fiscal, en concreto, del diseño y evolución de las transferencias intergubernamentales en un sistema multi–nivel (donde existen diferentes niveles de gobierno elegidos democráticamente). Tradicionalmente el estudio de la descentralización fiscal ha correspondido a la literatura sobre federalismo fiscal. En ella se parte de una concepción de los políticos como actores benevolentes cuyas acciones están orientadas a maximizar la eficiencia económica. La justificación de los procesos de descentralización fiscal se basa en una perspectiva exclusivamente económica, de carácter fundamentalmente normativo, donde las instituciones y los procesos políticos están excluidos. En esta tesis la perspectiva adoptada tiene carácter positivo, es decir, el principal objetivo es explicar por qué y cómo se produce la descentralización fiscal y sitúa las instituciones y la competición electoral interpartidista como ejes fundamentales del marco teórico. Además, se parte de una concepción radicalmente distinta de los políticos, a quienes se caracteriza como actores cuyo principal objetivo es permanecer en el poder. Esta perspectiva enlaza con el desarrollo reciente, dentro de la literatura sobre la descentralización, de una serie de estudios en los que las instituciones y las variables relacionadas con la competición entre partidos políticos son fundamentales para explicar las causas de los procesos de transferencia de poder hacia gobiernos subnacionales. La tesis consta de una introducción, seis capítulos y las conclusiones. En el primer capítulo se presenta un repaso de la literatura sobre los procesos de descentralización en general y sobre la descentralización fiscal en particular. Además, en la última parte del capítulo se introduce la definición de los actores del proceso – gobierno central y gobiernos subnacionales – y de sus preferencias. En el segundo capítulo se desarrolla el marco teórico y las dos hipótesis generales de la tesis. Las hipótesis generales son dos: la primera es que en un contexto centralizado los políticos nacionales distribuirán las transferencias intergubernamentales favoreciendo a los gobiernos subnacionales swing. La segunda es que en un marco institucional descentralizado los políticos nacionales transferirán más recursos a los gobiernos

subnacionales del mismo color político y, entre ellos, a aquellos respecto de los cuales el gobierno electoral es más dependiente para ganar las elecciones. Las hipótesis son elaboradas partiendo de dos contextos institucionales distintos: uno centralizado y otro descentralizado que difieren en el nivel de competencias sobre gasto y sobre ingresos de los gobiernos subnacionales. En un contexto centralizado, en el que los políticos subnacionales tienen un nivel muy bajo de autonomía fiscal y pocas competencias sobre el gasto, los ciudadanos perciben al gobierno central como máximo responsable del conjunto de políticas públicas. Además, existen externalidades electorales entre políticos de un mismo partido que compiten en distintos niveles de gobierno y la estructura de los partidos es centralizada. En un escenario centralizado los gobiernos centrales son capaces de apropiarse de los beneficios electorales que generan los servicios públicos financiados con las transferencias. En un contexto descentralizado, donde los gobiernos subnacionales tienen atribuidos niveles altos de competencias sobre gasto y sobre ingresos los supuestos son distintos. Los ciudadanos atribuyen a los gobiernos subnacionales más responsabilidades sobre la provisión de servicios públicos en sus jurisdicciones. Además, las interdependencias electorales entre elecciones de distinto nivel son más débiles y existe centrifugación de la estructura organizativa (de poder) dentro de los partidos. Algunos de los supuestos realizados para cada contexto institucional son contrastados empíricamente en los capítulos tres y cuatro. El capítulo cinco recoge el análisis empírico de las dos hipótesis generales de la tesis. Finalmente, el capítulo seis explica las ineficiencias existentes en el sistema de financiación autonómica a partir de los incentivos perversos que algunas características del diseño institucional de la descentralización han generado. La metodología para contrastar las hipótesis ha sido utilizar un caso de estudio, el caso español, con datos cuantitativos y cualitativos. El Estado de las Autonomías representa un excelente caso para aplicar el marco teórico, pues en la evolución de la descentralización en España pueden distinguirse dos periodos: el primero, desde la aprobación de la Constitución hasta finales de los ochenta y principios de los noventa, en los que el contexto es centralizado. Y un segundo escenario, que comienza a principios de los noventa, en el que progresivamente aumentan los niveles de competencias de los gobiernos regionales. Por lo tanto, la elección del caso español resulta muy adecuada para contrastar empíricamente las dos hipótesis generales derivadas del marco teórico. Sobre los datos cuantitativos se trata de un time-series cross-section donde las unidades de análisis son las Comunidades Autónomas financiadas a través del sistema de Régimen Común. Las observaciones son los recursos per cápita regionales proporcionados por cada uno de los modelos de financiación autonómica existentes desde el año 1986 hasta el 2001. La evidencia empírica proporcionada por los datos se complementa con entrevistas en profundidad a líderes políticos del partido socialista. Los entrevistados pueden clasificarse en dos grupos: el primero está formado por políticos que ostentaron cargos dentro de la organización del partido que estaban relacionados con la financiación autonómica (por ejemplo, Secretario de Política Institucional). El segundo grupo se compone de miembros del ejecutivo socialista responsables de carteras ministeriales relacionadas directamente con el sistema de financiación de las Comunidades Autónomas (Ministerio de Economía y Hacienda y Ministerio de Administraciones Territoriales (más tarde llamado de Administración Pública). Las aportaciones de esta tesis doctoral son las siguientes. En primer lugar, la tesis ofrece una mejor comprensión del tema de la descentralización fiscal desde la perspectiva de la economía política. El análisis empírico corrobora significativamente las hipótesis derivadas del marco teórico, lo cual indica que, para un adecuado entendimiento de los procesos de descentralización, es necesario introducir factores políticos – tales como la competición electoral o la estructura de los partidos políticos. Este trabajo supone una interesante aportación dentro de la reciente literatura que analiza la descentralización desde una perspectiva político-institucional. En esta literatura la lógica de los procesos de reparto de competencias hacia niveles inferiores de gobiernos es fundamentalmente política. A diferencia de la teoría económica del federalismo fiscal, los políticos son representados como actores cuyas acciones persiguen principalmente mantenerse en el poder. Además, el singular marco teórico desarrollado en esta tesis sobre el diseño de las transferencias intergubernamentales constituye una aportación dentro de los estudios que hasta ahora se han publicado sobre el reparto de las transferencias entre distintos niveles de gobiernos. Existen distintas teorías sobre cuáles son los factores que predominan en el reparto de recursos desde la administración central/federal hacia las unidades subnacionales. Unas teorías indican que los recursos fluyen hacia los territorios donde el partido en el gobierno central tiene sus bases de apoyo. Otras teorías indican que las transferencias benefician a las regiones swing (aquellas donde la competición está más reñida). No existe un argumento teórico que indique por qué en algunos los factores políticos relevantes cambian a lo largo del tiempo o entre distintos casos. El marco teórico de esta tesis aporta esta explicación, señalando que el elemento central para entender qué factores predominan en el reparto de transferencias es el contexto institucional donde el gobierno central y los gobiernos subnacionales interactúan. Además, este trabajo profundiza en el estudio de la financiación autonómica desde una perspectiva de economía política, algo prácticamente inexplorado para el caso español. Por último, el análisis desarrollado en esta tesis tiene implicaciones sobre las decisiones de los políticos a la hora de descentralizar poderes hacia los niveles subnacionales. El estudio demuestra que, una vez los gobiernos subnacionales reciben un amplio volumen de competencias, la estructura de incentivos cambia y, lo que es más importante, hace que el proceso se torne irreversible.

Instituto Juan March de Estudios e Investigaciones

SANDRA LEÓN ALFONSO

THE POLITICAL ECONOMY OF FISCAL DECENTRALIZATION. BRINGING POLITICS TO THE STUDY OF INTERGOVERNMENTAL TRANSFERS

MADRID
2 0 0 6

Centro de Estudios Avanzados en Ciencias Sociales

Esta obra se presentó como tesis doctoral en la Universidad Autónoma de Madrid, el 15 de junio del 2006. El Tribunal estuvo compuesto por los profesores doctores, José Ramón Montero, Joan Subirats, Núria Bosch, Jesús Ruiz-Huerta y Francesc Pallarés.

Sandra León Alfonso es licenciada en Ciencias Políticas por la Universidad Pompeu Fabra. Formó parte de la decimotercera promoción de estudiantes del Centro de Estudios Avanzados en Ciencias Sociales del Instituto Juan March de Estudios e Investigaciones, donde obtuvo el título de *Master* en 2002. En el propio Centro elaboró su tesis doctoral bajo la dirección del Profesor José María Maravall.

A mi abuela Felisa

CONTENTS

List of Figures

Chapter 2

Chapter 3

Chapter 6

Chapter 7

List of Tables

Chapter 1

Chapter 4

Chapter 5

ACKNOWLEDGEMENTS

If this section had no introduction, one might think that the foregoing pages were exclusively the result of the work carried out by the person who signs them. That would be a misleading impression and this would be an incomplete book. In writing these acknowledgements I want to stress that this thesis is the result of a joint effort and to thank those people and institutions who have contributed to its development.

The Juan March Institute and its Center for Advanced Studies in the Social Sciences have given to me a great and crucial opportunity to join the world of research. Enjoying its human and material resources and challenging academic environment has been a privileged way of entering the social sciences. I will always be grateful to the Institute for having excellently laid the foundations of my intellectual training as a social scientist. Specifically, I would like to particularly congratulate its academic director, José María Maravall. He represents an admirable example to me of how to successfully combine an outstanding academic career with a strong commitment to promoting sound research in the social sciences. My gratitude to him extends well beyond these pages. He has assisted my research with rigorous advice, support and encouragement. And, most importantly, he has taught me to regard the uncertainty and complexity that research involves as a never-ending journey through knowledge. His love for the discipline will surely remain as a lasting trace in my future research work.

There are many other people to whom I feel indebted. I am very grateful to my Masters classmates and friends: Leire, Ferran, Rubén, Nacho and Andrés, who suffered my doubts in the early steps of this thesis and always assisted my work with sincere generosity. My gratitude goes very specially to Nacho Lago, *Ferran Martínez and Rubén Ruiz. I must also include Ignacio Sánchez-Cuenca, Andrew Richards and José Ramón Montero, for providing illuminating suggestions while developing the research project. I warmly thank Ana Rico, whose excellent teaching on decentralization issues at Pompeu Fabra University encouraged me to look more deeply into this field of study. Her trenchant observations and generous help were invaluable assets in the early stages of this dissertation. I am also grateful to Pablo Beramendi, José F. Albertos, Ignacio Urquizu, Carles Boix, Paloma Aguilar, Yasemin Soysal, Margaret Levi, Santiago Lago, John Huber, Adam Przeworski, Rosa Urbanos and Alfonso Utrilla for finding the time to discuss my work-in-progress and enhance it with their insights. From the early development of this dissertation to its closing words I have also benefited from a team of excellent professionals at the Institute. I warmly thank Magdalena for being both so supportive and effective in dealing with my continuous queries, needs and last-minute petitions. I am also grateful to Jackie and, most recently, Dolores, for their valuable assistance with the many administrative proceedings. I have great admiration for the successful work that Martha Peach, Almudena Knecht, Paz Fernández and Gema Sánchez carry out in the library. I must thank them for always being extremely helpful and effective in their assistance, no matter the urgency and type of demands.*

I am also deeply indebted to "La Caixa" Foundation. Thanks to its long and generous financial support, it was possible to advance my dissertation work in the active, excellent and rich academic environment at Harvard University. While in the USA, I received great assistance from my friend Alberto Abadie, who helped me out with the quantitative part of the dissertation. I thank him for his unconditional and continuous support, which he has always carried out with a wonderful combination of generosity, academic brilliance and personal modesty. I am also grateful to Dawn Brancati and Jonathan Rodden for enhancing my work with illuminating suggestions. I cannot forget my roommates Carol, Mila, Miguel and Ignacio and my friends Roberta, Amaya, Pepe, *Ferran, Lara and Marwan. All of them made my life in Boston a great experience and their friendship was a marvelous release when research problems seemed insurmountable.*

Deep gratitude goes to my friend Xavi and his parents for their unconditional and sincere friendship and their endless faith in what I do. I am also very grateful to Marijose and Rafa for their infinite help and loyalty throughout these years. I thank all my friends and my lifelong neighbors in Barcelona for having put so much love and trust in me, which has been a great source of strength to carry out my work. In driving this dissertation to an end I have crucially counted on the invaluable generosity of a wonderful person. Along with his selfless and unconditional help he brought joy and happiness, and magically turned the hard time of writing the closing words of this thesis into a period full of emotions and hope.

A special place in my deepest affections belongs to Angel, to whom this dissertation owes much. We shared a precious and unforgettable time during which he stoically coped with the sacrifices of writing a dissertation and faced with endless love and support my worries, fears and feelings.

If I had not been able to count on the support and assistance of the people and institutions I have just mentioned, it would have been extremely difficult to write this dissertation. But without the love and support of my family, it would have surely been impossible. This is so because I owe them what I am and what I have achieved. My deepest gratitude and love goes to my parents, Fernando and Pili, my sister Ana and la Tata Carmina. I thank them with all my love for their understanding, affection and extraordinary faith in me. Finally, this dissertation is dedicated to the memory of my grandmother Felisa Rodrigo, an incredible and brilliant woman whose passionate soul impregnates every single page of this book.

CHAPTER 1. RESEARCH QUESTION, STRATEGY AND METHODOLOGY

1.1. The question

Decentralization is in vogue and has become a central concern around the world. It has flourished throughout the second half of the XXth century in most Western European national governments. New regional elected governments with executive and sometimes legislative powers have emerged in the United Kingdom, Spain, Italy, France, Belgium, and Portugal;[1] or local governments (either at county level or in municipalities) have been strengthened, in particular in the Scandinavian countries (Engel and Ginderachter 1993; Sharpe 1993; Wright 1984). Additionally, central governments in other regions of the world are decentralizing fiscal, political and/or administrative responsibilities. According to Dillinger (1994: 8) 63 out of 75 transition and developing countries with populations greater than 5 million have embarked on some form of transfer of fiscal power from central to local government.[2] There is much empirical

---

[1] Portugal, Açores and Madeira Islands have had the statute of Autonomous Regions and their own power of taxation since 1976.

[2] In addition, according to the index on federalism created by Arzaghi and Henderson (2002) federalism has risen from a world average of 1.03 in 1975 to 1.94 in 1995. Developed countries tend to be more federalized. Latin American countries reached the same level of federalism as developed countries in 1995, with former Soviet bloc

evidence that decentralization is a worldwide phenomenon that adopts a multiplicity of forms.

The term decentralization encompasses a wide variety of institutional arrangements across countries and within countries over time. Scholars have not agreed on a common definition of decentralization so that "*it seems often to mean whatever the person using the term wants it to mean*" (Bird 1993: 208).[3] Though decentralization takes multiple forms, this investigation focuses on the *devolution of fiscal powers*.[4] I use the term devolution instead of the more general term of decentralization to stress that this study only deals with forms of decentralization where recipient units are democratically elected. This is different than other forms of decentralization such as deconcentration or delegation where the recipient units are primarily (in the case of deconcentration) and ultimately (in the case of delegation) accountable to central government.[5] *Fiscal powers* refer to the set of policies designed to increase the revenues or fiscal autonomy of

---

countries not far behind. Only countries in the Middle East and North Africa have little local fiscal autonomy, with minor changes over time. See also Henderson (2000) and the index on federalism he constructs.

[3] The most classical typology of decentralization is found in Rondinelli (1981; 1989). Other scholars have come up with different classification such as Mills (1994), Parker (1995), Rodden (2002) or Treisman (2000).

[4] The term "devolution of fiscal powers" refers to the transfer of powers to subnational units that are democratically elected. The existence of these subnational units is due to a political process of decentralization. This means that prior to, or simultaneously with, the transfer of fiscal powers, there is a process of political decentralization or devolution, that is, the establishment of democratically elected subnational governing bodies. For instance, the transfer of expenditure powers to a central government agency that is accountable to central government would not be defined as devolution of fiscal powers.

[5] See Rondinelli (1981) for a more accurate description of these forms of decentralization.

subnational governments (Falletti 2005).[6] It consists of a downward reallocation of revenue sources for subnational governments that can take a multiplicity of forms such as transfers from central government, new subnational taxes or tax-sharing.[7]

The object of study – devolution of fiscal powers – entails two concepts with different natures: the static one (devolution) and a dynamic one (fiscal decentralization). I use the term *devolution* to refer to an end state characterized by subcentral, democratically elected governments that have been transferred responsibility, resources or authority. Devolution is therefore the *state of being* of the political system and I take it as given. On the other hand, fiscal decentralization is conceived of as a process of reform, as an ever-changing balance of revenue sources and fiscal authority across

[6] Among different taxonomies of decentralization that one can find in the literature, I find particularly useful the classification developed by Tulia Falleti (2005). She describes different forms of decentralization based on the type of authority devolved. *Administrative decentralization* comprises a downward transfer of the administration and delivery of public policies such as education, health care or social services. This may entail the transfer of decision-making authority over these policy areas, but it is not a necessary condition. *Fiscal decentralization* refers to the set of policies that increases the revenue sources of subnational governments. Again, this form of decentralization may entail different degrees of decision-making authority over revenue sources (such as tax authority or unconditional vs. conditional transfers from central government). Finally, *political decentralization* involves the creation of new spaces for representation of subnational polities. It is usually enacted through constitutional amendments or electoral reforms.

[7] This definition of fiscal decentralization differentiates between decentralization of revenues and expenditures, as the latter fall within the administrative decentralization type. This is not so in many other definitions of fiscal decentralization, which collapse decentralization of revenues and expenditures. For instance, Bird defines fiscal intergovernmental arrangements as those that regulate *who sets and collects what taxes, who undertakes which expenditures and how vertical imbalances are rectified* (1998: 7). Expenditures also form part of the definition of fiscal decentralization in Rodden (2004).

government levels. In sum, the main purpose of this study is to explore how fiscal intergovernmental arrangements are designed and evolve in a *devolved* governance system.[8] Considering this, the research question of this thesis can be stated as follows: *What are the explanatory factors of fiscal decentralization?* Or, in other words, *what accounts for the particular pattern of fiscal intergovernmental arrangements? What are the variables that cause a modification of revenue sources and fiscal authority across levels of governments?* These questions encompass three different aspects of decentralization that have often been analyzed separately: *Why* do politicians undertake fiscal decentralization at a particular point in time? *How* does fiscal decentralization take place (what is the pattern of fiscal arrangements)? And how does it evolve (what are the *dynamics*)? These three questions are intimately linked. I cannot account for the pattern of fiscal

[8] Fiscal decentralization may occur simultaneously to political and administrative decentralization. In fact, the statement that fiscal decentralization should follow administrative decentralization (*"finance should follow function")* is one of the aspects that theorists on fiscal decentralization contemplate as a guiding principle of revenue assignment. That is, until expenditure assignment is decided, it should be avoided to decide on the proper division of taxes, borrowing powers and transfers (World Development Report 1999/2000 p. 117; Escobar-Lemmon 2001: 25; Rondinelli 1981; Bahl 1995). However, as Escobar points out, *"the exact nature of the relationship between fiscal and political decentralization is an open empirical question. Although it is reasonable to expect that these two processes will occur simultaneously, there is no reason to believe that must be the case"*. For instance, in many African countries, decentralization of responsibilities to subnational governments was not followed by decentralization of revenues, so that the quality of services provided by subnational governments decreased sharply. In contrast, in some Latin American countries the opposite occurred: decentralization of revenues was established without offloading corresponding responsibilities so that central government was left responsible for activities nominally in subnational hands. In Hungary, Russia and Ukraine decentralization of finance has also come before function.

intergovernmental agreements unless I explore politicians' preferences and strategies when choosing a particular allocation of revenue sources. In doing so, I uncover the *how* by exploring the *why*. Or, in other words, I first need to have a good understanding of politicians' motivations if I seek to account for the pattern of intergovernmental arrangements: *how* revenue sources are eventually distributed across levels of government is the result of *what* drives politicians' actions.

In this thesis I contend that what accounts for politicians' actions is the combination of politicians' preferences and the incentives that stem from the institutional framework where they make decisions. Assuming that preferences are stable, a modification of intergovernmental fiscal arrangements is the result of a variation in the incentives that stem from the institutional setting. Therefore, it is by exploring the *why* (which refers to variables that impact upon politicians' actions) that I can account for the pattern and the dynamics of fiscal decentralization.

1.1.1. The dependent variable: main components of fiscal intergovernmental arrangements

The design of intergovernmental fiscal relations is determined by the combination of different revenue sources: transfers, tax-raising powers, and borrowing capacity. Each combination may take a multiplicity of forms, which entail different degrees of autonomy[9] for recipient units (as displayed in Table 1.1). *Revenue-*

---

[9] In many studies fiscal decentralization has been measured as subnational percentage of revenue-sharing. However, it is also necessary to take into account the rules governing such transfers and the extent of control exercised by central government. Otherwise, we may end up overestimating (or underestimating) the overall level of fiscal decentralization in a particular country. For instance, the Mexican federal government increasingly decentralized social spending during the second half of the 1980s. However, the control over the earmarking of these funds continued to be strongly centralized (Montero 2001: 49). In

sharing involves the assignment of revenues of higher levels of government to lower levels through an allocation formula. It may be of four types. On the one hand, transfers may be automatic (prescribed by constitution or by ordinary law) or submitted to the discretion of central government. On the other hand, transfers may be unconditional (subnational governments have autonomy to decide how to spend transferred money) or earmarked for specific uses, such as paying teachers' salaries.

As far as revenue-raising capacity is concerned, it can be implemented in a variety of ways. First, it is important to note that there are four different aspects in the assignment of revenues that helps to clarify where the power lies (McLure and Martinez-Vazquez 2000):

a) Who chooses taxes
b) Who chooses the tax base
c) Who chooses the tax rate[10]
d) Who administers the tax

First, subnational governments may be granted exclusive rights to a broad-base tax (or a local tax like the property tax) such as the income tax or the VAT (then subnational governments choose a + b+ c+ d). Second, subnational governments may create a *surcharge* on a nationally administered and collected tax (this implies that the subnational government chooses the surcharge tax rate while central government does a + b+ d, that is, central government defines the tax base and collects both its own tax and surcharges set by subnational governments. Another way is *tax sharing* whereby subnational governments receive fixed fractions of revenues from national taxes that are collected within their

---

consequence, the overall level of fiscal decentralization is in practice lower than what may be inferred if fiscal decentralization is measured as the percentage of total expenditure that subnational governments control.

[10] From the point of view of sovereignty of subnational governments, this is the most important function because it allows them to choose the level of public spending they want to provide.

jurisdictions. Usually sharing rates are uniform across jurisdictions so that governments have no autonomy to decide the amount of revenues they receive although they have autonomy on how to spend them. Finally, subnational borrowing has emerged as one of the most important issues of decentralization. Central government may exercise some types of regulations such as direct government controls, like annual limits on borrowing or administrative authorization for loans (World Development Report 1999/2000).

Table 1.1. Main components of fiscal intergovernmental arrangements

Components	High subnational autonomy	Low subnational autonomy
Revenue-sharing (grants)	Automatic	Discretionary
	Unconditioned	Earmarked
Revenue-raising	Exclusive rights to some taxes (VAT or income tax)	Share national taxes (through surcharges or tax-sharing)
Borrowing	No central government regulation	Central government regulation

1.2. The puzzling sides of fiscal decentralization

Why is it important to study fiscal intergovernmental arrangements? What are the puzzling sides of fiscal decentralization? If, as I described above, decentralization has encompassed a great variety of forms, why choose fiscal decentralization? There are several reasons why fiscal decentralization deserves independent study. First, the extent to which revenue sources accompany the transfer of administrative responsibilities is crucial to the success of autonomous subnational governments. Control of revenue sources is the thorniest issue of any decentralization process. Whether happens with deconcentrated bureaucrats or contracted-out services, any recipient unit must have adequate revenues (raised by themselves or transferred from central government) as well as the power to make expenditure decisions if they want to carry out functions effectively. But fiscal intergovernmental arrangements are particularly important in the context of devolution. If subnational representatives are endowed with many expenditure responsibilities but lack resources to fulfill them, how are they going to meet citizens' demands? Administrative decentralization becomes an empty transfer of power if it takes place without a subsequent offloading of revenue sources to subnational government. In sum, the importance of fiscal decentralization lies in the fact that subnational political autonomy depends on how fiscal intergovernmental arrangements are designed. Or, in other words, it depends on how money is raised, distributed and spent. As Escobar points out (2001: 25):

> "it is relatively easy and cheap for the government to transfer responsibility for providing services to lower levels of government. What is far more difficult, as well as fiscally and politically costly, is for the national government to transfer the financial resources needed to make independent execution of these extra responsibilities feasible."

The foregoing quote suggests that central government faces more costs when reallocating fiscal authority downwards than when transferring responsibility over service provision. But, what are the costs that fiscal decentralization involves? And do central government politicians' decisions on fiscal decentralization respond to a cost-benefit calculus? One could argue that fiscal decentralization entails a considerable cost for central government that consists in a loss of power to command the behaviour of actors at subnational level. When authority over revenue sources is *devolved*, recipient units are subnational governments that are democratically elected and that may have different political incentives than national politicians, since they respond to different constituencies. Devolution of fiscal powers may then be regarded as an irrational or non-intuitive process since it decreases the influence of national politicians over expenditures and revenues. If fiscal decentralization represents a sacrifice for central governments, why therefore do central governments surrender power? Why do they choose to lose control over how public policies are financed and, in turn, over their functioning? The second reason to study fiscal decentralization is to uncover how fiscal decentralization responds to a rational behaviour. As I show in the next paragraph, this is not an easy task, as exploring benefits and costs of fiscal intergovernmental arrangements does not provide straightforward answers.

The extent to which central government gives up its authority over revenue sources turns on the particular design of fiscal intergovernmental arrangements. As was described in Table 1.1, fiscal intergovernmental arrangements may entail different combinations of revenue sources. On what grounds will central government and subnational representatives agree on a particular combination of revenue sources? What considerations lie in the selection of a particular form of fiscal decentralization? Why do politicians undertake fiscal decentralization *as they do*?

On the one hand, we may think that central government's concerns when adopting fiscal decentralization are related to maximizing the control of revenues. In this case, tax policy is an area in which politicians would be loath to cede authority to subnational governments, because that policy area offers many political advantages (see Epstein and O'Halloran 1999). Even though controlling tax policy entails setting overall rates, which taxpayers tend to resent, it also involves the possibility of granting corporations and other lobby groups special tax breaks, and represents the primary source of resources. In consequence, national politicians may be reluctant to transfer downwards powers over taxes because they then are no longer capable of granting tax benefits to different constituencies and they may lose the capacity of redistribution through the tax system. Accordingly, central government may be more willing to increase the revenues of subnational governments through transfers than through fiscal autonomy as the latter represents a greater sacrifice of national government power over subnational states (Montero 2001).

On the other hand, long-term considerations on budgetary stability and deficits may prevail in the design of fiscal intergovernmental arrangements. The argument goes as follows: when subnational revenues are funded by *"common pool"* resources (such as grants and/or tax sharing) this allows subnational governments to avoid the political and financial costs of their expenditures.[11] Subnational governments receive political benefits from transfers but they do not internalize their full cost since transfers are funded out of a common national pool of tax revenues. This may generate soft budget constraints for subnational governments and in turn give rise to overspending and deficits. Central government has eventually to bear the costs of raising revenues to finance expenditures. Following these considerations, we may expect the central administration to be willing to cede tax powers to subnational governments to prevent them from incurring a budget deficit.

So far I have only considered the role of central government. But how do subnational governments enter this process? What are their preferences over the type of fiscal intergovernmental arrangements? Will they be more willing to demand own-source revenues (despite the fact that tax autonomy may involve political costs)? Will preferences on autonomy therefore prevail over these (short-term) potential political costs? And, more importantly, to what extent do fiscal arrangements turn on the bargaining power of subnational actors?

---

[11] The common pool hypothesis states that *"other things being equal, higher levels of subnational expenditure funded through common pool resources are associated with larger overall government spending."* (Rodden 2001)

Further questions on fiscal decentralization remain unanswered as far as its dynamic is concerned. I have defined fiscal decentralization as an ever-changing balance of revenue sources. Once fiscal arrangements are established, what factors account for subsequent changes? As is said by some scholars, the evolution of subnational revenue sources might be subject to increasing subnational demands. Accordingly, the process of fiscal decentralization enters an unstoppable centrifugal dynamic and national politicians have difficulties in backtracking fiscal decentralization.[12] However, empirical evidence shows that in some cases (for instance, in Argentina), fiscal recentralization does occur. How can these changes be accounted for? Do they respond to a modification of actors' bargaining power?

All these considerations reveal that fiscal decentralization is a process that needs further exploration. We need a better understanding of actors' preferences, bargaining power and strategies to explain why fiscal arrangements are established *as they are* and what factors drive subsequent modifications. This thesis seeks to fill this gap. The argument in which I ground the theoretical framework of this study is presented in the next section.

1.3. Explaining fiscal decentralization: the argument

In this thesis fiscal decentralization is not an inevitable outcome, but a political choice. Politicians base their decisions, their choices, on their goals and the incentives that stem from the institutional structure where decisions are taken. Accordingly, in order to account for fiscal decentralization it is necessary to understand how the decision to decentralize enters the *political logic*. This logic is driven by both the institutional structure and

[12] This has been defined as a *"decentralization feeds decentralization"* dynamic, which makes recentralization pressures difficult to succeed.

politicians' preferences. More specifically, I contend that the interaction between institutions and politicians' goals plays a major role in the *form* and *dynamics* of fiscal intergovernmental agreements. Investigating the role that institutions and political competition play in explaining fiscal decentralization will assist us in understanding what makes it a matter of choice, and not an inevitable outcome.

I assume that political institutions, electoral-partisan dynamics and intergovernmental political bargaining are all necessary elements to account for *any* process of decentralization. Decentralization is therefore the result of a political process in which the strategic behaviour of national and subnational elites plays a crucial role. I take, therefore, a political elite-centered perspective in which politicians play the most important role in the process of fiscal decentralization. A modification of the intergovernmental fiscal contract represents a vertical and horizontal flow of power and resources between different levels of government, and the interplay between central government and subnational political elites is crucial to understanding what direction changes take. The *political logic* of decentralization is embedded in that interaction, in which forward-looking national and subnational political elites set up their strategies after calculating its potential political costs and gains. I contend that strategies of national and subnational politicians are dynamically changing as institutions change, and form part of any explanation of a modification of intergovernmental fiscal relations.

As I will show in the next chapter, the literature on welfare economics assumes that politicians are driven by public interest concerns. On the contrary, in the theoretical framework of this thesis politicians are driven purely by self-interest, for it is individual politicians' preferences in securing and maintaining office by winning elections that shapes the evolution of the fiscal intergovernmental contract.[13] Political elites' goals largely rest on

---

[13] It is individual self-interest that makes a federal contract self-enforcing and accordingly determines the stability of the federal bargain.

electoral and political-career concerns aimed at "political survival" (Ames 1987). In consequence, a modification of revenue sources across levels of government does not respond to the implementation of technical solutions but is the result of a *political compromise* that is brought about by political bargaining between different levels of government (Watts 2003; Watts 1994; Bird 1994). In fact, departing from the efficiency-oriented politicians of welfare economics, I contend that actors' choices may give rise to outcomes that are collectively sub-optimal.

This approach, which I define as political-institutional or "electoral" perspective, has recently taken several specific forms in the literature on decentralization.[14] In these studies the analysis of decentralization is grounded in political considerations, and therefore they depart from the welfare economics approach, where the economic rationale prevails. Political variables are basically centred either around reelection concerns (driven by median-voter demands and competition with other parties) or on the goals of career-oriented politicians (driven by the centralized/decentralized structure of the political party). In my theoretical framework I combine variables that relate both to the internal organization of parties and electoral competition and elaborate upon their impact on fiscal decentralization taking into consideration the institutional context where politicians make decisions. To summarize the approach from which I study decentralization I introduce the following quote:

> "differences in decentralization are not simply a matter of different local demands for services, different local capacities to raise revenue or administer programs (…) (but) political choices and political institutions have played a major role in explaining the variation in

---

The primary self-interest of politicians is to secure and maintain office by winning elections (Ordeshook and Shvetsova 1997).

[14] Garman et al. (1999, 2001), Boone (2003), O'Neill (2001a, 2001b, 2003), Escobar-Lemmon (2001), Eaton (2001, 2004), Watts (1994, 2003), Jeffery (2003), Montero and Samuels (2004), Penfold-Becerra (2004).

the form, degree and success of decentralization." (Montero and Samuels 2004: 3)

1.4. Research Strategy

In recent research political and fiscal decentralization often appear conflated. In this thesis I study fiscal decentralization *within* a politically decentralized governance system. That is, I take as given the existence of subnational levels of government that are democratically elected. I then simplify the political world by assuming that there are only two actors: national politicians and subnational politicians,[15] and endow them with preferences. I next create a model that represents central government's decision about the design of fiscal intergovernmental arrangements. More specifically, the model simplifies national politicians' decision on the distribution of intergovernmental grants (revenue-sharing) across subnational governments. According to the argument introduced above, the strategies of politicians will vary depending on the institutional context. Therefore I apply the model in two different institutional settings: a centralized context and a decentralized one. To define the incentive structure in each institutional setting I focus on three features: the internal organization of state-wide parties, electoral externalities across levels of government and citizens' ability to ascribe responsibilities across levels of government in a multi-level governance system. These characteristics determine, in the first place, the ability of central government to reap the electoral benefits from distributing intergovernmental transfers; and, in second place, the bargaining power of political actors. Accordingly, national politicians will adapt their allocation

[15] Individuals are the unit of analysis so the terms "central government" or "subnational governments" encompass central government politicians and subnational politicians, respectively. On the plausibility of treating composite actors as unitary actors see Scharpf (1991).

strategy – that pursues the maximization of electoral chances of reelection – to the costs and benefits each institutional setting entails. As a result, I come to two general hypotheses: one predicts the design of intergovernmental grants in a centralized context, whereas the second hypothesis establishes the allocation pattern in a decentralized setting.

I finally contend that the outcome that results from the combination of central and subnational governments' preferences and the structure of incentives may be collectively sub-optimal. More specifically, I explore how the particular design of fiscal and administrative decentralization generates an incentive structure that is incompatible with an efficient and stable model of regional financing. The main purpose is to show that that outcome is rational. No matter how actors commit to efficient and stable fiscal arrangements: these promises will never come true as long as the *perverse* structure of incentives remains.

1.4.1. The empirical analysis. The case of Spain

In this thesis the empirical analysis consists of three different parts. The first one is related to testing the assumptions made when creating the theoretical model. More specifically, I test suppositions with which I characterize a centralized and a decentralized institutional context. So, instead of taking as given those theoretical assumptions, I convert them into hypotheses and devote two chapters of the thesis to test their implications. I carry out empirical work that explores whether citizens' ability to ascribe responsibilities varies across contexts characterized by different levels of decentralization. I also test the hypothesis (a former assumption in the theoretical model) that electoral externalities across levels of government vary as decentralization increases.

In the second part, empirical work is aimed at testing the two general hypotheses. The Spanish case offers a unique opportunity to carry out the hypothesis-testing work. First, there exists a *devolved* territorial organization of the State - *Estado de las Autonomías* (State of Autonomies) - with 17 regional governments (Autonomous Communities) that are periodically elected in regional elections. Second, one can distinguish two different periods in the evolution of the territorial structure of the Spanish State. The first period spans from the early eighties to the early nineties and corresponds to a centralized context. In this period regional governments (Autonomous Communities, ACs hereafter) are created. They access autonomy through different legal procedures that also determine the level of authority and expenditure powers that are transferred downwards. Out of seventeen Autonomous Communities, there are seven that have accessed autonomy with larger expenditure responsibilities (the so-called "fast-track" regions). The remaining regions are granted lower levels of expenditure powers ("slow-track" or "ordinary" regions). The second period lasts from the mid-nineties to the present day and is roughly equivalent to a decentralized institutional setting. This is so because in the wake of the *Pactos Autonómicos* (Autonomous Agreements) of 1992 ordinary regions are gradually transferred greater expenditure powers. The last administrative decentralization wave takes place in 2001, when ordinary regions are granted powers over the provision of health care services. In summary, the Spanish case provides variation in the institutional context, which allows testing the general hypotheses – whereas other variables that may impact upon the design of fiscal decentralization are controlled.

In addition, as is well known, the Spanish Constitution set up a basic regulatory framework for the allocation of revenue sources across levels of government. However, the *open* nature of those provisions left room for the subsequent development and modification of fiscal intergovernmental arrangements. A number of authoritative voices have characterized fiscal decentralization in Spain as a politicized process. However, it is still unclear what *politicization* means and, more importantly, what outcomes result from the politicization of fiscal decentralization. There is thus a general acknowledgement that the structure of political competition and political parties has shaped the dynamics of intergovernmental fiscal relations in Spain. However, systematic measurement of such statements (that is, *who benefits from what* in the system) lags behind. By using Spain as a case study I take upon that empirical task and, most importantly, I place it within a theoretical framework that might be tested in other countries.

The third part of the analysis studies the combination of actors' preferences and the structure of incentives where they make decisions that gives rise to an outcome that is collectively sub-optimal. I use as a case study the Spanish system of regional financing, which has suffered from permanent instability and has gradually depleted the central administration's resources. I ground the rationale of such paradoxical result in three characteristics of the design of fiscal and administrative decentralization in Spain: asymmetries, the prominent role of bilateral negotiations and the *open* nature of the territorial organization of the State. I contend that these features have generated an incentive structure that is incompatible with the stability and efficiency in the financing of Autonomous Communities.

Finally, undertaking empirical analysis on the Spanish case is interesting for an additional reason. Research on administrative and fiscal decentralization in Spain has traditionally navigated two waters: the discipline of Law (particularly the area on Constitutional Law) and Economy (Public Finance). There is sound research on the process of formation and evolution of the State of Autonomies from the perspective of constitutional procedures and Constitutional Court judgments. The Public Economic field has also spawned vast research on the Spanish regional financing system. This literature has made an important contribution in terms of enhancing knowledge on the implementation of each regional financing model, stressing shortcomings and advancing enhancements. However, none of them have adequately addressed how the set of rules and proceedings that have so far regulated fiscal intergovernmental relations in Spain respond to the political factors. This thesis represents the first attempt to introduce a political economy perspective in studying the regional system of financing in Spain.

1.5. Data

I have used both quantitative and qualitative data to carry out the hypotheses-testing work. In chapter four I use survey data to analyze individuals' ability to identify the most responsible level of government for each policy area. Aggregated data has been used in chapter four to analyze electoral externalities across levels of government and in chapter five to test the distribution of intergovernmental transfers in distinct institutional contexts.

I also considered the necessity of using in-depth interviews to collect more data that would complement the empirical evidence provided through quantitative data. In-depth interviews represent a very important source of primary information and they are particularly valuable when the theoretical framework is built on politicians' strategies. If individuals are the unit of analysis and hypotheses focus on their strategies: why not ask *real* politicians - who were involved in fiscal intergovernmental bargaining - about their strategies?

I carried out eight in-depth interviews. Information about interviewees is provided in the appendix. They consisted in conversations with political leaders, who fall within two categories: individuals occupying top positions within the central administration, in particular, within the Ministries that are involved in fiscal intergovernmental relations (the Ministry of Public Administration and the Treasury) (six interviewees) and individuals who were responsible for issues related to fiscal decentralization within the Socialist Party (two interviewees). Of course this does not represent a clear-cut division as most leaders within the central administration also had a relevant position within the PSOE's organization.

On the technical part, all of the interviews have been recorded and transcribed and they on average lasted for one hour and a half.

I designed a questionnaire that was divided into two parts. The first one involved a battery of questions related to fiscal intergovernmental arrangements. They addressed issues relating to the bargaining process that brought about each model of regional financing in Spain. Therefore, I asked about the characterization of regional governments' demands, the central administration's position on fiscal decentralization, or a description of regional representatives' bargaining power. These questions were aimed at getting a better understanding of the process of fiscal intergovernmental bargaining throughout the analyzed period. Collected data were eventually used to provide supportive evidence on the general hypotheses of the model. The second part of the questionnaire dealt with the internal organization of the PSOE and was aimed at gaining some knowledge on whether increasing decentralization had any impact on the internal structure of a state-wide party.

1.6. Organization of chapters

In the next chapter (chapter two) I introduce a general review of the literature on decentralization that goes from the general to the concrete. Accordingly, I firstly introduce the main arguments used to account for general decentralization processes (that is, political, administrative and fiscal decentralization). Subsequently, I characterize the main explanatory factors of fiscal decentralization. The chapter ends with a presentation of the general theoretical premises of the thesis, including the macro vs. micro logics of decentralization and a characterization of political actors' preferences. Having introduced these theoretical assumptions, in chapter three I proceed to create a model to account for the design of intergovernmental transfers. I apply the model in two different institutional settings: a centralized context and a decentralized one. To define the incentive structure in each institutional setting I focus on three features: the internal organization of state-wide parties, electoral externalities across levels of government, and citizens' ability to ascribe responsibilities in a multi-level governance system. Taking into account incentives generated in each scenario the chapter ends with the introduction of the two general hypotheses of the thesis. In chapter four and five I test empirically the assumptions made in each institutional context. Chapter four explores the effects of decentralization on citizens' ability to assign responsibilities for policy outcomes to different levels of government. The empirical analysis is carried out with Spanish survey data. In Spain the process of decentralization has been asymmetrical both in its revenue and expenditure side. As a result, three different groups of regions exist with divergent powers over revenue sources and expenditure responsibilities. In addition, regions have been increasingly granted greater tax and expenditure powers. In consequence, there is variance in decentralization levels both across-regions and over time. Using the Spanish case, therefore, allows us to test the impact of decentralization upon individuals' capabilities to allocate responsibilities while other institutional factors are controlled for.

In chapter five I test the impact of decentralization on electoral externalities and the internal structure of state-wide parties. The main hypothesis is that, as decentralization increases, electoral externalities become weaker. This means that, as subnational units gain more powers, the electoral fates of national politicians become less correlated with those of their local and regional counterparts. There are basically two types of causal mechanisms that link decentralization with electoral externalities. The first has to do with citizens' voting behaviour. In a decentralized context citizens gradually learn to correctly ascribe responsibilities across levels of government (an assumption that has been tested empirically in chapter four). As a result, they are more likely to vote differently in national and subnational electoral contests, which in turn diminishes electoral externalities. The second causal mechanism is related to subnational representatives' strategies. As regional governments are endowed with a high level of authority and greater expenditure powers, they face increasing incentives to maximize their autonomy in designing their policy and electoral agenda. Leaders that compete in subnational elections with a national party label have incentives to pursue *differentiation* policy and electoral strategies (even when these strategies confront them with their national counterparts). This is so because a downward transfer of expenditure and fiscal authority empowers subnational leaders of state-wide parties, who gradually succeed in putting within-party powers on the level with their assigned government responsibilities. There is a steady centrifugation of power within the party's internal organization. As a result, the costs of adopting policy and electoral strategies that differ from the party headquarters' guidelines become lower for subnational party members. On the other hand, the potential benefits of pursuing differentiation strategies increase as subnational leaders show high preferences for autonomy and when the state-wide party faces an electoral downturn in national elections. These hypotheses are tested for the Spanish case using both quantitative and interview-based data.

Further deductive analysis is carried out in chapter five, where I test the two general hypotheses on the Spanish case. In the first part of the chapter I characterize the Spanish system of regional financing from 1986 to 2001. I assume the three models of regional financing that were implemented during this period correspond with distinct institutional contexts. I define the context in which the first definitive model of regional financing (that spans from 1986 to 1991) is within a centralized scenario; whereas I contend that the third definitive system of regional financing (1997-2001) was designed and implemented in a decentralized one. Empirical work analyzes whether the allocation pattern of unconditional funds follows the two general hypotheses, which predict the allocation of funds in a centralized and a decentralized context. As decentralization is a gradual process, the institutional context in the 1992-1996 period falls into intermediate levels of decentralization. Accordingly, there is no prediction on the allocation pattern of unconditional funds based on the two general hypotheses. Instead, the distributional pattern in this financing system is revealed through the empirical analysis. General hypotheses are further corroborated through qualitative data obtained from interviewees to politicians who directly or indirectly participated in the design and implementation of the system of regional financing in Spain.

Chapter six deals with the dynamics of decentralization and explores how actors' choices may give rise to outcomes that are collectively sub-optimal. In particular, I study how the particular design of fiscal and administrative decentralization in Spain has generated incentives that are incompatible with the establishment of a stable and efficient model of regional financing. Finally, in chapter eight I summarize the theoretical argument, empirical findings and the main contributions of this thesis.

CHAPTER 2. EXPLAINING DECENTRALIZATION

2.1. Introduction

Despite the fact that there is a huge literature on normative issues of the role of subnational governments,[1] the positive issue of why decentralization occurs has received much less attention (Arzaghi and Henderson 2002; Manor 1999: 27; Garman, Haggard and Willis 2001; Eaton 2001, 2004). In the literature on fiscal decentralization there is a shortage of evidence on how and why decisions were made to decentralize. It has focused more on normative concerns relating to the economic and political effects of decentralization rather than explaining when and how countries decentralize. As a result, there is a lack of a coherent theoretical approach to study what causes decentralization and, therefore, systematic empirical testing lags behind. In addition, even though many scholars recognize that political factors play a role in decentralization processes[2] the literature is short of theoretical and empirical work that deals with political incentives as the core explanatory factors of decentralization.[3] In sum, not only is the

---

[1] Tiebout 1956; Oates 1977, 1986, 1989, 1995; Musgrave 1959; Persson, Roland and Tabellini 1996; Persson and Tabellini 1999.

[2] See the discussion between Rondinelli (1989; 1990) and Slater (1990). See also Samoff (1990).

[3] This contradiction is exemplified in the work of Rondinelli (1989: 60), when he states that *"...even when decentralization has been justified*

literature on decentralization more prone to study the analysis of its consequences, but also the studies that deal with its causes usually neglect the political factors within the set of explanatory mechanisms that account for decentralization.

When seeking to account for the causality of decentralization, we are left with a series of different *rationales*.[4] Broadly speaking, studies grounded in a normative approach explain the rationale of decentralization from expected outputs ascribed to it (such as political stability or economic efficiency). However, there has been no theoretical agreement on normative assumptions and the empirical evidence shows that expectations are only tenuously related to what actually takes place after decentralization is implemented. In addition, some studies characterize decentralization as a result of a (top-down) process directed from political elites at the center. Decentralization, therefore, is represented as a means for elites to guarantee some benefits - such as political stability - or to relieve political costs (for instance, by transferring downwards the implementation of cost-containment policies). On the other hand, other studies argue that decentralization is the result of pressures from below (bottom-up) – that is, from groups of citizens who are willing to increasing their participation in public decision-making. In sum, we are left

---

on economic grounds, most governments have not attempted to decentralize primarily for economic reasons (...) many recent experiments with decentralization could not be assessed entirely by economic criteria because they were initiated primarily for political reasons." However, he later disregards those political factors and only refers to the "strong political commitment and support" that must come from national leaders to transfer planning, decision making and managerial authority. We ignore which factors have prompted national politicians to "be willing to" decentralize.

[4] 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."*

with a set of different rationales that do not specify precise causal mechanisms, and that appear to be relevant in one country but not necessarily consistent across countries. In view of such complexity, some scholars argue that the rationale of decentralization:

> "cannot follow concrete rules because it occurs in each particular country, with its own history and traditions, and its own specific institutional, political and economic context." (Bird and Vallaincourt 2000: 2)[5]

Of course each decentralization process may be regarded as unique and only be explained through the specific context (political, historical, economic and cultural) in which it takes place. But we may then end up referring to countries as if they are isolated cases unconnected to each other (e.g. "Spain is Spain" and "Argentina is Argentina").

Although it would be absurd to ignore the importance of context-specific factors in promoting decentralization, this cannot prevent researchers from coming to some generalizations. This task could be accomplished through the development of a theoretical framework that is tested on as many cases as possible. Theory should be capable of accounting for diversity of individual decentralizing reforms across time and place. As I already stated in the introductory chapter, this is the main purpose of this thesis. To carry out that task I focus on a particular type of decentralizing process – fiscal intergovernmental arrangements. In my theoretical

---

[5] For instance, Manor (1999) in the beginning of the chapter devoted to explaining the latest wave of decentralization says that *"Decentralization in each country is the result of a combination of causes (…) (which) varies from country to country"* or *"Decentralization has been taken for a variety of motives and with a variety of goals in mind"* (p.26). or "Thus as one would expect, the diversity of reasons for the "why" reflects the diversity of the country cases." (Ebel and Yilmaz 2001)

framework I introduce more realistic assumptions about institutions and politics than theories based on normative economic rationale (that simply ignore them) as I believe that this approach is better suited to offer more powerful explanations for observed patterns of fiscal decentralization. I therefore characterize politicians as individuals driven by electoral concerns and fiscal decentralization as the result of strategies that best help politicians to advance their electoral goals. As I will analyze next, this characterization of politicians is also present in a recent branch of the literature on decentralization. In these studies decentralization is driven by electoral party competition or through the internal organization of political parties. In contrast to them, my contribution consists in the development of a model where I combine both politicians' electoral competition and intra-party concerns.

The literature review is organized from general to specific. In the next section I present a summary of the main rationales used to account for any decentralization process (political, administrative, and fiscal). I then proceed with a description of the literature on fiscal federalism. In Section 2.4 I turn to a series of recent studies that have introduced political factors to the core of the explanatory factors of decentralization. Finally, the last section deals with the basic features of my theoretical framework, namely the micro-logics of decentralization and politicians' preferences.

2.2. Rationales for decentralization

There is a strong case for decentralization on political grounds in terms of political participation and democracy. From this perspective decentralization is democratically valuable because it institutionalizes the participation of those affected by local decisions and strengthens local responsiveness and accountability. This has been defined as 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.[6,7]

However, there is no agreement with respect to the role of bottom-up pressures to decentralize. For instance Manor (1999) states that pressure from ordinary people had little influence in the decentralization processes in developing countries and that people's enthusiasm for decentralization often developed *after* decentralization had taken place.

A different political rationale for decentralization is to accommodate regional demands for greater political and financial autonomy due to cultural, ethnic, linguistic and/or religious cleavages within the state (Van Houten 1999; Gobetti 1996; Sharpe 1993). Decentralization is the result of centrifugal pressures from subnational governments, which claim to be more capable than the central administration to meet their constituencies' preferences and demands for public goods and services. They demand more authority to select the combinations of public goods that best fit the preferences of the citizens they

---

[6] The bottom-up approach arguments have underlain some of the explanations of decentralization. For instance, Aja (1999: 46) in his analysis of the Spanish process of decentralization identifies as causal factors the *"societal reaction against political, administrative and economic centralism"* "*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) Autonomy is identified as an essential democratic demand in Spain. In addition, a "Northern model" may be identified in the initial steps of the devolution process in all Scandinavian countries. This model is characterized by the predominance of the principles of local democracy, which consist in bringing decision-making closer to people and promoting citizens' participation at the local level.

[7] For a critical review of this approach see Linz (2000) and Tresiman (2003).

represent.[8] Thus, decentralization is regarded as a central government attempt to increase the legitimacy and sustainability of heterogeneous national states.

This idea has been developed in demand-driven median-voter type models**.** According to these models, heterogeneous countries will face overwhelming pressure to decentralize. Therefore, decentralization is the consequence of high levels of heterogeneity among individual preferences (Alesina and Spolaore 1997, Bolton and Roland 1997 and Panizza 1999). This approach does not hold for some countries that are ethnically diverse. For instance O'Neill (2000: 5) shows that in the Andean region – which is highly heterogeneous in terms of ethnicity - decentralization has not been the result of a capitulation by central governments to demands from below. Rather, it is the result of a top-down process where *"neither ethnic diversity by itself nor channeled through marches and demonstrations coincides with the incidence of decentralizing reforms."* In fact, an increase in political stability or citizens' participation are examples of the potential gains ascribed to decentralization that have not been wholly empirically verified. In addition, demand-driven median voter models based on demands for local autonomy link directly the presence of citizens' heterogeneous preferences with a new institutional arrangement that consists in the decentralization of powers. However, as is argued in Fearon and Van Houten's paper (Fearon and Van Houten 2002), differences in regional culture or ethnicity do not automatically generate a regional autonomy movement. Rather, they represent cultural "materials" available to be politicized by political entrepreneurs under specific circumstances. Therefore it might be said that there is an 'in-between step' between citizens' preferences and institutional arrangements in which politics play a prominent role.

---

[8] This is exemplified by the recent devolution processes in Italy (Gobetti 1996, Emiliani et al. 1997, Subirats 1998) and Belgium (Van Houten 1999).

Another set of arguments aimed at explaining decentralization is related to the expansion of the welfare state. Some authors argue that the expansion of the public sector and increasing state intervention in economic and social policy areas gives rise to new functional requirements that the State structure can no longer cope with, so that it is forced to transfer responsibilities to lower levels of government (Sharpe 1993). Decentralization is thus 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 dominated the literature on institutional change during the 1980s. Taking this approach as a point of departure, decentralization is the functional response of elites to resolve 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: 15), 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."

Finally, there are other arguments that associate decentralization with periods of economic crisis and cost-containment policies (that have come to be known as so-called *"decentralization of penury"*). As Engel and Ginderachter (1993:18) 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 administration was therefore regarded as a way to implement flexible adjustment, by devolving the responsibility for maintaining tight economic control to subnational governments.[9]

---

[9] For instance, Denmark and Finland represent a very good example of such policies. Blom-Hansen and Pallensen (2001: 618) investigate how the decentralization of the public budget in Denmark between 1982

If there are shortcomings in the provision of decentralized policies – caused by the implementation of a tight budget – central government can reduce political costs by blaming subnational governments for an underprovision of services. However, as some authors have shown (O'Neill 2000; Vries 2000; Montero 2001) economic downturns have also prompted the re-concentration of power at central government.

2.3. Fiscal Federalism Theory: a misleading path towards causes

Explanations to account for decentralization within the literature on welfare economics are unsatisfactory in understanding the *driving forces* of decentralization. These theories' main economic justification for decentralization rests largely on allocative and productive efficiency gains. A basic assumption in this literature is that public economic intervention actually pursues efficiency. As decentralization is regarded as a means to an economic end or as a policy that only serves economic objectives (a more efficient delivery of public goods) it ignores the importance of the structure of political incentives stemming from institutions that may lead politicians to make decisions far from the most preferred or efficient ones.

---

and 1993 was used by the central to maintain economic restrain 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) 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)

The extensive normative discussion of the potential gains associated with the descentralization of fiscal powers has mainly been developed by the economic literature on fiscal federalism.[10] Economic theories of fiscal decentralization have primarily come from two schools: the so-called Public Finance School (Musgrave 1959 and Oates 1972; 1988; 1991; 1999) and the Public Choice School (Brennan and Buchanan 1980).[11]

The Public Finance School makes a strong case for decentralizing finance on economic grounds. According to this theory the most important issue for federalism is that decisions on the structure of taxes and expenditures in a jurisdiction are tailored to citizens' preferences, regardless of whether the decision-making power is guaranteed constitutionally to autonomous local governments or is the result of central government delegation.[12] Oates developed a fiscal federalism theory drawing from the scant tripartite division of the public sector that Musgrave (1959) sketched out in his seminal work on public finance. According to Oates' theory, the provision of local public goods by local governments promises significant welfare gains, as they are more capable than central government of meeting citizens' demands and needs (allocative efficiency). As the level of the output of the service is tailored to the preferences of the citizens that consume the service, the allocation of resources is more efficient than if it is

---

[10] This literature, together with the literature on public goods, has been traditionally treated as part of the public finance field.

[11] Some of the early contributors to the Public Choice School as Buchanan and M. Olson were trained in public finance and contributed to the development of both schools (Hettich and Winer 1997).

[12] Oates acknowledges that a case for decentralization can be also made on political grounds. He states in a footnote that *"it can be argued, for example, that a federal system, in contrast to a wholly centralized form of government, provides a safeguards against the excessive concentration of public power, fosters diversity and innovation, and prommotes the development of a responsible and experienced citizenry by providing wider opportunities for participation in public decision-making." (1999: 14)*

provided homogeneously by central government.[13] Productive efficiency increases, as expenditure decisions are better tailored to the real costs of providing services. Besides, the economic efficiency gained through the diversification of the public good's output is enhanced by consumer mobility and the so-called "voting-on-foot"[14] mechanism (Tiebout 1956).[15] In addition,

---

[13] Fiscal federalism writings associate demographic and physical dimensions to decentralization welfare gains. Accordingly, conditions relating to the land area of the state, the size of its population and the geographical distribution of such population are treated as determinants of the level of fiscal centralization. For instance, Wallis and Oates (1988) show there is a negative and significative correlation between population, urbanization and the observed variation of the level of fiscal centralization in the US state and local sector, both over time and across states. The hypotheses in the work of Wallis and Oates take the following form: "The larger the size of a state in terms of land area, the less centralized, other things equal, should be its public sector" or "the larger the population of the state, other things equal, the less centralized should be its public sector," or "the larger the fraction of a state's population residing in urban areas, the less centralized, other things equal, should be the state and local sector." (pages 13 and 14)

[14] When the local "fiscal package" (the pattern of expenditures and the structures of taxes in a community) is not suited to the tastes of an individual, he can move to another community where the fiscal package is more suited to his tastes.

[15] Tiebout is theoretically concerned about not having "market type" solutions to determine the level of expenditures on public goods. The basic problem is that there is no mechanism to force the consumer-voter to state his true preferences about public goods: in fact his rational behavior is to understate his preferences and hope to enjoy the goods while avoiding the tax. So the government is unable to ascertain his wants for public goods and tax him accordingly. The consequence is that a large portion of national income is allocated in a "non optimal" way. Tiebout says that this problem is valid for federal expenditures but that need not apply to local governments. At the local level the act of moving or failing to move from a jurisdiction replaces the usual market test of willingness to buy a good and reveals the consumer-voter's demands for public goods.

decentralization can promote innovation and experimentation in the provision of public goods.

Within the Public Choice School, Brennan and Buchanan's theory (known as the *"Leviathan hypothesis"*) characterizes the government as a revenue-maximizer that systematically seeks to exploit its citizens through the maximization of tax revenue. They argue that the greater the extent to which taxes and expenditures are decentralized (*ceteris paribus*) the smaller the public sector's size. The causal mechanisms that associate fiscal decentralization with a smaller public sector is tax competition across subnational units. Subnational jurisdictions compete among each other, as they try to avoid the "exit" of "mobile" assets (capital) by lowering taxes (Rodden 2001). The same argument about tax competition is used by Weingast (see Garret and Rodden 2001; Weingast 1995; Qian and Weingast 1997) to link decentralization to market-friendly politics. Fiscal decentralization makes subnational units compete for mobile capital, which prompts subnational politicians to implement market-friendly policies in order to prevent the outward flow of mobile capital. However, this version of competitive federalism invites many of the same criticisms made about Tiebout models.[16]

---

[16] For a critical review of Tiebout's argument see Donahue (1997). He doubts about the argument that interstate competition can discipline government. He argues that equilibrium under interstate competition may yield policies that are not the most preferred ones by the citizen (ex: gambling). This is a result of a problem of collective action (no state wants to be the last one in relaxing gambling rules). In addition, he points that location elasticity varies widely among constituents. Individuals typically make their interstate migration decisions for reasons that have little or nothing to do with the performance of officeholders (they enjoy a larger "citizen's surplus": cultural affinities, friends, family, etc). And more importantly, the heterogeneity of locational elasticity with respect to state policy may prompt states to undertake policies to favor constituencies that are more mobile and more desirable, at the expense of constituencies less mobile and less desirable. In short, the article poses a doubt in that interstate competition for constituents is a superior alternative to enforce accountability than intrastate competition for

The economic theories on fiscal decentralization have spawned a series of studies aimed at testing the efficiency gains ascribed to it. 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). In addition, the effects of decentralization have been fully studied with respect to macroeconomic aspects such as subnational debts and deficits (Rodden 2003), economic growth and inflation (Treisman 1999, 2000), inequalities (Linz 2000; Mahler 2002) and regional disparities (see West and Wong 1995). At present there is neither theoretical nor empirical agreement with respect to the relationship between decentralization and the size of the public sector and the same applies to the association between decentralization and the rate of economic growth (Bird et al. 1998: 5).[17] In particular, some of the positive outputs ascribed to decentralization have not occurred in developing countries, which have recently experienced a wave of decentralizing practices. This has spawned a series of articles that warn us against the idea of decentralization as a panacea, deal with the conditions under which it can work in developing countries; and conclude by casting doubt upon the benefits of decentralization

---

electoral support (Rose-Ackerman and Rodden 1997) present some arguments in the same direction. They state that in a democracy elected leaders must respond not only to exit threats but also to electoral threats (1997: 1533). In consequence, politicians may face incentives to ignore the threats of the mobile and make pacts with coalition of less mobile constituents.

[17] In his seminal work, Oates devotes a chapter to an empirical analysis of the Fiscal Federalism theory. His objective is to test whether the normative theory developed in the former chapters can explain cross-country variation in intergovernmental fiscal relations. Empirical evidence shows that the variables that measure the level of demand differentiation (those that can yield allocative efficiency gains) have no any significant relationship with the degree of fiscal centralization. He also acknowledges that the explanatory power of the analysis is low.

and stressing its dangers (Tanzi 1995; Prud´Homme 1995; Hommes 1995; Bird et al. 1998).

In fact, some of the potential gains ascribed theoretically to decentralization have not arisen in reality. This has given rise to a mismatch between theory and practice, between normative concerns and empirical analysis. This mismatch can be explained both by some inaccuracies in the theory and the difficulty of collecting more refined data. First, normative analysis of fiscal decentralization makes heroic assumptions such as the absence of spillover effects or economies of scale in the production of the local public good that turn out to be unsupportable when contrasted with reality.[18] Second, the links between fiscal federalism theory and empirical analysis have been quite tenuous because, according to Rodden (2002), there is a lack of more refined data on the design, content and form of decentralization.[19] In empirical studies questions related to the specific design of decentralization are ignored, not because theories that are being tested do not take into account the particularities of design; but because there is a shortage of detailed data on it.[20,21]

---

[18] For a critical revision of the assumptions of fiscal federalism theory see Hamlin (1991); Rodden (2002; 2001); Rey (1991); Seabright (1996); Prud'Homme (1995); Tanzi (1995).

[19] A first attempt at measuring decentralization taking into account several dimensions is Henderson's federalism index (Henderson 2002) The index is the average over six categories: the government structure (if it is officially unitary or federal); (2) the regional executive (if it is elected or not); (3) the municipal government (if it is elected or not); (4) the national government (if it can suspend local or regional governments or not); (5) and (6) if provincial and local governments have no revenue raising [expenditure] authority, limited authority, or more complete authority.

[20] As Bird et al. (1998: 26) point out *"To debate whether decentralization is good or bad is unproductive and misleading since the impact of decentralization depends on design."*

[21] For instance, due to problems of finding more refined data, many scholars have used the level of subnational expenditure over total expenditure to measure the degree of fiscal decentralization. They have

Third, the form that decentralization actually takes in the world does not resemble the form foreseen in the fiscal federalism literature, that is, a clean transfer of authority and/or resources from central to subnational governments and no interference between local and federal spheres of authority. In practice decentralization usually implies a fragmentation of responsibilities within public policy areas and resources between different levels of government (Jordana 2002: 8; Rodden 2002: 27) and thus gives rise to a more intertwined and complex state. This fragmentation is particularly unavoidable with respect to fiscal decentralization, as subnational governments are not capable of fully financing policy responsibilities out of their own tax-raising powers and therefore need transfers from central government (which gives rise to vertical fiscal imbalances).

Finally, as decentralization is regarded as a means to an economic end or as a policy that only serves economic objectives it ignores the importance of political factors. Public finance has traditionally focused on normative questions within a framework that overlooks political institutions and the interests and preferences of politicians (Hettich and Winer 1997). Even the study of a politically sensitive issue such as taxation has concentrated on Pareto-efficiency and disregarded political factors (Holcombe 1999). According to this author, the structure of expenditures and taxes is the result of political process in which different groups (professional politicians, regional leaders, bureaucracies and citizens) participate. In consequence, it should respond more to a political rationale than to an economic one. In order to understand this process, then, we need a stronger focus on

---

used it either as explanatory variable (in the study of the consequences of fiscal decentralization) or as dependent variable (in the study of its causes). However, the theories being tested by those scholars point to fiscal decentralization as a form of local tax-raising powers so that expenditure decentralization proves to be a wrong measure of decentralization, what partially explains the mismatch between theory predictions and empirical evidence.

the political conditions that influence the behaviour of actors at different levels of government.

For all these reasons I contend that fiscal federalism theory represents a misleading path in the search for the causes of fiscal decentralization. Its normative role attempts to define what the government should do to maximize economic welfare but this proves to be only tenuously related to the *positive* role of government, that is, what governments actually do.

2.4. Theories of decentralization based on political motivations

Studies that deal with causes of fiscal decentralization have until recently neglected the political factors that form part of the mechanisms that account for it. I refer to the motivations of politicians in undertaking decentralization and how they are constrained by the institutional framework within which they make decisions. In consequence, there is a lack of theoretical building and systematic cross-national analysis on the role of institutions and politics in the process of decentralization (Rodden 2002: 27). Fortunately, some authors have recently attempted to fill this theoretical and empirical gap.

This new approach is exemplified in articles written by Garman, Haggard and Willis (1999; 2001). They seek to explain cross-country differences in the level of fiscal decentralization and argue that the degree of fiscal decentralization depends on the distribution of power within political parties, that is, on the internal structure of political parties. Garman et al. argue that changes in the level of decentralization are the result of the bargaining process between politicians at different levels of government (the president - as they analyze Latin-American presidential systems- legislators and governors). The result of the bargaining process is determined by the institutional setting. In particular, it will depend upon the degree of decentralization of party control with respect to several institutional characteristics such as electoral laws (control over nominations for national legislative office, the employment of closed -or open-list system), or the control over campaign finances. The degree of decentralization will determine if legislators are more beholden to the president's or to governors' ideal points. Accordingly:

> "...if parties are more centralized, any bargaining over inter-governmental fiscal relations will favor the center and the fiscal structure of the state will be more centralized. Conversely, if party control is less centralized, the state's fiscal structure will also tend be more decentralized, other things being equal."[22]

There are several shortcomings in Garman et al.'s article. First, there is an inconsistency in the presentation of presidents' ideal points. In setting president's preferences regarding fiscal decentralization they present two conflicting interests: on the one hand, the president may benefit from claiming efficiency gains from tailoring policies to citizens' demands (allocative efficiency). On the other, these gains may be offset by the costs in terms of a loss of resources (and thus of the redistributive function) and principal-agent problems. The contradiction in Garman et al.'s work is that, according to the rest of the theory, neither expected efficiency gains nor potential principal-agent costs (nor a cost-benefit calculus of both) play any role in determining changes in the level of fiscal decentralization. Rather, centralized (decentralized) outcomes are associated with national-level (subnational-level) control of authority within political parties. For this reason it is unnecessary to introduce a conflict between presidents' preferences, since the outcome of decentralization does not eventually depend on its resolution, that is, on the specific weight of efficiency gains and costs of decentralization in presidents' calculus. Moreover, it is also questionable how the authors have defined presidential costs and benefits of decentralization. For instance, it is difficult to evaluate principal-agent costs in advance since they very much depend on the

---

[22] See Garman et al (2001: 207).

specific design of fiscal intergovernmental relations.[23] Regarding allocative efficiency promises of decentralization, I have already brought into question in former paragraphs the empirical validity of such normative outputs.

Second, the theory of Garman, Haggard and Willis is exclusively based on intra-party competition variables. And this is probably why it fails when dealing with situations that involve inter-party competition. For instance, when there is a divided government (when legislators belong to a different party than that of the president) they predict that legislators will try to transfer resources to their co-partisans at the sub-national level (in order to check the powers of the president). However they leave unanswered why legislators will sacrifice resources in favor of sub-national governments they might not control in the future.

When the president relies on a majority coalition in the legislature, decentralization outcomes will depend on the extent of decentralization of party control. But what about a more complex distribution of power? Assume lines of accountability and authority within the ruling coalition parties are opposed (that is, when in one of the parties that form the coalition government sub-national interests prevail and in the other party member national

---

[23]In addition, these authors state that presidents will prefer that responsibilities be financed through local taxes than through transfers. Although the former option may involve less loss of resources for the presidency, it also implies a presidency's loss of control over the policies that are financed through local taxes (unless he controls tax base and rate). Again, the crucial factor for evaluating decentralization losses for the presidency is the specific design of fiscal decentralization, and this is a fact that is often overlooked when talking about expected costs or consequences of decentralization. On the other hand, Garman et al. assume that governors will seek *"to restrict presidential control while expanding their own"* (2001: 210), and thus they will be more concerned about the certainty of receiving unconditioned transfers distributed according to a fixed formula than about assuming the political costs that raising taxes involve.

interests prevail). Which line of accountability will be predominant? In short, when a single party controls the legislature and presidency, the theory predicts decentralization outcomes depending on the lines of authority and accountability within the party. But in a more complex political context with inter-party competition, the theory loses it explanatory power, as it becomes vague and ambiguous in its predictions on decentralization. Probably because of these theoretical flaws, intra-party theory does not fit Latin-American cases very well.[24]

Another sign of the theory's flaws is that Garman et al. assume that a system with high levels of decentralization is always the result of sub-national pressures for greater decentralization. They do not envisage that presidents may decentralize not because legislators are more beholden to subnational party leaders in terms of career advancement but because they have an *interest* in doing so. Central government's action may not be prompted by within-party power structure, but by concerns about inter-party competition. This has been clearly shown above when characterizing the strategy of *"decentralization of penury"*. Regardless of the internal organization of political parties, national politicians may prefer to avoid the electoral costs of implementing cost-containment policies in the present period (and discount any subsequent future improvement of the financial burden after economic recession) and transfer unwanted fiscal responsibilities downwards.[25]

---

[24] As they recognize, "In Venezuela party organization is relatively centralized, yet revenue sharing follows a pattern that appears to correspond with the interests of subnational governments." (2001: 222) On the contrary, Bolivia, which has a very centralized party system (controlled by national elites and with a closed-list system) underwent a drastic decentralizing reform in 1994 that reconfigured Bolivia's territorial division of power (O'Neill 2000: 5).

[25] In this case national politicians' interest on decentralization is *not* related to claiming credit for the potential benefits of decentralization in terms of an increase in efficiency. Quite the opposite, the transfer of costly fiscal responsibilities to subnational governments usually worsens

Finally, even though the work of those authors partially explains cross-sectional variations in overall levels of decentralization among Latin-American cases, their theory remains weak in explaining subsequent reforms, as they focus on institutional variables (party rules) that change little over time.

Garman, Haggard and Willis make a very relevant final point related to the problem of endogeneity. Concerns about endogenous causal relations are crucial for the understanding of the dynamic of decentralization processes. For the purpose of the argument they assume that there is a unidirectional effect that goes from the internal organization of political parties to the fiscal structure of the state. But the order of independent/dependent variables may be reversed when the analysis is focused on explaining the dynamic nature of decentralization (see Figure 2.1). That is, decentralization depends upon the distribution of power within political parties, but at the same time the reassignment of spending and taxing responsibilities that results from decentralization can itself influence the distribution of power within parties. Concern for endogeneity is especially relevant when we attempt to get at the dynamic of decentralization processes from an intergovernmental bargaining perspective. The direction of causality may be reversed since the assignment of powers that results from decentralization may empower some actors while weakening others, which represents a new scenario for intergovernmental bargaining.[26]

The theoretical structure of this article is based on Riker's seminal book, *"Federalism: Origin, Operation, Significance"*

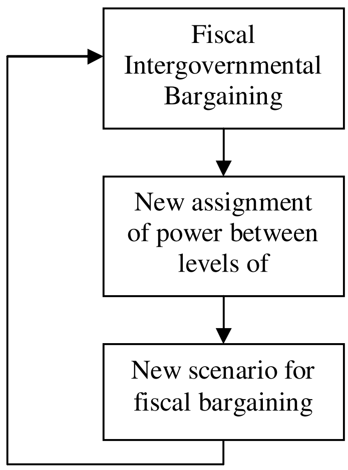
---

their financial burden and in turn their capacity to provide services in an efficient way.

[26] As Eaton (2001: 101) states *"decentralization has the potential to transform some of the most significant actors and relationships, including the developmental capacity of states, the behavior of interest groups and social movements, and the strategic calculations of politicians, non-governmental organizations and voters."*

(1964).[27] In his study Riker demonstrated the importance of political parties in accounting for the evolution of the federal bargain. When dealing with cross-country variation in the level of federalism he argues: *"...the proximate cause of variations in the degree of centralization (or peripheralization) in the constitutional structure of a federalism is the variation in degree of party centralization."*[28] Riker suggests that US federalist institutions have no significant impact on the stability of the federal bargain. He contends that 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 ability of the federal government to "overawe" constituent units.

Figure 2.1. The problem of endogeneity



[27] For an analysis on the role of political parties in Australia and Canada see Campbell (1994).

[28] See Riker (1964: 129).

Those variables (partisan harmony and electoral externalities) have also been used in analyzing the macroeconomic effects of decentralization. For instance, Rodden and Wibbels (2003) and Jones, Sanguinetti and Tommasi (2000) have found a positive correlation between partisan harmony in federal countries and good macroeconomic management. The confluence of electoral fates between the incumbent party at central government and its co-partisans at the sub-national level (electoral externalities) reduces incentives for opportunistic behavior, which is reflected in lower levels of sub-national deficits in those states or provinces that are governed by the same party at central level (partisan harmony).[29] They provide empirical evidence of how the macroeconomic effects of federalism depend upon the underlying incentives built into the particular institutions of each country. However, they overlook the fact that these underlying incentives not only affect the consequences of the intergovernmental bargain but crucially affect the intergovernmental fiscal contract itself. Following these considerations, I introduce electoral externalities and partisan harmony variables in the theoretical framework that I develop in the next chapter.

Another exception to the literature's gap on the use of political variables to explain decentralization is to be found in the work of Kathleen O'Neill (2000, 2001, 2001a). She considers that decentralization stems from the rational calculation of political parties' elites, who seek to maximize their electoral possibilities in presidential systems (as she concentrates in the Andean region: Bolivia, Ecuador, Peru, Colombia and Venezuela). This theory is

---

[29] These studies introduce partisan harmony and electoral externalities as the political variables that explain when subnational governments will have incentives to overspend. Fiscal irresponsible behaviour (that is, overspending) arises when national governments are elected from national constituencies and evaluated on the basis of macroeconomic policy. Under these conditions, they cannot commit to a "no bailout policy" as their commitment is not credible for subnational governments. In consequence, the latter incur into deficits, as they know that central government will bail them out.

based, thus, on inter-party competition, and it mainly purports to explain the onset of decentralizing reforms, that is, the adoption of political decentralization across the Andean countries. According to this theory, each party compares the possibilities of winning elections if it keeps power at the central level against the expected benefits under a decentralized system. When the party has strong sub-national support (territorially concentrated support) and weak electoral prospects at the national level, it has incentives to decentralize since it expects electoral benefits from decentralization. So the party strategy consists in a loss of power in the present for future electoral benefits at the sub-national level. Thus *"a party distributes political and fiscal power to the arenas in which their political allies seem most likely to gain control of it."* (O'Neill 2000: 12) The stability of the party's electoral support is crucial in that calculation. If the party has volatile electoral results, it has fewer incentives to decentralize, since it has to bear immediate costs while future benefits are uncertain. In addition, where presidents care less about the future electoral benefits of their parties, less decentralization is expected (they will not be willing to diminish their personal power for the sake of future electoral benefits for the party). A point of criticism here is that, although the final result will depend on the presidents' political horizons (if he expects to remain in power in the short or long term) and on political institutional variables (such as the extent to which each party acts as a coherent unit and has control over its presidential candidates); O' Neill disregards how these factors may influence the probabilities of undertaking decentralization. Some of these variables lacking in O'Neill's work (intra-party variables) are taken into account in Garman et al.'s article (and the other way around: Garman et al.'s article lacks inter-party competition variables).

In a different article O'Neill (2001) purports to overcome this shortcoming with the combination of both intra-party and inter-party theory to account for shifts in fiscal decentralization over time in three cases: Argentina, Mexico and Peru. The combination of the two models results in the following prediction: *president's* *electoral strategies will be of primary importance in explaining variation in fiscal decentralization, particularly the level of discretion in intergovernmental transfers; but variables concerning intra-party competition will be of crucial importance when electoral competition does not determine the party's position relative to the other parties, that is, when there is not a clear policy choice.*[30] This combination of political institutional variables (party rules) and electoral competition to account for fiscal decentralization opens a new way in the research on decentralization and is used as the basis of the model I develop in the next chapter.

Eaton (2001) also uses political incentives to account for decentralization. He seeks to examine *"why national politicians often renege and back-track on their earlier support for decentralization."* (Eaton 2001: 103) That is, he wants to gain an insight into the dynamic (politics of decentralization and re-centralization). Briefly, he argues that the variation across different countries' experiences with decentralization result from the shifting political incentives of national politicians. In the two cases reviewed in his article (Argentina and the Philippines) the decision to decentralize has then led to subsequent backtracking as a consequence of the shifting attitudes of national politicians.[31]

---

[30] For instance, in Argentina when the *Peronist party* won presidency and had control over Congress and Senate then inter-party variables (that had predominated while the power was divided between a *Justicialista* president and Congress, and a *Peronist* Senate) gave way to intra-party considerations.

[31] It is commonly assumed that decentralization builds a constituency for itself in the aftermath of the process, and parties that decentralize often make recentralization costly (for instance, writing it into the Constitution). In spite of these potential obstacles to politicians backtracking, Eaton shows an all-powerful national political elite that undertakes recentralization apparently without opposition from public opinion. However, he fails to acknowledge that the easiness with which politicians backtrack powers may be related to the *type* of decentralization that was formerly enacted. His case studies reflect fiscal

More specifically, the article suggests that national politicians are more concerned about short-term interests than about claiming credit for long-term gains promised by the advocates of decentralization. In consequence, when the former are threatened, they reverse decentralizing policies that had once advanced their interests. This approach stresses, as I discussed earlier, that neither expected efficiency gains, nor potential principal-agent costs play any role in national legislators' strategies on decentralization. Rather, politicians remain more wary of the potential impact of decentralization in their own goals. Thus:

> "short-term calculations determine the form that decentralization actually takes. Exploring the shifting attitudes of national politicians toward decentralized practices is a necessary step in understanding variation across time and space." (p.122)

To summarize, the work of these scholars represent recent attempts to find a set of political variables explaining cross-country differences in the degree of fiscal decentralization. Many authors think that it is not possible to find a unique set of variables to account for cross-country variation in fiscal decentralization. Theories presented above are a partial attempt at it, although they basically focus on the Latin American region.

There is still a lot of room for research regarding the incentives that politicians face at all levels of government and how this interacts with the structure of political competition between different levels governments (electoral externalities, partisan harmony), the internal structure of parties or the representation of sub-national governments. Under what conditions does co-partisanship between central and sub-national governments give

---

decentralization practices, which may become easier to recentralize than political decentralization (the creation of new democratic institutions as the popular election of subnational officials).

rise to a decentralization or centralization of power? How is it related with the structure of the party system and electoral externalities between levels of government? To what extent is decentralization the result of central government initiative or the consequence of successful pressures from subnational governments?

Some scholars have stressed that successful decentralization requires that rules are compatible with incentives (Burki, Perry and Dillinger 1999: 6). When studying the failures of decentralization, particularly in developing countries, some scholars have noted that there is a need to set up rules that create incentives, for instance, to promote a hard budget constraint (and thus avoid the opportunistic behaviour of subnational governments (Jordana 2002: 21). If looking at the broader set of rules and institutions that affect political behaviour is necessary in understanding the aftermath of decentralization, the same logic applies to the study of its explanatory factors. That is, in order to understand the decision to decentralize, it is helpful to look at how institutions and rules affect politicians' incentives so that they are more prone to surrender their power. My approach goes beyond the general premises that associate decentralization with politicians' commitment to democratic improvement or to a functional response to public sector growth. It aims in the direction of setting a more realistic view of political behaviour where fiscal inter-governmental arrangements:

> "are not simply a matter of different local demands for services, different local capacities to raise revenue or administer programs (…) (but) political choices and political institutions have played a major role in explaining the variation in the form, degree and success of decentralization." (Montero and Samuels 2003: 3)

2.5. Establishing a new theoretical framework to explain decentralization: Micro vs Macrologics

In order to account for the different form, degree and dynamics of fiscal decentralization in a politically decentralized context, there is need for a better understanding of the factors that bring about a modification of the distribution of power between levels of government. Any decision to undertake an institutional reform such as the modification of intergovernmental fiscal rules may be conditioned by different types of factors.

2.5.1. Macro Logics

I define *macro* factors as those that set the stage where fiscal decentralization takes place, limit the range of choices political elites have and define the *feasibility* of decentralization. They are related to the path-dependent processes that account for the existing institutional, organizational and policy settings of the country; or demographic and physical characteristics; or to a temporary event (like an economic downturn). Fiscal decentralization does not occur in isolation from those factors. The interaction between the goals of politicians at different levels of governments and institutions takes place in a particular institutional and organizational setting that narrows the choice set of actors. For instance, among federal countries there is considerable variety in many dimensions, namely the number of sub-national units, the historical origin of the federation or the level of homogeneity in terms of language or ethnic groups. These differences may provide some help in understanding the range of feasible changes, that is, its potential capacity for change. For instance, federalism in Belgium is based on a socio-cultural cleavage between the Flemish speaking and the French speaking part of Belgium that has given rise to a strong dual and bipolar political system. These features shape the feasible forms that any modification of the intergovernmental fiscal contract may take in a way that is not applicable to the case of Germany, a country that has a federal structure that does not respond to the accommodation of a social-cultural cleavage and that is based on a power-integrating model of intrastate bargaining (Braun 2003a). Another example would be the demographic and geographical characteristics of the country. The extent of decentralization may be limited by the available economies of scale in those services that have a cost per person that varies inversely with the size and concentration of the population.

The *macro logics* of fiscal decentralization neither represent a sort of inevitability nor freeze any of the existing arrangements in place. They just establish the *framework* and possible limits of decentralization, that is, the plausible range of national and subnational politicians' political and economic alternatives. Pierson summarizes this point succinctly:

> "actors do not inherit a blank slate that they can remake at will when their preferences change or the balance of power shifts. Instead, they find that the dead weight of previous institutional choices seriously limits their room to manoeuvre." (Pierson 2000: 810)

As path-dependent processes or geographic and demographic factors do not provide any explanation for the understanding of what alternative is eventually chosen, they hardly assist us in reaching general conclusions on the explanatory factors of the modification of intergovernmental fiscal arrangements. This is illustrated by the fact that the same factor may be linked to opposite outcomes (for instance, economic crisis has been associated both to centralization and decentralization practices). In addition, some of those variables like land size or social-cultural cleavages) do not change over time, while politicians in those countries witness important modifications of their intergovernmental fiscal arrangements. Empirical analysis shows that there is a correlation between some of these factors and fiscal decentralization. For instance, taking federalism as one of those macro factors has lead some authors to test the simple hypothesis that federal countries will be more decentralized than unitary ones (see Escobar-Lemon 2001). The resulting significant correlation between federalism and decentralization is too blunt to substantially inform us about *when* fiscal decentralization takes place and *how* the basics of the new intergovernmental fiscal arrangement are modified. In sum, macro-contextual factors leave unanswered the precise causal mechanisms through which they may impact on a modification of the intergovernmental distribution of policy authority and resources. Finally, the analysis of the particular institutional legacies of broad social, economic and political macro factors make the creation of a comparative framework for the analysis of explanatory factors of fiscal decentralization a difficult task, as each country may be regarded as a unique and separate reality.

For moving from correlation to causation and to be able to reach general conclusions regarding intergovernmental fiscal arrangements the focus of the analysis in the next section turns to the "micro" logics of political elites.

2.5.2. Micro Logics

The micro logics regard decentralization as a political *choice* made by political elites. This choice is determined by the interaction of national and subnational politicians' goals with the leverage and incentives that stem from the institutional setting.[32] It is important to note that fiscal arrangements - the particular assignment of taxes or the design of intergovernmental transfers – take a specific form in each country. However, in all of them the resulting system of federal finance is invariably a political creation, a product of a *political bargaining process* that remains unchanged so long as its outcomes are acceptable.

---

[32] See Gourevitch (1986) for a description of the role of domestic factors in explaining why countries chose particular policies in response to major disruptions of the international economy.

A system of intergovernmental fiscal relations represents a *political compromise* that is reached through a process of ongoing political bargaining. This process is driven by the interplay between federal and subnational levels of government and the conflict that stems from that interaction (e.g. tensions between rich and poor territories and conflicts between and within political parties). The finance system of each country must be understood within that *political framework*. A challenging aim on the research agenda is to understand the particular terms that make up the political compromise in different countries and make possible the evaluation of the likelihood of changes in those institutions.

The importance of macro-political factors against proximate causes in explaining decentralization depends very much on the questions being asked. For instance, if the question focused on why developing countries have a different territorial distribution of power than they did three decades ago, then I would probably have to resort more to macro-political factors such as the pressure from international financial institutions to undertake reform or democratic transition (Haggard and Kaufman 1992: 43). However, my purpose is to understand changes in the distribution of revenue sources across levels of government, a question in which the interaction between political elites' goals and the institutional structure is likely to loom large. Accordingly, when some of the macro-political factors appear in the causal chain they do it within the particular political strategies of national and sub-national politicians. Macro-level factors do not prompt *per se* any institutional change. They are not sufficient to explain decentralization. A mere correlation does not imply causation even though research into the explanatory factors often assumes that. Rather, macro factors do not enter the set of explanatory factors until political actors use the conditions created by them as part of their political strategies.

In summary, this study focuses on elite decision-making, on the micro logics of fiscal decentralization, that is, the incentives that national and subnational politicians face to *choose* to change intergovernmental fiscal agreements. They may be defined as the *"proximate causes"* or the lens through which the impact of macrofactors is filtered. Fiscal decentralization is regarded as a political compromise reached through an ongoing process of political bargaining that remains unchanged so long as the perceived *political costs* it yields are higher than the potential benefits ascribed to a different design of fiscal institutions.

Figure 2.2. Factors that enter the political logic of decentralization

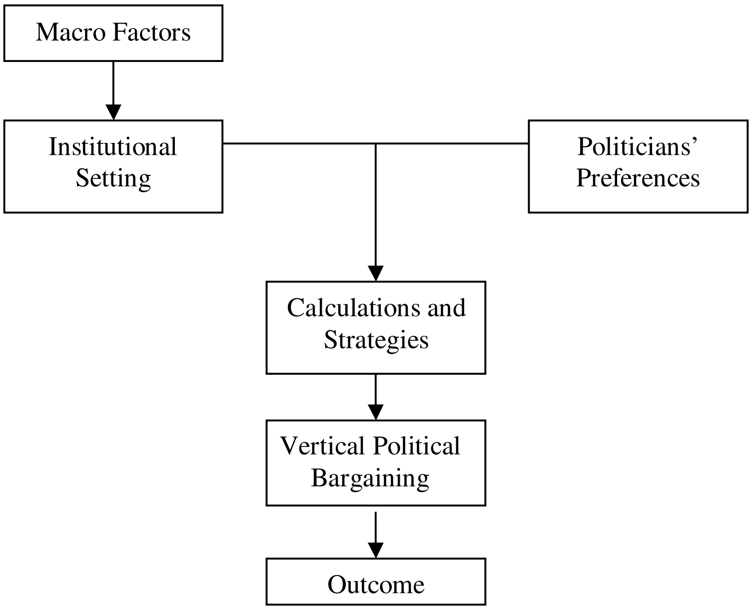


Figure 2.2 displays the main components of the political framework within which I study fiscal decentralization. In the process of political bargaining[33] politicians will establish their

[33] "*Vertical political bargaining"* refers to the negotiation process that takes place between central government and subnational governments on the overall amount of monies the latter need to finance

strategies after calculating the costs and benefits each strategy entails in terms of fulfilling their preferences. The institutional framework in which politicians make their decisions determines the set of costs and benefits of pursuing their goals. Therefore, in each institutional setting politicians adopt the strategy that allows them to maximize preferences. So I expect dynamically changing strategies of politicians according to the variation in the institutional setting. In the next section I discuss the motivations of politicians when making policy and introduce central government and subnational governments' preferences, which I assume to be constant over time.

2.5.3. The motivations of politicians when making policy

Theoretical and empirical analysis into the motivations of politicians when making policy point out that legislators and presidents value two goals, namely carrying out their policy goals and securing their re-election (Jacobs and Shapiro 2000: 9). There are two different perspectives on that. The first is the *"median voter"* theory and the retrospective voting model, which state that politicians behave according to "median voter" preferences in order to secure their re-election or that of their party. The personal

---

their expenditures. They compete for resources, as both national and subnational policymakers' main purpose is to retain/gain the maximum amount of resources without political costs. According to the governance system (a *devolved* one) the agreement is reached through a process of negotiation among equals – that is, independent and democratically elected governments. The institutional structure determines the balance of power between levels of government and in turn the ability of each level of government to shape the design of intergovernmental fiscal relations in the process of political bargaining. As I will discuss in the next chapter, variables such as the structure of the party system or electoral competition impinge upon interdependences among national and subnational politicians and in turn on the outcome of the negotiation process.

benefits that elections bring to them are what drive their calculations when making policy. The second one states that pursuing their own policy goals (what they consider to be "good public policy") and those of their supporters is what motivates politicians when making policy, which challenges the view that politicians track public opinion.[34] So in this second perspective policy decisions are not a means to re-election but an end in itself, and elections remain the means to attain policy goals.

In my model politicians have both political survival and the maximization of autonomy as their main motivation when making policy. Elections are an end in themselves and political survival means staying in power or securing the ways to access power,[35] while the maximization of autonomy/authority refers to the capacity to make decisions over tax revenues and expenditures. When politicians undertake fiscal decentralization, they lose control of resources and power to command the behaviour of actors at the subnational level, which in turn curtails their power to enact their most preferred policies. What makes the surrender of power a *rational* choice? Are they willing to lose autonomy in decision-making if it allows them to stay in power? Then, is it that they want to keep *deciding* about *less*?

This study assumes that political elites are strategic and forward-looking and that they may accept a modification of fiscal intergovernmental arrangements that diminish their control of resources if this decision guarantees their political survival. As I have reviewed in the former chapter, other arguments about the explanatory factors of decentralization assume that politicians undertake decentralization because they pursue other objectives such as political stability (by de-activating regional conflict) or economic growth (Manor 1999). That is, a modification of intergovernmental fiscal rules is the consequence of politicians

---

[34] For a review of these two theories see Jacobs and Shapiro (2000).

[35] Staying in power means not only winning elections but also considerations regarding the best way to be part of the group of candidates the party chooses to run elections (within political party considerations).

pursuing what they consider to be good policy (efficiency-enhancing or stability-enhancing). In this case decentralization is the result of proactive policies made by *benevolent* national politicians that are willing to take on board the short-term costs of decentralization in order to secure a better future such as long-term economic or social benefits. However, if these benefits do not come, or they accrue to future office holders, why do they exchange certain costs for uncertain future benefits that are in principle unrelated to their electoral chances of survival? We need a better understanding of the particular costs and benefits they face, and the level of uncertainty that accounts for the decision. My approach brings in strategic politicians to the political scene. The argument about long-term social or economic goals fails to address adequately the reality of national politicians' motivations, which are based on highly strategic, political calculations centred on maintaining power. The analysis of fiscal arrangements from a perspective that focuses on highly strategic politicians represents a challenging argument within the fiscal federalism literature, which has traditionally regarded the modification of intergovernmental fiscal relations as the consequence of technical or efficiency-oriented decisions.

2.5.4. Preferences of politicians

I start from the premise that national and subnational politicians have the predominant role in explaining decentralization.[36] They are the main players. This is plausible as the context in which I analyze fiscal decentralization is a

---

[36] In this study I will adopt an agent-centred perspective. This means that the individual agent is taken as the building block. Individuals are assumed to have certain objectives and preferences and to interact in specific institutional contexts. Thus, aggregate outcomes – as the transformation of the territorial distribution of power – are the result of the behavior of individual agents (political actors) and the limits impose on them by the institutional setting (Mueller 1997).

politically decentralized one in which there are democratically elected subnational units. I will exclusively refer to democratic governments since it is under these political regimes that the process of devolution to independently elected sub-national units is feasible. The fact that national and sub-national politicians have the predominant role in decentralization does not mean that other actors play no role.[37] Besides, although politicians seek to survive in the political arena, this does not imply they do not pursue other political or social goals. However, in a democratic context politicians are first and foremost constrained by the party competition that is played out in the electoral arena so that other political and social goals they have are unavoidably conditioned by the electoral game in which they take place.

The cost/benefit calculus exemplifies the different trade-offs that decentralization implies for national as well as subnational political elites.[38] Decentralization will constrict national politicians' future control over policy-making while it may help to enhance their continued political survival. For subnational politicians decentralization involves more power but also more responsibility, citizens will demand a lot from subnational officials and punish them if they use their devolved tax powers to increase the tax burden. As we will see later, this means that the state or provincial government politicians may have different preferences regarding the type of powers they want to have devolved.

---

[37] As Samuels and Montero (2005: 11) point out, extra-governmental actors such as labor unions, non-governmental organizations and associations may exert important *bottom-up* pressures for decentralization. *"However* – they add - *these (…) extra-governmental actors tend to rely on politicians and their parties as interlocutors."*

[38] In fact, in some of the works that deal with the explanatory factors of decentralization it is overlooked that it may imply some trade-offs for political elites. For instance, as it was already discussed, economic arguments for decentralization are based on its "efficiency enhancing" properties, but we ignore if the gains of efficiency may be surpassed by the political costs that decentralization involves and why these costs do not seem to matter for "benevolent" politicians.

2.5.4.1. Central government politicians

National politicians are members of the central/federal executive. I assume national politicians are rational actors whose most fundamental objectives are twofold: to remain in power and to control policy and fiscal resources. Central government politicians are career-oriented and will seek to maximize control of resources and policies and secure re-election. In addition to winning the electoral contest, their election concerns are also related to their political career's incentives. Ideally national politicians try to attain both objectives (remain in power and control resources). However, the adoption of decentralizing reforms challenges one of the fundamental objectives of politicians, that is, the maximization (or maintenance) of political and fiscal resources. Central government politicians will only be willing to cede some of their control over resources on behalf of their electoral and career-oriented concerns.

2.5.4.2. Sub-national governments' politicians

As national politicians they prefer more power to less although their capacity to secure decentralization will depend on the balance of power between them and national officials. They also want to stay in power and thus will not press for resources if it threatens their political survival. They want to maximize their autonomy in decision-making *and* resources and, accordingly, oppose being granted powers without the corresponding resources, as this may affect their quality of services they provide and in turn their chances of re-election. Their preferences regarding the proper *sources* of revenue may vary depending on the economic development of the region. Poor regions will prefer to be granted general purpose transfers while rich regions will prefer to broaden their taxing powers, as they are able to extract a large amount of money from regional tax bases. This difference is important to mention as in all federal countries there are huge disparities between regional/provincial/units.[39]

In short, decentralization is a rational institutional choice made by utility-maximizing politicians. It is a process that at first might be regarded as irrational or non-intuitive, since in principle, national politicians are reluctant to cede authority to sub-national governments. So what remains to be seen is what makes fiscal decentralization possible from a rational approach. In the next chapter I frame the overall process displayed in Figure 1 to account for fiscal intergovernmental arrangements. More specifically, following Figure 1, the *Outcome* box will consist in the allocation of intergovernmental transfers across levels of government. I then introduce two different institutional settings – characterized by different levels of decentralization - and establish the strategies that politicians follow in the process of political bargaining. I hypothesize that politicians will follow different allocation strategies in each institutional setting.

---

[39] For instance, Argentina and Brazil are federations with important economic disparities across regions.

CHAPTER 3. THE POLITICAL ECONOMY OF INTERGOVERNMENTAL TRANSFERS. A NEW THEORETICAL FRAMEWORK

3.1. Introduction

In this chapter I explore how politics and institutions interact and how this interaction accounts for intergovernmental fiscal arrangements. That is, this chapter investigates the explanatory factors that account for a particular *distribution* of transfers among jurisdictions.

The chapter is structured as follows. Section 2 briefly reviews the literature that explores the allocation of intergovernmental transfers from a positive approach. In Section 3 I present the theoretical framework, which is subsequently integrated into a model outlined in Section 4. From this model I derive the general hypotheses of the dissertation.

3.2. Intergovernmental transfers

What are the general principles of grant design? According to Fiscal Federalism theory (Musgrave 1959; Oates 1972, 1991) intergovernmental transfers should be used to compensate for vertical fiscal imbalances, to offset horizontal fiscal disparities[1] or to influence state/local choices (in the presence of positive/negative externalities across jurisdictions). It is more difficult to design an efficient and equitable tax system at the state-local level. In order to keep a fair and efficient system of taxation, state and local expenditure should be financed through revenue sharing. Therefore, the more expenditure powers subnational jurisdictions have, the greater the amount of transfers that are needed to cover the vertical fiscal gap. The allocation of transfers should also be made in accordance with indicators that measure the fiscal capacity of local governments. The main purpose of these grants is to assure that each jurisdiction can provide a "satisfactory" level of public services with the same fiscal effort. Socioeconomic variables that assess the demand for particular public services (such as the percentage of elderly population) or indicators that measure the costs per unit of expenditure (such as insularity) should determine the allocation of these transfers. Finally, transfers may be used by central government to encourage (or discourage) expansion (or reduction) of particular services involving external positive (negative) effects across jurisdictions. Transfers may adopt the form of unconditional block grants, matching grants, or specific-purpose block grants.

This chapter explores the design of fiscal intergovernmental arrangements in practice. The main argument is that to fully understand the rationale behind any interjurisdictional transfer system it is necessary to go *beyond* an explanation based exclusively on a normative approach. That is, the efficiency and equity concerns that embed politicians' objectives in the normative perspective must be complemented by consideration of

---

[1] A vertical fiscal imbalance is the gap between subnational governments' taxing and expenditure powers. Or, in other words, it is the difference between expenditure assignment (who does what) and revenue assignment (who levies what taxes). Horizontal fiscal imbalances arise when the potential tax bases vary widely from jurisdiction to jurisdiction. That is, when subnational have unequal tax raising capacity.

their political objectives. Political concerns may prevail at the expense of banishing an efficient and/or equal allocation of funds. The positive approach I adopt gives an answer grounded in the electoral politics of intergovernmental transfers, that is, on the incentives politicians have to use transfers to further their own electoral prospects. In sum, my explanations revolve around how politicians *do* distribute transfers rather than how they *should* do.

3.3. Political economy models of redistribution and intergovernmental transfers

There are political economy models of tactical redistribution that describe how political parties design their policy platforms in order to further their electoral goals. These have been developed in the work of Cox and McCubbins (1986), Lindbeck and Weibull (1987) or Dixit and Londregan (1995, 1996, 1998). They model the electoral politics of income redistribution using probabilistic voting models where voters and politicians have private concerns for consumption and votes, respectively. The goal of politicians in these models is to maximize their expected electoral support[2] (the assumption is that politicians know the propensity of particular groups to vote for specific parties). Accordingly, they end up distributing resources towards voters that have particular political characteristics (such as willingness to tradeoff ideological preference in return for promises of economic benefits) that politicians cannot ignore.[3] These studies account for the existence

[2] Dixit and Londregan (1998) introduced a modification on politicians' concerns: politicians balance their own ideology against votes and (unlike previous models) they also calculated the inefficient economic consequences derived from tactical redistribution of income (taxes and transfers). Dixit and Londregan argue that economic inefficiencies may temper politicians' tactical redistribution of welfare as ideology does.

[3] In the context of intergovernmental transfers the classic commitment problem consists of politicians being unable to ignore the

of stable electoral coalitions that are constantly rewarded by politicians, even when this strategy represents an economically inefficient redistribution of welfare. However, they come to different conclusions regarding which types of electoral constituencies are favored by politicians: swing voters vs. loyal voters.[4] On the one hand, those who conclude that politicians target swing voters assume that spending will only affect which party citizens choose (so the efforts are directed at "conversion" of the vote). One of the main criticisms made about this assumption is that turnout remains unaffected by spending. On the other hand, those studies in which politicians follow the strategy of targeting core support constituencies rest on the assumption that expenditures increase electoral participation (and thus the electoral competition is driven by "mobilization" of the "loyal" vote).

These arguments are not explicitly concerned with the distribution of intergovernmental transfers (but with direct transfer payments). However, some authors have used them to test the distribution of intergovernmental transfers. The empirical evidence is consistent with the hypothesis that central government politicians do manage to skew intergovernmental grants to particular areas. This seems to be so even for categories of

---

political characteristics of regions (their swing vs. loyal nature, political affiliation or overrepresentation) and sticking to long-term promises to implement an economically efficient allocation of transfers.

[4] In Cox and McCubbins (1986) the redistributive strategies that candidates adopt in equilibrium are aimed at maintaining the electoral coalition of core supporters. In this case candidates' goals not only include simple maximization of expected votes but also a maximization of a concave function of votes (which introduces the assumption of risk aversion). As swing groups are *riskier* investments than core support groups, the latter will be "over-invested". On the other hand, Dixit and Londregan (1995, 1996) analyze under what conditions "swing voters" (defined as those voters *"nearly indifferent between the parties on the basis of policy position and traditional loyalties, and more likely to switch their votes on the basis of particularistic benefits"*) obtain a higher share of redistributive benefits.

transfers that are governed by formulas. However, there is no conclusive evidence about the mechanism through which this tactical distribution works ("mobilization" or "conversion"). Some studies emphasize that the effect results from a combination of both. "Mobilization" is a *defensive* strategy in which the incumbent at the center decides to skew funds towards core support territories.[5] The "conversion" or "swing" strategy consists in a tactical distribution of transfers towards those jurisdictions where the electoral contest is expected to be close or where the incumbent expects to gain a higher marginal increase of votes.

Besides focusing on the swing/loyal nature of each jurisdiction, these studies incorporate other characteristics of subnational levels of governments to account for the distortions in the distribution of intergovernmental grants. These characteristics namely are: *partisan affiliation* (if the ruling party at subnational level coincides with the ruling party at the national level) and *political representation* (each jurisdiction's per capita deputies and senators or, in other words, the extent of overrepresentation of the jurisdiction in legislative chambers). Whereas in models of income redistribution politicians could not ignore voters' characteristics, in models of intergovernmental transfers central government politicians cannot ignore the jurisdictions' features (such as political representation or partisan affiliation). They believe that taking them into account will further their electoral goals. These studies therefore adopt a *supply-side* approach in that the electoral and political characteristics of subnational jurisdictions enter the calculations of politicians at the center when having to decide how to allocate transfers among jurisdictions.

Another set of explanations revolves around the ability of subnational jurisdictions to transmit demands to central government. This is a *demand-side* approach in that the allocation of transfers results from the capacity of subnational politicians to successfully pressurize central government for more monies. The

---

[5] Cox and McCubbins (1986: 383) define the mobilization strategy as "Hold what you have got" and "Take care of your own."

difference between the supply-side and the demand-side approach basically lies in the leverage that subnational governments can exert over national politicians to shape the distribution of resources. When supply-side mechanisms are in place, politicians at the center incorporate the political characteristics of jurisdictions into their calculations so that the allocation of transfers serves them to further their own political goals. Subnational politicians' particular demands play no role in these calculations. On the other hand, in a demand-side approach the allocation of intergovernmental transfers reflects the unequal bargaining power of subnational executives to pressurize central government for their demands.

There is lots of research on this topic, but the field is somewhat chaotic. There exist different explanations but there is no dominant theory that helps decide when one argument matters more than another. My theoretical proposal is to use the institutional setting to account for the design of intergovernmental transfers. The institutional context is characterized by the degree of decentralization[6,7] of the system. I predict the predominance of

---

[6] The introduction of the decentralization variable requires here further clarification. As was explained above, by definition intergovernmental transfers exist in a *devolved* state. Devolution is a term that refers to a governance system with (at least) two tiers of democratically elected governments that have independent political powers over one or more fields. The term decentralization refers to the allocation of expenditure and revenue powers between levels of government. Devolved systems differ in the degree of decentralization and this heterogeneity does not always fit perfectly in the federal/unitary dichotomy. For instance, among formal federal countries there are stark differences on many dimensions of decentralization. For instance, the number of policy responsibilities ascribed to subnational governments (measured as the percentage of subnational expenditures over total expenditures) goes from 58% in Canada or 48% in USA to 31% in Austria or 29% in Mexico. In contrast, some unitary countries such as the Scandinavian ones, exhibit higher percentages in expenditure decentralization than in some federal countries (Denmark 45%, Finland

one approach over the other (*supply-side* vs. *demand side*) and of the mechanisms that operate within each one (swing vs. loyal vote and partisan affiliation) by accounting for the different incentives that the central incumbent faces in separate decentralized settings. More specifically, I state that the extent of decentralization affects:

a) how much electoral benefit from expenditure transfers remains at national level and
b) the capacity of subnational governments to pressurize central government to react to their demands.

As I will later analyze, those factors directly affect central government's electoral goals. As the expected electoral benefits/cost determine the strategies on the allocation of intergovernmental transfers, I predict how these strategies vary in different decentralized contexts.

In the next section I present some of the recent literature on the political economy of intergovernmental grants for unitary and federal countries. These investigations analyze the ongoing fiscal arrangements on a case study basis and focus on several characteristics of the recipient jurisdictions (swing/loyal nature, party affiliation and/or political representation) as the main explanatory variables. What links the theoretical basis of these works is their common positive approach. Central government is assumed to maximize its own welfare - rather than being automatically considered an efficiency-oriented actor, as would characterize a normative approach. These studies provide empirical evidence that politicians use intergovernmental transfers to further their own electoral objectives. This finding is robust to

---

36%, and Sweden and Norway 33%) (*Source*: SGS indicators; The World Bank).

[7] For the purposes of this paper I assume that decentralized systems can easily be classified by means of ranking (low vs. high decentralized systems). I am aware of the empirical difficulties in assuming that it is possible to classify systems by means of a decentralized continuum (see Rodden 2001; Stegarescu 2004; Ebel and Yilmaz 2001).

the inclusion of control variables - such as per capita income or population - that are related to (normative) explanations based on equity or efficiency considerations.

3.4. The positive approach in the study of intergovernmental transfers

As far as the studies on unitary countries are concerned, on the one hand, Case (2001) and Schady (2000) provide empirical evidence that supports the “mobilization” model. Case shows that in Albania there is a positive, significant and robust relationship between the level of electoral support to the Democratic Party (the incumbent party at the central level) in subnational jurisdictions (communes) and the amount of grants received by the commune. Another example is found in the work of Schady (2000). He shows that projects funded through *FONCODES* (a Social Fund that was created by Fujimori in 1991 in order to improve employment rates, access to social services and alleviate poverty) are disproportionately transferred towards provinces in which Fujimori’s party had lost electoral support. On the other hand, Dahlberg and Johanssen (2002) found evidence that central government targets “swing” jurisdictions. The Swedish central government used a grant program aimed at ecological sustainable development and employment promotion to win votes in those municipalities where there were swing voters.[8]

As far as federal countries are concerned, Dasgupta et al. (2001) and Khemani (2003) introduce in their analyses partisan affiliation of the subnational government as an independent variable. Their model predicts that transfers from the ruling party at the center will be biased towards subnational governments that are ruled by the same party as the one at the central level.

---

[8] Bosch and Suárez (1995) analyze the allocation of transfers to Spanish municipalities but find no evidence on the influence of political variables.

Moreover, within these "party affiliated" states, the "swing" ones (where the electoral contest is expected to be close), will receive larger shares of central government's transfers. Thus, the effect of the "swing" nature of a jurisdiction is *mediated* by the partisan affiliation of the subnational government.

Ansolabehere and Snyder (2003) provide empirical evidence that support "loyal voters" models and the hypothesis that the best strategy of national politicians is to transfer disproportionately more resources to core support areas. They turn the focus of the analysis towards state level and show that, from 1957 to 1997, US *state* governing parties skew the distribution of funds towards counties where the majority party have higher levels of electoral support. Their results also show that an increase in transfers to a county increases turnout, which is consistent with the assumption that parties may gain by mobilizing their core constituencies. Levitt and Snyder (1995) provide empirical evidence in the same direction. They find that federal outlays across congressional districts are positively and significantly correlated with the number of democratic voters in presidential elections. However, the correlation is only significant when large Democratic majorities control the Upper House and the Lower House of the Legislature (1975-1981). The bias is higher in programs that target specific activities or areas, and in those where the allocation of spending is prescribed by a formula (versus those where executive agencies have more discretion).[9]

Finally, Gibson, Calvo and Falleti (1999) and Porto and Sanguinetti (2001) analyze the effects of political representation (electoral overrepresentation of territories in the National Assembly) on the distribution of funds among different provinces

---

[9] The evidence that these authors provide regarding the particular effect of the party-affiliation variable on the distribution of outlays is more limited. This variable is measured as the number of years between 1984 and 1992 that a district was represented by a democrat (a period with strong Republican control at federal level). The effect of this variable is always negative though it is only sometimes significantly different from zero.

in Argentina and find evidence that, controlling for economic variables, the federal government has systematically and disproportionately allocated funds towards peripheral provinces where they can mobilize votes at a low cost (as they are overrepresented in the lower-house and more dependent on central transfers).[10] In Gibson et al. (1999) the empirical analysis also controls for the party affiliation variable, which shows a positive and significant coefficient (although its effect is less strong than for the political representation variable).

After reviewing these studies we are left with a group of political and electoral characteristics of jurisdictions that politicians cannot commit to ignore when adopting their allocation strategies. Despite the fact that analyses are made for both unitary and federal countries, no hypotheses exist regarding how different institutional settings may determine national government's allocation strategy. In the next section I seek to make some progress on that. My theoretical framework for the distribution of intergovernmental transfers focuses on how different institutional contexts entail separate incentive structures for national politicians. My point of departure is a devolved structure with different degrees of decentralization. Then I explore in two stages the relationship between the degree of political decentralization and national politicians' allocation strategies.

3.5. Theoretical framework

There are differences between studying the electoral politics of income redistribution and those of intergovernmental grants. First, in models of redistribution of welfare the incumbent at the center is assumed to have unrestricted powers to allocate resources towards individual voters. The transfer of income directly affects

---

[10] Ansolabehere et al. (2002) provide empirical evidence that overrepresented counties receive higher shares of funds from the state than underrepresented counties.

voters' private consumption and the benefits of redistribution for the incumbent at the center are also direct and consist in the creation (or maintenance) of electoral support groups. In sum, central government directly receives the political payoffs derived from each dollar spent in redistribution.

In models of intergovernmental transfers voters are assumed to reward politicians in elections for public expenditures that are financed through transfers from the center. Resources do not flow directly from central government to citizens since there is an intermediary actor – the subnational government – who receives and spends transfers, and in turn mediates the relationship between central government and the subnational jurisdiction's population. Subnational governments may also reap some of the benefits that stem from expenditure transfers so that (unlike income redistribution models) they may not fully and directly go to central government.

In a decentralized system the strategic calculation of the incumbent at the center must take into account that political payoffs (in the form of electoral support) that grants generate may work in opposite directions. On the one hand, grants that finance public projects in the states or provinces may foster electoral support amongst citizens for the ruling party at the center. On the other hand, since these grants improve the welfare of the subnational jurisdiction's population, the incumbent in the state (who may belong to a different party to the one at the center) may partially or totally reap the electoral benefits of those expenditures. The center may therefore face a situation where it has to bear the political costs of imposing taxation while the political benefits generated by expenditure transfers are reaped by subnational governments.

The extent to which the political payoffs derived from expenditure transfers are reaped by one level of government or the other crucially determines the allocation strategy of central government. However, the studies on the electoral politics of intergovernmental transfers have rarely explored which factors determine a particular distribution of benefits between tiers of government. My assumption is that these factors may be contingent on the institutional context. In order to establish some hypotheses on the distribution of transfers, then, I first describe how the institutional setting affects both national politicians' expected electoral gains and the power of subnational governments to influence the design of intergovernmental transfers.

My basic assumption is that the degree of decentralization[11] is negatively correlated to the electoral benefits from expenditure transfers that are received at central level and positively correlated with the capacity of subnational jurisdictions to central government for more monies. The mechanisms that operate in the first correlation are two, namely clarity of responsibilities and electoral externalities, which are discussed in the next section. In Section 3.2 I disentangle the mechanisms that account for the positive correlation between decentralization and subnational actors' power.

3.5.1. The distribution of electoral benefits among different levels of government

The effect of political decentralization over the capacity of central government to reap the electoral benefits from expenditure transfers[12] is mediated through the following variables (see Figure 3.1):

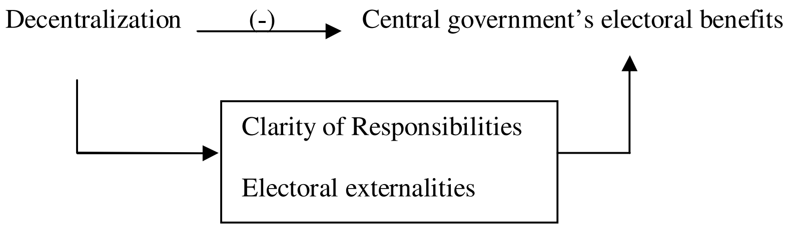
a) Clarity of responsibilities across different levels of government.
b) Electoral Externalities across levels of government.

---

[11] See footnotes 9 and 10.

[12] I assume that there are always electoral benefits that stem from the use of expenditure transfers.

Figure 3.1. The structure of causal links between dependent, independent, and mediating variables



3.5.1.1. Clarity of responsibilities

In federal countries fiscal decentralization is far from the structure presented in some theoretical models in which authority over taxes and expenditures is clearly separated between levels of government. Rather, the intergovernmental fiscal system in a federal country usually has an intertwined form and there is strong interdependence between levels of government with regard to fiscal decisions. The responsibility over *setting and collecting taxes and undertaking expenditures* is shared between different levels of government. If the allocation of responsibilities over fiscal policies is blurred, citizens may be unable to distinguish *who does what and who finances what* in a decentralized context. Consequently, citizens might end up randomly punishing or rewarding politicians at different levels of government for their fiscal decisions. If this is so, the strategy of manipulating intergovernmental transfers to foster electoral support would become useless for central government, as they cannot predict who will reap the electoral benefits from expenditure transfers. However, the use of strategies in the allocation of transfers becomes plausible if we take into account the degree of decentralization of the system and its impact upon citizens' ability to distinguish responsibilities. I assume that different institutional designs of decentralization involve different citizens' capabilities to ascribe responsibilities across levels of government, which in turn affects their ability to correctly punish or reward politicians for policy outcomes.

Decentralized systems present a high variance of institutional designs. In some of them subnational governments are responsible for a broader set of fiscal powers than in others. When subnational levels of government are created, it takes some time for the population of the jurisdictions to become used to new subnational institutions. That is, for citizens it takes time to become familiar with a new level of government and to be aware of its policy and fiscal responsibilities. The same happens when there is a change in decentralization, that is, when subnational governments are transferred more powers over the provision and financing of public goods. As decentralization increases, that is, as subnational governments are endowed with a broader set of responsibilities, subnational institutions establish themselves as a clearly separated and autonomous tier of government. This process strengthens subnational institutions and gradually turns them into the closest level of government for the population. Citizens progressively learn to make subnational politicians responsible for their new political decisions and to direct their demands towards the local level. In addition, the higher the level of decentralization the more capable citizens are of ascribing responsibilities over the pattern of expenditures and taxes in their jurisdictions. At high levels of decentralization there is one level of government (subnational level) that clearly predominates over the federal/national level, which makes it easier for citizens to ascribe responsibilities for policy outcomes across levels of government. The first assumption is, then, that for higher levels of decentralization individuals are more capable of understanding how the basics of the intergovernmental system work, that is, *who does what and who finances it*.

A related factor is whom citizens reward for public expenditures. The existence of vertical fiscal imbalances – that is, the mismatch between subnational government's spending and taxing powers – is a common feature in decentralized systems.

Central government's transfers are set up to fill the gap between subnational governments' expenditure and tax powers. That is, central government finances transfers and subnational governments spend them (see Figure 3.2). Following the assumption introduced in the former paragraph, for higher levels of decentralization citizens know how the basics of the intergovernmental fiscal system work (who does what and who finances what).[13] Then comes the question of whether citizens reward more those that finance expenditures (central government) or rather those who spend them (the subnational government), as this will determine the level of government that gets the most electoral benefits from expenditure transfers. If citizens reward electorally those who finance public goods or services more than those who provide them (so that arrow *a* in Figure 3.2 prevails over arrow *b*), it follows then that central government will get the lion's (electoral) share of expenditure transfers. On the other hand, citizens may reward more the level of government that provides services and public goods. In this context central government is less able to reap the electoral benefits from expenditure transfers, as benefits will remain at subnational level.

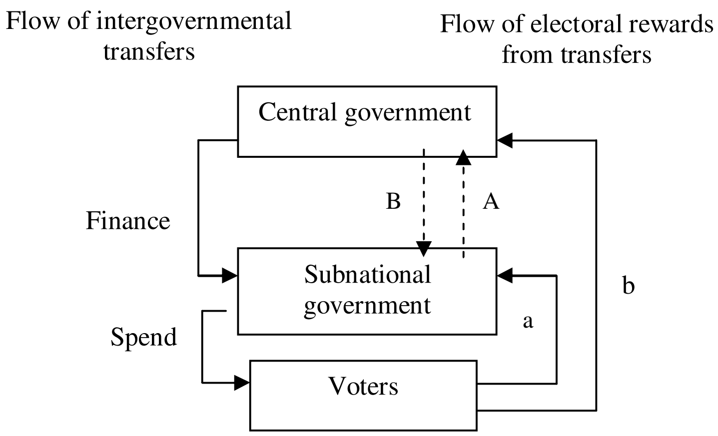
Citizens will tend to reward the level of government they identify as responsible for the overall pattern of service and goods provision in their jurisdiction. In a centralized context citizens ascribe low importance to subnational institutions (which have low decision-making and expenditure powers) and still regard central government as the main level of government responsible for both the financing and provision of goods and services. In an institutional context with strong subnational governments (or, in other words, with a high level of expenditure and tax decentralization), citizens ascribe high salience to subnational institutions and identify the local administration as the most

---

[13] In the first assumption I assumed that voters are aware that the core of their taxing liabilities is national taxes and that subnational governments receive transfers from central government to finance subnational expenditures.

responsible level of government for policy outcomes. In consequence, in highly decentralized systems electoral rewards for expenditure transfers will accrue to the subnational administration.

Figure 3.2. The flow of intergovernmental transfers and electoral rewards



In summary, at high levels of decentralization citizens are better informed on how the system of intergovernmental relations works. They are aware that the subnational administration is the most responsible level of government over the provision of services and public goods in their jurisdictions and ascribe electoral rewards for expenditure transfers accordingly. *In consequence, the higher the level of decentralization the lower the capacity of central government to reap the electoral benefits from expenditure transfers.*

3.5.1.2. Electoral Externalities across levels of government

One could still argue that central government can reap some of the electoral benefits accrued to the local administration through vertical electoral externalities. Electoral externalities across levels of government exist when the electoral fates of national politicians are correlated with those of their local and regional counterparts (row A in Figure 3.2). Or, when the chances of (re)election of subnational politicians are highly determined by the value of their national party labels (row B).[14]

However, as decentralization increases electoral externalities become weaker. When regional governments are endowed with a high level of authority and expenditure powers, subnational elections are increasingly held on local issues, which may foster the formation of differentiated constituencies for the local and regional counterparts of state-wide parties.[15] This means that citizens may vote differently in national and local elections, which can make subnational leaders' electoral fate become gradually independent from that of their copartisans at the center. If this is so, then the electoral benefits subnational politicians receive from expenditure transfers can hardly involve positive electoral externalities to central government.

---

[14] Electoral externalities refer to electoral interdependences between copartisans at different levels of government, that is, between members of state-wide parties that compete in national and subnational electoral contests.

[15] Some scholars have recently turned to electoral externalities to account for the incentives subnational governments have to *cooperate* with the federal government in the provision of national collective goods (even when this strategy implies giving up some valuable local benefits). The explanations, according to Filippov et al. (2004) is that *"local and regional politicians will not seek to disrupt unduly the functions of the federal government for fear of damaging the electoral standing of national politicians from their party and, thereby, their own subsequent electoral chances."* See also Rodden (2001).

In summary, in a politically decentralized country where expenditures and decision-making powers are very decentralized citizens are more informed about intergovernmental fiscal relations; they make subnational politicians responsible for the provision of goods and services in their jurisdictions; and vote differently in national and subnational elections. These factors may decrease the electoral benefits from expenditure transfers that remain at the central level and determine the strategies of central governments in the use of intergovernmental grants.

3.5.2. The intervention of subnational governments in the decision-making process

This section deals with factors that affect the *demand-side* of intergovernmental grants or, in other words, the subnational governments' role in the allocation process. As was mentioned above, devolved countries exhibit great differences regarding many aspects of decentralization. Divergences in the extent of decentralization may affect the ability of subnational governments to press the centre for a more advantageous arrangement on transfers. More specifically, my assumption is that for high levels of decentralization subnational governments are more capable of influencing the distribution of transfers (see Figure 3.3). The mediating variables of this positive causal relationship are electoral externalities and decentralization of the state-wide party's structure.

First, as was explained above, higher levels of decentralization involve weaker electoral externalities. This decreases the electoral costs which otherwise would have prevented subnational politicians from adopting a strategy of intergovernmental "bickering" against their national counterparts.[16] For the case of

---

[16] I assume that a strategy of intergovernmental "bickering" between copartisans may give rise to party disunity and fragmentation. State-wide

expenditure transfers, local politicians can claim electoral credit for public expenditures financed through transfers (purposely disregarding the fact that they are financed through central government transfers) and/or blame central government for insufficient funding when this strategy yields them valuable benefits.[17,18] The ultimate aim of this strategy is to reap all the electoral benefits from expenditure transfers, even when this strategy confronts subnational politicians with their copartisans at central level. In a high-decentralized context, then, subnational leaders are more capable of mobilizing their own constituencies, but they may use their powers against national copartisans' electoral interests. When this happens, central government may have problems to ask for subnational leaders' electoral support in national elections. As a result, central government cannot fully count on local leaders' support to be reelected and subnational copartisans may make it conditional on a higher transfer or resources.

Second, when subnational governments are endowed with a greater level of powers and authority, this introduces some centrifugal pressures within the structure of national parties that make national and subnational counterparts more independent

---

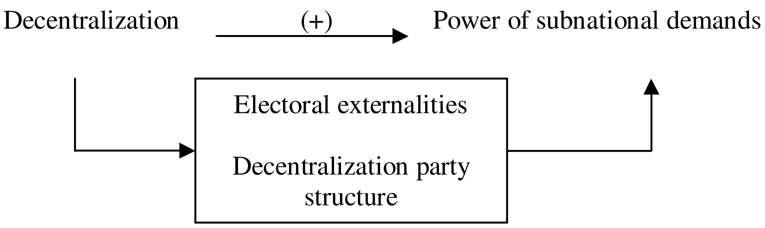
parties may incur important electoral costs if voters regard them as unable to force compliance and unity among subnational party branches.

[17] An example can be found in subnational governments' fiscal behaviour. Party affiliated regional leaders may have incentives to overspend because they reap electoral benefits (concentrated benefits) while the macroeconomic costs this behaviour may cause (i.e. deficit) are mainly borne by central government.

[18] For instance, in Australia, since the beginning of the twentieth century the national leadership of the Labor Party has continuously proposed a constitutional change that would end federalism. However, as state-level electoral platforms based on such constitutional amendments were unlikely to succeed, Labor party state-level organizations starkly opposed the centralist proposals of their national leadership. In consequence, the electoral fates between national and state-level politicians started to diverge, which in turn fostered state-level politicians' opposition to a centralist drift (Filippov et al. 2004: 202-204).

from each other and the latter more powerful.[19] This means that subnational leaders have more influence within the party structure to select the candidates that run for national and subnational elections or to set the political agenda. A more powerful position within the party structure diminishes the potential *within-party* costs (in terms of being punished by national members of the party apparatus) of claiming electoral credit against their national counterparts for public expenditures financed through transfers.

Figure 3.3. The structure of causal links between dependent, independent, and mediating variables



In summary, then, the particular structure of incentives that stems from higher levels of decentralization makes national politicians more vulnerable to subnational demands. Opposing them either may risk their probabilities of running for the following elections or withdraw local leaders' support in the national electoral campaign, or both.

[19] There are other factors that may create centrifugal pressures within the party system. For instance, at the beginning of the twentieth century in Canada some provincial governments gradually became financially self-supportive due to new economic activity at the provincial scale (such as electric power stations) and the increased importance of natural resources. Party provincial branches stopped being dependent on the central party funds to finance provincial elections, which created centrifugal pressures within the party structure (Filippov et al. 2004: 206).

3.5.3. Model[20]

My point of departure is from a devolved structure where there is a central government and subnational governments (states {1,…,S}) that are democratically elected. There are two parties: the incumbent at the central level (party A) and the opposition at the central level (party B). Central government allocates grants g_1, g_2,…g_s to each state. Individuals vote taking into account two criteria: ideology (a random continuous variable *X*) and the amount of welfare received from the incumbent. Voters' welfare depends on the level of public expenditures in their state, which I assume is equivalent to the amount of grants transferred from central government to state *s* (g_s):

$$U_i = U_{is}(g_s)$$

An individual evaluates the incumbent at the center on the basis of the amount of welfare provided in office, as compared to a randomly distributed cut-off point. He re-elects the incumbent when the level of welfare is above this threshold point. The realization of each individual threshold value depends on ideology. A voter located at *X* in the ideology scale has a threshold value $X(g_s)$ above which he votes for party A. The individual threshold values are private information but the cumulative distribution function of thresholds in each state Φs is common knowledge.

States can be defined according to some *supply side* and *demand side* characteristics. Supply side characteristics are their *swing* or *loyal* nature; the degree of electoral overrepresentation; or the partisan affiliation of the state incumbent. The *demand side* features account for subnational government's bargaining power on the design of transfers. The swing/loyal nature of the state is reflected in the different density functions of thresholds values

[20] This model draws from models in Khemani (2003) and Dasgupta (2001).

(Figure 3.4 and 3.5). Figure 3.4 exhibits the density function ϕ of threshold values in a "loyal" state *j.* The function has a downward slope because the density is higher at low cut-off points than at high threshold points. Or, in other words, there is a higher proportion of individuals with low threshold values than with high ones. On the contrary, in a "swing" state *h* the density function ϕ has a positive slope (Figure 3.5), which means that the density is greater at high cut-off points.

The proportion of votes that Party A gets in a "loyal" state *j* is given by:

$$P_j = N_j \Phi(g_j),$$

where N_j is the number of voters in state *j* and $\Phi(g_j)$ means the probability that individual threshold values are equal to or less than g_j.

On the other hand, the proportion of votes that Party B gets is:

$$P_h = N_h\,(1 - \Phi(g_h))$$

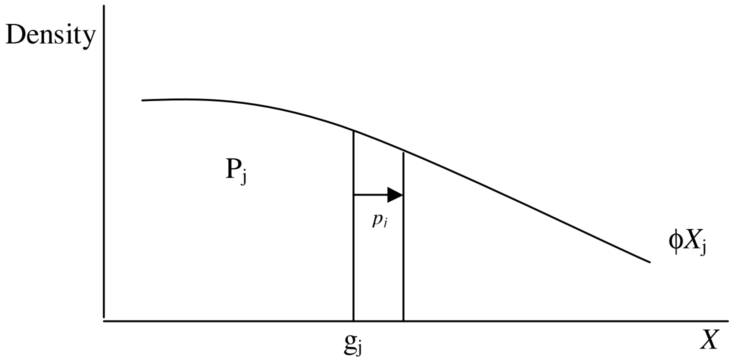
For any given level of transfers g_s, party A obtains more votes in a core state than in a swing state ($P_j > P_h$). However, a unit of transfers in jurisdiction *h* provides a higher additional proportion of votes for Party A (p_h) than the same unit increase in jurisdiction *j* (p_j). This is so because the density above g_s is greater in state *h* than in state *j*.

Consider a state s $\in S^{A,B}$ that receives a per capita transfer from the center of g_s. As was explained above, a voter with ideology X_i votes for the incumbent at the central level in national elections if the level of transfers is higher than his threshold point $X(g_s)$:

$$X_i(g_s) - g_s < 0\,, \qquad (1)$$

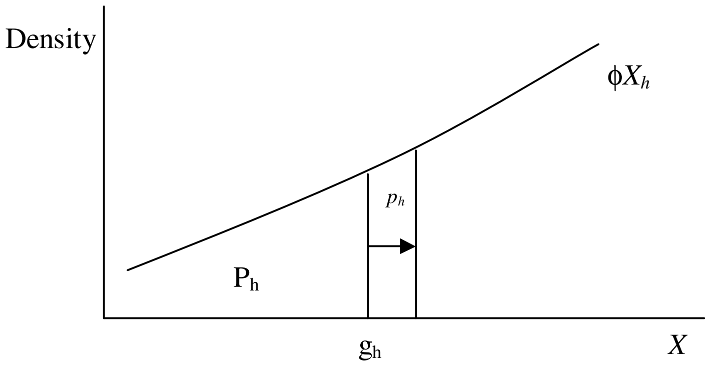
and will vote the opposition party at the center otherwise.[21]

Figure 3.4. "Loyal" State



p_h= additional proportion of votes for the incumbent party at the center from a unit increase of transfers

Figure 3.5. "Swing" State



p_h= additional proportion of votes for the incumbent party at the center from a unit increase of transfers

---

[21] The incumbent at the center is reelected only when the electoral benefit from expenditure transfers that goes to the center ($\theta f_s g_s$) is higher than the individual threshold value of reelection (X_i): X_i $(g_s) < \theta f_s g_s$.

However, in a devolved state welfare generated through transfers may benefit different levels of government. Let $\theta \in (0,1)$ and $f > 0$. Then θf_s is the electoral benefit that the incumbent at the center reaps per each unit of grants it transfers to each state; while $(1 - \theta)f_s$ is the electoral benefit derived by the incumbent in the state per each unit of transfers it receives. The electoral benefit is equivalent to the welfare that expenditure transfers generate amongst voters. For instance, when $\theta = 1$ the incumbent at the center receives the entire electoral benefit from intergovernmental grants because voters have entirely held central government responsible for welfare generated through transfers. Let $e \in (-1 \leq e \leq 0)$.[22] Then e is the proportion of the electoral payoffs derived by the subnational incumbent that also benefits the central incumbent.

In a devolved state, then, equation (1) becomes:

$$X_i(g_s) - \theta f_s g_s + e(1 - \theta) f_s g_s < 0, \tag{2}$$

the theoretical considerations made on decentralization in section 3 imply that:

In a centralized context $\theta f_s = 1$.

This means that electoral benefits from expenditure transfers are fully accrued to the central level, regardless of the partisan affiliation of the subnational incumbent. The central incumbent's strategy in the allocation of transfers will be determined by the

---

[22] The term e transforms the last part of this equation $X_i(g_s) < \theta f_s g_s - e(1 - \theta) f_s g_s$ into a positive value, which means that the incumbent at the center benefits from a portion of the electoral benefits that are reaped by the subnational government.

electoral characteristics of the state, that is, its swing or loyal nature.

From a) and taking into account that $p_j > p_h$; the first hypothesis follows:

H_1: In a centralized context central government will face incentives to skew more resources towards regions where it reaps more electoral benefits from each unit of transfers (swing subnational governments or overrepresented), regardless of their partisan affiliation.

In a decentralized context $\theta f_s < 1$.

Theoretical concerns made in section 5 imply that in a decentralized context central government is less able to reap the electoral benefits that stem from expenditure transfers. Equation (2) shows that the probabilities of the central incumbent being re-elected will very much depend on the extent to which they can reap some of the electoral benefits that the subnational incumbent receives from expenditure transfers. This is measured by the term *e*. The closer the value of *e* to -1, the higher the electoral benefits accrued to central government out of those received by the subnational incumbent. The term *e* measures a sort of *spillover effect* of subnational electoral support on the central incumbent.

The value of *e* depends on several factors. The first one is partisan affiliation of subnational governments. The value of the term *e* is 0 for non-affiliated subnational governments. For partisan affiliated regions, the value of *e* will vary depending on the willingness and/or capacity of partisan affiliated incumbents to mobilize their constituencies and administrative resources in support of the central incumbent. From the theoretical assumptions made in section 3 we know that in a decentralized context subnational leaders from partisan affiliated states may have incentives to use their powers against national copartisans' electoral interests (due to weak electoral externalities). Strategies of intergovernmental "bickering" in affiliated jurisdictions may virtually decrease *e* values to 0. In addition, we know they accrue decision-making powers within the national party and control an important amount of administrative resources. Therefore, in this context the design of intergovernmental transfers will respond to the central incumbent's need to benefit from *electoral spillovers* in national elections. That is, they will skew resources towards those affiliated state incumbents whose political support and resources are crucial to win national elections. It is important to note here that these states may or *may not* coincide with those that are regarded by central government as the most appealing for their electoral characteristics (swing/overrepresentation). In setting the allocation strategies in a decentralized context the central incumbent will then give priority to other state characteristics such as partisan affiliation or mobilization capacity of subnational copartisans. Taking into account these considerations, the second hypothesis follows:

> *H_2: In a decentralized context central government will have incentives to skew more resources towards partisan affiliated regions and, among them, towards the ones whose political support and resources are crucial to win national elections.*

CHAPTER 4. CLARITY OF RESPONSIBILITIES IN A DECENTRALIZED CONTEXT

4.1. Introduction: Accountability and decentralization

The purpose of this chapter is to analyze empirically whether different levels of decentralization have an impact on citizens' capacity to allocate responsibilities across levels of government. One of the assumptions made in the theoretical framework of the previous chapter was that citizens' are more capable to ascribe responsibilities between different administrations as decentralization increases. In this chapter I convert this assumption into a hypothesis and test it on the Spanish case.

I hypothesize that the relationship between clarity of responsibilities and decentralization has a u-shape form. That is, citizens are better able to ascribe responsibilities in contexts where the level of decentralization is either very low or very high. For intermediate levels of decentralization individuals would perform worse. The hypothesis is tested on the Spanish case. In Spain the process of decentralization has been asymmetrical both in its revenue and expenditure side. This has given rise to three different groups of regions with divergent powers with respect to revenue sources and administrative decentralization. Testing the hypothesis on the Spanish Autonomous Communities allows for variance in decentralization levels while other institutional factors are controlled for.

This chapter is organized as follows: in Section 2 I survey and discuss the different mechanisms by which decentralization disciplines politicians and present the hypothesis on the impact of decentralization levels on clarity of responsibilities. In Section 3 I introduce the problems in measuring decentralization and describe the main features of the decentralization process in Spain. Data and the specification of two empirical models appear in Section 4, in which I also discuss the obtained results. Finally, section 5 provides some concluding remarks.

4.2. Decentralization and Accountability

Accountability is an electoral mechanism that citizens use to hold politicians responsible for the outcomes derived from their past actions (Cheibub and Przeworski 1999: 225). This requires, first and foremost, that there is clarity of responsibilities. Voters must be capable of establishing a causal link between outcomes and politicians' past actions. They must be able to distinguish *who is responsible for what.*

There exist information problems to make accountability an effective control mechanism in decentralized systems. In multitiered countries the authority for public functions or finances is shared between different levels of government. The intertwined distribution of powers diffuses responsibility, which in turn may hamper citizens' ability to hold politicians accountable. The literature on decentralization emphasizes different mechanisms by which the assignment of authority for public functions or finances to lower levels of government can discipline and control politicians. The first mechanism relates to political decentralization, that is, the extension of direct or indirect participation of the citizens in public decision/making through local and regional elections. From this perspective decentralization is democratically valuable because it institutionalizes the participation of those affected by local decisions and strengthens local responsiveness and accountability.

The second mechanism has to do with the impact of fiscal federalism in preventing governments from a revenue-maximizing behavior (Tiebout 1956, Brennan and Buchanan 1980, Buchanan 1995). More specifically, competition among local jurisdictions in the provision of public goods disciplines governments because full-mobile voters abandon jurisdictions where politicians do not offer the revenue-expenditure pattern they prefer most. As it was discussed in chapter one, Weingast (1995) develops a theory on a specific form of federalism (*market-preserving* federalism) that is grounded on the mechanism of tax competition. He argues that as leaders of political units in a decentralized political system must compete for mobile sources of revenue, this prevents them from imposing regulations that can hamper the market. These theories advance fiscal federalism as a superior form of organization of the public sector. This organization is characterized by having strongly decentralized subcentral jurisdictions with broad powers over taxation and expenditures. Tax competition and exit threat mechanisms guarantee that fiscal decisions in each jurisdiction are tailored to citizens' preferences. But average public sector's decentralization in reality is far from the strongly decentralized context in which fiscal disciplinary mechanisms take place.

The intergovernmental fiscal system in devolved countries usually takes an intertwined form, and there is strong interdependence among levels of government in expenditure and revenue decisions.[1] Coordination among different levels of

---

[1] According to one of the most recent comparative analysis on fiscal federalism, the average percentage of subnational autonomous own-taxes (taxes where subnational governments can determine tax rate and/or tax base) over general consolidated tax revenues in OECD countries (1999-2001) is 19.1 while in the EU15 it is only of 7.9. As for expenditure decentralization, a wide-ranging survey of local and regional finances in the 15 EU members shows the widespread presence of government functions or services that are performed jointly by different levels of government. As the author of one of these studies states "it is difficult to draw neat lines around the precise jurisdictions in charge of services at subcentral levels, since joint actions and competences are often present" (Pola 1999). Rodden (2003) also presents some evidence of the

government in the provision of public goods or joint financing is common and most important revenue and expenditure decisions are made through a complex intergovernmental bargaining process.

The existence of intertwined fiscal and policy/making processes violates some of the conditions in which fiscal federalism theories are grounded. An intertwined division of functional responsibilities and revenues across levels of government blurs the share of responsibility each level of government has for policy outcomes. Consequently, even if decentralization promotes new forms of political participation through local and regional elections, it may undermine the conditions that make elections an effective control mechanism. If voters have difficulties in ascertaining responsibilities over the existing pattern of revenues and expenditures in their jurisdictions, they are less able to correctly punish or reward politicians for their past actions. If this is so it follows then that, contrary to the theories presented above, decentralization does not create the conditions to control and discipline the government.

In the next section I present the hypothesis on the relationship between decentralization and clarity of responsibilities. The idea is that despite decentralization generally involves complex intergovernmental fiscal relations, the degree of government decentralization may have an effect on citizens' capacity to ascribe responsibilities. Or, in other words, the hypothesis deals with the particular institutional design of decentralization that can better serve the conditions to hold politicians' accountable.[2]

---

intertwined fiscal intergovernmental relations in three federations: Australia, Germany and Canada.

[2] Other scholars have analyzed what factors account for the electoral effects of clarity of responsibilities. For instance, Powell and Whitten (1993) explore the match between politicians' performance in office andits electoral consequences, that is, the conditions under which voting becomes an effective tool to make the incumbent accountable for economic performance. They conclude that clarity of responsibility is an essential factor to understand the electoral consequences of economic

4.2.1. Hypothesis

This section introduces the hypothesis on the implications of different degrees of decentralization on citizens' capacity to ascribe responsibilities among different levels of government. I hypothesize a non-linear correlation between the degree of decentralization and citizens' "ability to blame". More specifically, I state that the correlation has a "u" shape.

I assume there are three levels of decentralization: high, intermediate and low. For intermediate levels responsibilities are jointly performed by the central and subnational governments. For high and low levels the distribution of public functions and finances across levels of government is less intertwined because power and authority is concentrated at one level of government. In a system with a low degree of decentralization the majority of citizens regard central government as the major responsible for the pattern of taxes and expenditures in their jurisdictions. Despite some expenditure and revenue powers being formally decentralized, subnational governments have a very low degree of discretion over the rules that govern them. The jurisdiction's population regards central government as the most responsible level of government over both the financing and provision of goods and services. They know the bulk of decisions over the revenue-expenditure pattern in their jurisdictions comes from the

---

conditions. More specifically, factors such as minority or coalition governments, the lack of voting cohesion of the major governing party or bicameral opposition blur the responsibility of politicians and insulate them from the economic decisions or conditions that would make them lose or win votes in elections. In addition, Leyden and Borrelli (1995) show that unified control of state government makes US governors' electoral fates more dependent on state economic conditions. However, Royen et al. (2000) find that clarity of responsibilities is not a significant variable to account for economic voting and, contrary to Powell and Whitten's hypothesis, conclude that there are more economic effects for coalition governments than for single-party governments.

central level and accordingly ascribe low salience to regional institutions.

As decentralization increases, subnational governments are responsible for a higher percentage of expenditures and revenues and they are granted broader authority over their regulation and allocation. The distribution of public functions and financing across governments is thus more intertwined. In consequence, policy and fiscal outcomes are the result of a mixture of national and subnational actions. The assignment of particular responsibilities throughout the process that brings about policy outcomes becomes more difficult. As a result, it is at intermediate levels of decentralization when citizens are less able to identify who is responsible for the pattern of expenditures and taxes in their jurisdictions and therefore less capable to correctly blame or reward politicians for policy outcomes.

Finally, clarity of responsibilities among levels of government becomes higher as subnational powers are emphasized. That is, at the highest levels of decentralization control over expenditures and taxes is greatly concentrated at the subnational level and therefore subnational institutions arise as a clearly separated and autonomous tier of government. In this context citizens have gradually learned that subnational politicians are the most responsible for the legislation, management and implementation of policy and fiscal decisions in their jurisdictions.

This does not imply they know the particular complexities that govern intergovernmental relations but that they are capable to ascertain the level of government on which most powers are concentrated. In sum, at low and high levels of decentralization there is always one level of government that clearly predominates over the other, which makes easier for citizens to clarify responsibilities for policy outcomes. For intermediate levels of decentralization the allocation of responsibilities is more intertwined so that the jurisdictions' population is less able to draw a line around the responsibilities of each level of government.

4.3. Testing the hypothesis. The case of Spain

4.3.1. Measuring decentralization

Defining and measuring decentralization is a difficult task. Authority for public functions and finances is allocated across levels of government virtually in as many forms as number of countries. In addition, many dimensions of decentralization cannot be accounted for by using a single quantitative measure. A basic differentiation could be drawn by classifying systems according to the existence or absence of subnational powers over revenues and expenditures. However, it is difficult to find variance in such a dichotomous variable since even in the most centralized countries subnational governments are responsible for the provision of some public goods or the levy of taxes. A potential further extension of that basic classification would imply the differentiation and ranking of revenues and expenditure categories. For instance, any attempt to define the different types of subnational tax revenues by means of rankings would require considering some dimensions such as the degree of control subnational central governments exert upon taxes or the scope of sub-central activity (defined in Table 4.1 as "A" - that stands for "authority" and "P" – that stands for "percentage of consolidated total revenues/expenditures", which measures the scope of subnational activity). The same would apply for subnational expenditures.[3]

The classification exhibited in Table 4.1 entails a high number of potential combinations of categories and dimensions. Each potential combination of percentage/authority values for revenues

---

[3] Even when the formal assignment of public functions is the same, a system where subnational governments have autonomy to determine how to allocate expenditures is more decentralized than another system where subnational spending is regulated by national legislation. Likewise, a system where the scope of subnational taxes is higher is more decentralized than a system where the scope is lower, even if in both systems subnational governments have the same degree of authority upon taxes.

and expenditures gives rise to new subcategories, which become difficult to rank in a decentralization scale without having a serious problem of arbitrariness.[4] In consequence, the attempt to account for fiscal intergovernmental relations may come at the cost of a virtually insurmountable complexity in measuring the degree of public sector decentralization.[5]

Table 4.1. Categorization of revenue and expenditure sides of decentralization

Power	Values	Indicators	Values
REVENUES	Taxes	Percentages	High Low
		Authority	High Low None
	Grants	Percentage	High Low
		Authority	High Low None
EXPENDITURES	Percentage		High Low
	Authority		High Low None

[4] Consider two multitiered systems where subnational governments have powers over taxes and expenditures (category a). In the first one the combination of values for each indicator is the following: Taxes (P(h); A(l)) and Expenditures (P(h); A(l)). In the second one the combination is as follows: Taxes (P(l); A(l)) and Expenditures (P(h); A(h)).It is not easy to rank them without having a problem of arbitrariness.

[5] Some empirical works have recently challenged the conventional measures of fiscal decentralization and warn that erroneous measurement may generate bias and therefore wrong conclusions on the effects of fiscal decentralization (Ebel and Yilmaz 2003; Rodden 2001; Stegarescu 2004).

In this chapter the hypothesis is tested for one country. A case-study allows sorting out some of the difficulties in measuring decentralization, as the number of potential combinations of revenue and expenditure dimensions is lower. In measuring the degree of fiscal decentralization across regions it may become easier to identify the extreme cases (jurisdictions with the highest and the lowest levels of decentralization). This may facilitate the operationalization of decentralization for the empirical analysis. The classification of the Spanish regions by means of a decentralization ranking requires a brief description of fiscal intergovernmental relations in Spain since the approval of the Constitution (1978) and its evolution onwards.

4.3.2. Asymmetries in the process of tax and expenditure decentralization

The Constitution established two different procedural mechanisms for Autonomous Communities (ACs hereafter) to be formed (Aja 1999, Ruiz-Almendral 2003). The first mechanism provided ACs for larger and faster autonomy and it is usually referred to as the "fast-track" process. There were seven ACs that followed this path: Basque Country, Navarre, Catalonia, Canary Islands, Galicia, Andalusia and Valencia.[6] They assumed executive and legislative powers in areas such as health care, education or environment policies. The second path entailed more limited autonomy and established a slower path of devolution of spending responsibilities.[7] This "slow-track" was followed by the rest of ACs. The provision of some of the responsibilities taken by

[6] More precisely, the Canary Islands and Valencia accessed autonomy following the procedural mechanisms established in article 143 (that provided for lower levels of responsibilities and authority) but in 1982 they were endowed with high-autonomy competences.

[7] The Constitution specified that the two paths could eventually converge so that all regions in the Common Regime of financing would have the same spending responsibilities.

the fast-track group of ACs involved a huge transfer of economic resources so that initially there were significant differences between the amount of resources and powers assumed by fast-track ACs and those undertaken by the rest.

On the other hand, the Constitution introduced two differentiated models of regional financing: the *Foral* regime applicable to the Basque Country (*Concierto*) and Navarre (*Convenio*); and the Common regime, which is applicable to the rest of the ACs. The main difference between them lies in their taxing authority. Under the *Foral* regime the major taxes are fully administered by the regional governments.[8] Regions under the Common system have had very limited taxation powers, which have made them more dependent upon transfers from central government.

In sum, the decentralization that was enshrined in the Constitution gave rise to three different groups of regions, which differed in the combination tax and expenditure powers (see Table 4.2). The Basque Country and Navarre formed group 1. They were financed according to the *Foral* model and accessed autonomy through the fast-track process, which entailed larger powers. Regions financed through the Common regime - and formed through fast-track procedures make the second group of regions (Andalusia, Canary Islands, Catalonia, Comunidad Valenciana and Galicia). Finally, those that followed the slow-track process to access autonomy and the Common model of regional financing form the third group of ACs (Extremadura, Castilla León, Castilla la Mancha, Asturias, Cantabria, La Rioja, Murcia, Balearic Islands, Madrid and Aragon).

---

[8] These regional governments pay an amount of money to central government for the costs of public services provided by the State in those regions (ex. National defense).

4.3.2.1. The evolution of decentralization

Autonomous Communities have become more similar in terms of the powers over taxes and expenditures they control, although relevant differences persist in regional financing (see Table A.2 and Table A.3 in the appendix).

Table 4.2. Classification of Autonomous Communities according to expenditure and fiscal powers until December 2001

	EXPENDITURE DECENTRALIZATION	
REGIONAL SYSTEM OF FINANCING	Low	High
Common Regime (limited tax powers)	Asturias Balearic Islands Cantabria Castilla la Mancha Castilla-León Extremadura Madrid Murcia La Rioja	Andalusia Canary Islands Catalonia Galicia C.Valenciana
Foral Regime (broad tax powers)		Basque Country Navarre

Throughout a long period of time the main social policies such as education or health care have been gradually transferred to the slow-path regions (see Table A.2 in the appendix). Consequently, at present there are virtually no differences regarding the amount of regional spending subnational governments control. In addition, all ACs have broad executive and legislative powers over the majority of transferred policy areas. Some divergences remain among regions in minor fields or in the form of specific regulations.[9]

Table A.2 in the appendix shows there are still significant differences in regional revenues between the *Foral* regime and the Common regime. For instance, Navarre and the Basque Country fully control management, collection and inspection of income tax, vat, corporate tax and excise tax. In the last Regional Financing Act (passed in December 2001) the rest of the ACs were ceded 33% of the income tax, 35% of vat and 40% of excise taxes. However, these regions were only granted tax administration and regulatory powers on the income tax. Despite tax autonomy is notably higher in the *Foral* Communities, the new system of regional financing approved in December 2001 introduced a considerable degree of tax decentralization. It represents the most important attempt to close the gap between tax and expenditure responsibilities for Common regime ACs. In summary, as a consequence of the latest reforms on expenditure decentralization regional asymmetries just hold due to differentiated models of regional financing (see Table 4.3).

4.4. Empirical Analysis

In order to test the impact of different levels of decentralization on citizens' ability to "correctly blame" for policy outcomes I have adopted a two-stage procedure. The first model estimates the extent to which decentralization can account for the amount of knowledge individuals possess on *who does what* in a multitiered system. In a second model I have estimated the effects of the modification of decentralization levels on citizens' subjective knowledge in regional politics. This second model compares the amount of citizens' information in two different

---

[9] For instance, there are several ACs that have stipulated a special civil law.

points in time (1998 and 2002). The allocation of taxes and expenditures has been modified in this four-year period (1998-2002) and I expect this modification to have an impact on individuals' self-reported level of information.

Table 4.3. Asymmetries in tax and expenditure decentralization after January 2002

	EXPENDITURE DECENTRALIZATION	
REGIONAL SYSTEM OF FINANCING	High	
Common Regime (limited tax powers)	Asturias Balearic Islands Cantabria Castilla la Mancha Castilla-León Extremadura Madrid Murcia La Rioja	Andalusia Canary Islands Catalonia Galicia Comunidad Valenciana
Foral Regime (broad tax powers)	Basque Country Navarre	

4.4.1. Operationalizing decentralization

The main explanatory variable is level of decentralization, which comprises three categories. These categories result from the division of regions into three groups according to their tax and expenditure powers as for 1998. Regions with the highest level of autonomy are the *Foral* ones: the Basque Country and Navarre (group 1 - G1 regions hereafter - in Table 4.4). ACs with the lowest level of decentralization are those financed through the Common regime that accessed autonomy according to the slow-track process, that is, with more limited autonomy and a slower path of devolution of spending responsibilities (group 3 or G3 regions hereafter). Finally, intermediate levels of decentralization are found in regions that were granted powers over a broad set of expenditures through the fast-track process but with limited taxing powers (group 2 or G2 regions hereafter). This variable enters the econometric analysis as an ordered categorical variable.

4.4.2. The dependent variable

In the first model citizens' information has been proxied by an index that measures individuals' capacity to correctly identify the most responsible level of government (local, regional, central) over a set of policy areas. I focus on 7 policy areas: health care, education, unemployment, housing, public transportation and public security.[10]

---

[10] The survey question includes a set of eleven policy areas: housing, health care, education, the problem of drug abuse, public security, unemployment, infrastructures (i.e roads and rail links), the situation of agriculture and fishing, the protection of the environment, public transportation and the situation of industry and trade. Some of these policy areas are government functions performed jointly by regional governments and central government; others are carried out exclusively by Autonomous Communities or central government. There are some policy areas that were included in the survey question but which I excluded from the index: drugs, infrastructures, agriculture and fishing, and the protection of the environment. The generality of the question on drugs abuse makes difficult to point out an only responsible level of government. "Infrastructures" have been excluded because government functions in this area are shared between the regional and central administration. Central government has authority over road (or rail) links that go through more than one region while regional governments are responsible over road (or rail) links within their jurisdictions. "Agriculture and fishing" have been excluded from the index due to the unspecified survey question. The allocation of responsibilities over agriculture is different from that of fishing policies. Central and regional

Table 4.4. Classification of Autonomous Communities according to their level of decentralization

Group 1	Group 2	Group 3
High decentralization	Intermediate Decentralization	Low Decentralization
Basque Country Navarre	Andalusia Catalonia Canary Islands Comunidad Valenciana Galicia	Asturias Aragon Balearic Islands Castilla la Mancha Castilla-León Extremadura Madrid Murcia La Rioja
Powers	Powers	Powers
High tax and expenditure powers	Low tax powers High expenditure powers	Low tax powers Low expenditure powers

---

government perform joint functions on fishing while Autonomous Communities have exclusive powers on agriculture. Finally, the "protection of the environment" is performed jointly by central government and the regions. This means that the central administration enacts basic laws while Autonomous Communities have discretion in legislative development and execution (*competencias concurrentes*), which hampers the identification of the most responsible level of government. Health care and education are also jointly provided by the central and regional level. However, they have been included in the index because their budgetary weigh involves the transfer of large amounts of administrative, human and financial resources, which I believe enhances the identification of the responsible administration.

The corresponding survey questions[11] ask individuals to identify the level of government that is most responsible for each policy area.[12] Responses to these questions have been coded as 1 when the individual answers correctly (that is, when the respondent correctly identifies the level of government in each policy area) and 0 when he does not.[13] Therefore, the index scale has a potential minimum of 0 and a maximum of 7. For instance, if the index variable takes value 2 it means that out of 7 policy areas the respondent was able to assign responsibilities correctly over two. Table 4.5 shows the distribution of policy areas according to the main responsible level of government in 1998 (when the survey was conducted).[14]

---

[11] The survey was conducted by the *Centro de Investigaciones Sociológicas* - Center for Sociological Research in May 1998.

[12] The survey question asks: Which is the most responsible level of government (central government, regional government or local government) if things go well or badly in the following policy areas?

[13] Categories "Not known/not answered" are coded as zero.

[14] Powers over education were decentralized in a twofold process. Primary and secondary education was decentralized towards fast-track regions from 1980 to 1983 while slow-track regions received these powers from 1997 to 1999. Responsibilities over university education were devolved to fast-track regions from 1985 to 1986 while slow-track regions received them ten years later. The survey in which the empirical analysis is based was conducted in 1998. In 1998 year there is only one slow-track region that had received powers over primary and secondary education (see Table A.2 in the appendix) and slow-track regions have only exercised power over university education for one year. Following these considerations, in constructing the index I have considered that the most responsible government for education policies in slow-track regions is central government.

4.4.3. Control variables

Decades of survey research have demonstrated that citizens have limited information about basic political facts. Individuals pay little attention to politics, as it is exemplified by the fact that they fail to recognize the names of their elected representatives. However, there are numerous informational shortcuts that may assist citizens in obtaining political knowledge and making reasoned political choices (Lupia and McCubbins 1998). Citizens may obtain such knowledge from what other people say, write or do so that opinion leaders, the media or political discussion with friends may become a source of political information for individuals.

Table 4.5. Intergovernmental distribution of powers by policy area as for 1998

	Level of government		
Policy Area	*Central*	*Regional*	*Local*
Health Care	X (G3)	X (G1, G2)	
Education	X (G3)	X (G1, G2)	
Public Transportation		X	X
Housing		X	
Unemployment	X		
Security	X		
Industry and Trade		X	

Note: G1= regions in group 1; G2 = regions in group 2 ; G3 = regions in group 3
Source: Spanish 1978 Constitution; Aja (1999); Pola (1999)

To account for these considerations, the first econometric model includes control variables that may represent sources of information for individuals. These variables may affect citizens' general political knowledge and, in turn, their particular knowledge on the allocation of responsibilities in a multitiered system. In the econometric analysis these sources of information acquisition have been operationalized through the following independent variables: Education (0, no studies at all, 1 primary, 2 secondary education, 3, university and 4 postgraduate education); Work (0 retired, unemployed or housewife; 1 student; 2 when the individual works); Electoral participation is participation in the 1996 general election (0 if the individual did not vote, 1 if the individual did vote); Social participation is a scale that goes from 0 to 20 that measures the individual's participation in cultural, sports, religious, regional or local associations; charity societies; ecological, human rights, pacifist or feminist movements; and political organizations (0, when the individual never participated in any of them, 20 when the individual participates in all of them); Age; and Native (1 if the individual was born in the region where he resides; 0 if he was not).

The informational mechanisms that are at work through these variables are accounted as follows. Education and age generate knowledge because they provide the individual with opportunities to obtain information from both their own experience and the political environment. Electoral participation may act as a direct source of information for the individual, that is, a way to obtain knowledge from own experience. Personal interrelations are characterized by an exchange of information, for instance at work or through social networks. Long-term residents in a region may have an informational advantage on regional issues (for instance, a better capacity to understand the singular political facts of the region) than those that were born in a different Autonomous Community and have resided for a short period of time in the region (I call this variable *Native*). I measure the interrelation of time of residence and region-born with an interaction of *Native* and *Age*. Finally, I have also included a variable on subjective knowledge on regional political issues. More specifically, it measures the self-reported knowledge on the activities that the regional government performs (3, very informed; 2, somewhat; 1, little; 0 not at all). Summary statistics of all independent variables are depicted in Table 4.6.

Model 1

Y_{index} = β_0+ β_1 Decentralization + β_2Information on regional issues + β_3Education + β_4Work + β_5Electoral participation + β_6Social participation + β_7Age + δ_8Native + δ_9Native*Age + e

If my hypothesis is correct, then I would expect to find the following results:

a) Individuals that reside in highly decentralized regions (group 1) and low decentralized regions (group 3) perform better in the allocation of responsibilities across governments than respondents who reside in regions with an intermediate level of decentralization (group 2 is the control group).

Table 4.6. Summary Statistics of Model 1

VARIABLES	OBSERVATIONS	MEAN	STD.DEV.	MIN.	MAX.
Index	9936	2.888	1.653	0	7
Decentralization	9991	2.425	0.666	1	3
Information on regional government's activities	9791	2.991	0.736	0	3
Education	9925	1.399	0.816	0	4
Work	9913	0.409	0.491	0	2
Electoral Participation	9990	1.512	0.733	0	1
Social Participation	9783	1.677	2.749	0	20
Age	9986	45.46	18.322	18	95
Native	9972	0.797	0.402	0	1

4.4.4. Results

In Table 4.7 I present the OLS regression results for the estimation of Model 1. Most of the variables are of the sign I predicted from my theoretical analysis and many are statistically significant. The important result is that, as was hypothesized, different levels of decentralization make citizens differ in their ability to ascribe responsibilities among different levels of government. Individuals that reside in regions where the pattern of power allocation is less intertwined (either as a consequence of high levels of decentralization or low levels of decentralization) are more capable of identifying correctly the most responsible level of government for each policy area.

Variables that measure sources of information acquisition show the predicted sign. Electoral participation enhances the probabilities of ascribing responsibilities correctly. Additionally, individuals that are exposed to personal interaction at work or through social networks are significantly more capable of allocating responsibilities among different levels of government. Education and being a native-born resident is positively associated to the dependent variable but coefficients are only significantly different from zero for education. Contrary to predictions, age does not seem to generate knowledge, as it is not significant and shows a negative sign. Likewise, the interaction of *Age* and *Native* has a negative correlation with the dependent variable. That is, contrary to my predictions, as age increases, the probability that native-born residents correctly identify the most responsible level of government for each policy area decreases. On the basis of the empirical analysis, then, I can assert that the extent to which the public sector is decentralized affects citizens' ability to ascribe responsibilities across levels of government. Although model specification could be improved upon (there is a low Adjusted R_2) the empirical evidence gives reasonable support to the hypothesis.

Table 4.7. Regression Results

	MODEL 1	MODEL 1.A	MODEL 1.B	MODEL 1.C
	Index	Asymmetric powers	Exclusive powers	Exclusive central
Explanatory Variables				
Decentralization (c: group 2)				
Group 1	0.21 (0.06)***	0.15 (0.03)***	0.03 (0.04)	- 0.32 (0.07)***
Group 3	0.15 (0.03)***	0.36 (0.02)***	- 0.31 (0.02)***	0.41 (0.04)***
Electoral Participation (c: no vote)				
Voted	0.29 (0.03)***	0.11 (0.02)***	0.11 (0.02)***	0.12 (0.04)***
Information on regional issues (c: Not at all)				
Little	0.75 (0.04)***	0.27 (0.02)***	0.37 (0.02)***	0.46 (0.05)***
Somewhat	0.96 (0.05)***	0.29 (0.03)***	0.55 (0.03)***	0.41 (0.06)***
Very Much	1.07 (0.14)***	0.37 (0.08)***	0.52 (0.09)***	0.55 (0.17)***
Work status (c: unemployed, housewife, retired)				
Student	-0.04 (0.08)	0.04 (0.04)	- 0.01 (0.05)	- 0.07 (0.09)
Work	0.16 (0.04)***	0.04 (0.02)	0.09 (0.02)***	0.02 (0.05)
Education (c: no studies)				
Primary	0.52 (0.07)***	0.14 (0.04)***	0.26 (0.04)***	0.24 (0.08)***
Secondary	0.65 (0.08)***	0.16 (0.05)***	0.37 (0.05)***	0.34 (0.09)***
University	0.77 (0.09)***	0.19 (0.05)***	0.42 (0.05)***	0.37 (0.10)***
Doctorate/ Postgraduate	0.95 (0.31)***	0.21 (0.18)	0.48 (0.19)**	0.10 (0.36)
Social participation	0.02 (0.31)***	- 0.001 (0.004)	0.02 (0.004)***	- 0.01 (0.008)
Native	0.13 (0.13)	0.016 (0.07)	0.10 (0.08)	0.04 (0.15)
Age	- 0.003 (0.002)	- 0.0009 (0.001)	- 0.002 (0.001)	- 0.003 (0.002)
Native*Age	- 0.005 (0.002)**	- 0.001 (0.001)	- 0.003 (0.001)*	- 0.002 (0.003)
Constant	1.95 (0.15)***	0.88 (0.092)***	0.86 (0.09)***	- 0.45 (0.18)**
Adjusted R^2	0.10	0.05	0.10	0.02
N	9420	9439	9459	9458
Estimation method	OLS	OLS	OLS	Logit

Note: Standard error of parameter estimates are in parentheses. Levels of statistical significance are ***p<.01; **p<0.05; *p<.10
c: control variable

Next I analyze whether the differences found among groups of regions hold for different types of policy areas. As was explained above, the index was created with individuals' responses over *who does what* for 7 policy areas. According to Table 4.4, these seven policy areas can be grouped depending on the degree of authority that regional governments have over them. There is a set of three policy areas that are exclusively performed by regional governments: housing, industry and trade, and public transportation (*exclusive policies*, hereafter). As far as unemployment is concerned, it remains at central level's hands (*exclusive central*). Finally, there are three policy areas (health care, education and public transportation) in which the degree of authority varies across regions (*asymmetric policies*). Regions in group 1 have been granted powers over the three of them; regions in group 2 have been granted powers over education and health care; and finally for regions in group 3 executive and legislative powers in those areas remain at the central level.

I have separated the former dependent variable (*index*) into three different variables: *exclusive policies* (an index created with housing, industry and trade and public transportation policy areas); *asymmetric policies* (an index created with health care, education and security); and *exclusive central* (a dummy variable that is coded as 1 when the individual correctly ascribes the government responsibility for unemployment and 0 otherwise). I have estimated Model 1 with three different dependent variables: *asymmetric policies* (Model 1.a), *exclusive policies* (Model 1.b) and *exclusive central* (Model 1.c). The results only support the hypothesis when the dependent variable is *asymmetric policies*. When other types of policy areas are introduced as exogenous variables, predicted differences fall apart. More specifically, results in Model 1.b show that individuals from regions with the lowest level of decentralization (group 3) are significantly less informed (than individuals from regions in group 2) about the allocation of responsibilities in policy areas that formally fall within the exclusive powers of regional governments. In addition, respondents from regions in group 1 are not significantly more informed than those from regions in group 2. The regression in Model 1.c exhibits opposite results. That is, for a policy area (unemployment) at central government's hands, respondents from regions with the highest level of decentralization significantly perform worse than individuals from regions in group 2. However, differences between individuals in group 3 and group 2 are shown as predicted.

How can these results be better interpreted? A further exploration on responses in each policy area provides the answer. Residents in regions with the highest levels of decentralization consistently show a *regionalist bias* in their allocation of responsibilities. That is, they tend to over-identify their regional government as the most responsible level of government. For instance, a majority of them regards the regional government as the most responsible level of government for a policy area - unemployment - that falls within central government's exclusive powers (see Table A.4 in the appendix). This is the explanation for having a significant negative coefficient for group 1 category in the estimation of Model 1.c. On the contrary, residents in regions with lowest levels of decentralization show a *centralist bias* in their responses. This means that they overestimate the share of central government's responsibilities over policy areas. For instance, a majority of respondents from this group of regions identifies (erroneously) central government as the responsible administration for policies that fall within regional governments' exclusive powers (see Table A.5 and A.6 in the appendix). This accounts for the coefficient and sign of category 3 in the regression of Model 1.b.

In sum, the empirical evidence gives reasonable support to the hypothesis that clarity of responsibilities is higher for low and high levels of decentralization. The particular design of decentralized institutions has an effect on citizens' capacity to ascribe responsibilities across levels of government. However, a more detailed exploration on citizens' knowledge by policy area shows a biased estimation of government responsibilities in regions with low and high levels of decentralization. This gives us a better idea of the mechanisms at work on the relationship between decentralization and clarity of responsibilities. At extreme levels of decentralization powers are concentrated at one level of government. The jurisdiction's population knows that the bulk of decisions over revenues and expenditures are taken at one level of government. This explains why they are able to correctly ascribe responsibilities in policy areas that fall within the set of competences of the most predominant level of government (exclusive powers for high levels of decentralization and central powers for low levels of decentralization) and make a mistake otherwise. Therefore, it is *not* that extreme levels of decentralization yield sophisticated citizens capable of distinguishing *who does what* for each policy area. Rather, their *comparative advantage* lies in their capability to identify the most responsible level of government for overall policy outcomes. This is what accounts for their relative better performance in the empirical analysis.

4.4.5. Analyzing the impact of changes over time

In this section the main objective is to explore whether a modification of public sector decentralization is correlated with a change in the amount of citizens' information. For that purpose I compare the results of the survey conducted in 1998 with the results obtained in a survey conducted four years later, in 2002. The allocation of taxes and expenditures among Spanish regions was modified from 1998 to 2002. I expect this modification to have an impact on the individual's information.

I hypothesize a positive correlation between citizens' knowledge on regional government's activities and the degree of decentralization in 1998. For those Autonomous Communities where decentralization is lower their regional governments perform a more limited set of public functions, as compared to regions with higher levels of decentralization. I thus expect a lower level of self-reported knowledge on regional governments' activities.

Decentralization increases during the period that lasts from 1998 to 2002. So does the role of regional governments in the administration, financing and provision of public goods. I predict that citizens' knowledge will increase as salience and responsibilities of regional institutions do. As was explained above (and as it is shown in Tables A.2 and A.3 in the appendix), from 1998 to 2002 ordinary regions (group 3 in the analysis) were transferred powers over health care policies and primary and secondary education. This decentralization wave made regions in group 2 and group 3 virtually identical as for the amount of regional spending they control. Therefore, in 2002 decentralization variance consolidates in two groups of regions that only differ in revenue decentralization: group 1 (Navarre and the Basque Country) and group 2 (formed by the remainder regions). As a result of these decentralizing reforms I expect a significative increase in the level of regional knowledge reported by citizens that reside in regions in group 3. That is, as a consequence of decentralizing reforms, the former regions with the lowest levels of decentralization (group 3) have been granted new expenditure powers. The salience of regional institutions has therefore increased and I expect this to be reflected in an increase in citizens' self-evaluation of knowledge in regional issues.

The dependent variable in this second analysis is different from the one used in Model 1. In the first model I constructed an index of neutral factual knowledge to measure the individual's capacity to identify the level of government in charge of services' provision. Unfortunately, the survey conducted in 2002 did not include the corresponding question so that it was not possible to create the same index. I have then to measure citizens' knowledge through subjective evaluations. More specifically, I endogeneize individuals' self-reported knowledge on the activities of the regional government. This variable ranges from 0 (not informed at all on regional government's activities) to 3 (very informed). Intermediate values are 1 (little) and 2 (somewhat). Given that self-reported knowledge constitutes an ordered categorical variable, I use ordered probit analysis to estimate Model 2.[15]

Variables that may represent sources of knowledge for individuals are included as controls, namely the level of education, work, electoral participation, being a native-born resident and age (the codification of these variables is the same as in Model 1). In addition, I have included a variable that measures the interest on regional issues (coded 0, not interested at all, 1 little, 2 somewhat and 3 very informed). Table 4.8 and 4.9 depict summary statistics for variables of Model 2.

Model 2

$Y_{subjective\ information\ on\ regional\ governments'\ activities} = \beta_0 + \beta_1$Decentralization + β_2Education + δ_1Native + δ_2Native*age + β_3Interest on regional issues + β_4Work + β_5Electoral participation + e

Table 4.8. Summary Statistics Model 2 (1998)

Variables	Observations	Mean	Std. Dev	Min	Max
Subjective Information	9790	1	0.73	00	3
Decentralization	9991	2.42	0.66	1	3
Education	9925	1.39	0.81	0	4
Native	9972	0.79	0.40	0	1
Age	9985	45.46	18.31	18	95
Interest on Regional Issues	9940	1.09	0.91	0	3
Work	9913	0.89	0.95	0	2
Electoral Participation	9990	0.65	0.47	0	1

[15] An ordered probit analysis does not assume that adjacent responses are equidistant from each other (Long 1997). For this reason it is a better estimation method than linear regression.

Table 4.9. Summary Statistics Model 2 (2002)

Variables	Observations	Mean	Std. Dev	Min	Max
Subjective Information	10330	1.07	0.75	0	3
Decentralization	10476	2.44	0.66	1	3
Education	10439	1.52	0.86	0	4
Native	10136	0.81	0.38	0	1
Age	10467	45.7	18.24	18	94
Interest on Regional Issues	10414	1.11	0.91	0	3
Work	10412	0.98	0.96	0	2
Electoral Participation	10476	0.65	0.47	0	1

To test the impact of decentralizing reforms on citizens' knowledge I have followed a two-stage procedure. First, I have estimated Model 2 separately for the 1998 survey and the 2002 survey. In this model the main explanatory variable is, again, decentralization (with three categories: group 1 (high level of decentralization), group 2 (intermediate level) and group 3 (low level)).

Second, in order to measure the impact of decentralization over time in Model 3 I have combined data from two different surveys: the one conducted in 1998 and a survey conducted in 2002[16] (see Summary Statistics in Table 4.10). I have created two different dummy variables that measure different levels of decentralization. The dummy variable *High* is coded as 1 when the respondent resides in a region from group 1 (high level of decentralization) and 0 if he resides in a region from group 2 (intermediate levels of decentralization). Likewise, the dummy variable *Low* is coded as 1 when the individual resides in a region

---

[16] Surveys were conducted by the Center of Sociological Investigations (*Centro de Investigaciones Sociológicas*). Survey codes: Cis2286 (1998) and Cis2455 (2002).

from group 3 (low level of decentralization) and 0 if he is resident in a region from group 2.

Control variables are the same as in Model 2. The main purpose is to interact these dummies with the dummy of the Survey year in order to see whether there is any significative difference in responses from one survey to the other. I expect to find a positive coefficient for the interaction of Group 3 with the Survey year. That is, I expect citizens from regions in group 3 to have a higher level of knowledge in 2002 (after the decentralization wave was complete) than in 1998. In addition, I expect to find no significant differences across time between the level of knowledge of residents in regions from group 1, as these Autonomous Communities have not been granted new powers in the four-year period (1998-2002).

Model 3

$Y_{\textit{subjective information on regional governments' activities}} = \beta_0 + \beta_1$Region Group + β_2Region Group*Survey Year + β_3Education + δ_1Native + δ_2Native*age + β_4Interest on regional issues + β_5Work + β_6Electoral participation

Table 4.10. Summary Statistics of Model 3 (pooled data 1998 + 2002)

Variable	**Observations**	**Mean**	**Std. Dev.**	**Min**	**Max**
Subjective Information	20120	2.95	0.74	0	3
Decentralization	20467	2.43	0.66	1	3
High	9505	0.21	0.40	0	1
Low	17953	0.58	0.49	0	1
Survey Year	20469	0.51	0.49	0	1
Education	20364	1.46	0.84	0	4
Native	20108	0.80	0.39	0	1
Age	20462	45.61	18.31	18	95
Interest on regional issues	20361	2.89	0.91	0	3
Work	20325	1.63	0.61	0	2
Electoral participation	20466	1.50	0.74	0	1

Regressions (1) and (2) of Table 4.11 show that the level of knowledge varies among respondents from different regions, but they do it in different ways across time. In 1998 there is a significant and positive correlation between the level of decentralization of the respondent's region and self-reported knowledge on regional issues. That is, as predicted, respondents from regions with high levels of decentralization self-report a higher level of knowledge on regional issues than individuals from regions with lower levels of decentralization. In 2002 the correlation between each decentralization category and the dependent variable has changed. Individuals from high decentralized regions (group 1) continue to show a significant higher level of knowledge than respondents from regions in group 2. However, the coefficient for respondents in group 3 has changed the sign. In 2002 those individuals are more informed on regional issues than residents from regions in group 2. Despite the effect is small and only significant at 10% level, I did not expect it. I predicted that differences in knowledge between individuals from regions in group 3 and those from regions in group 2 would melt away as a consequence of last decentralizing reforms.

Regressions (3) and (4) in Table 4.11 show the results for the combined data. As predicted, there has been a modification of citizens' self-reported knowledge in those regions that were transferred broad expenditure powers from 1998 to 2002. The positive sign of the interaction of the dummy *Low* and *Survey Year* in regression (3) means that in 2002 individuals from low-decentralized regions (group 3) are significantly better informed than in 1998. As decentralization increases, regional institutions gradually become more salient, which is reflected in an increase in citizens' self-reported knowledge on regional institutions.[17]

[17] I have also estimated Model 3 having as a dependent variable the respondent's self-reported knowledge on the activities from the regional parliament. Results are very similar to those presented in Table 4.11 and therefore support the hypothesis as well (results not shown).

Table 4.11. Ordered Probit Analysis for Model 2 and Model 3

Explanatory Variables	**MODEL 2 (1) (1998)**	**MODEL 2 (2) (2002)**	**MODEL 3 (3) (Region group: Low)**	**MODEL 3 (4) (Region group: High)**
Decentralization (c: group 2)				
Group 1	0.36 (0.07)***	0.44 (0.07)***		
Group 3	-0.14(0.04)***	0.07 (0.04)*		
Survey year			- 0.006 (0.04)	-0.008(0.04)
Low			-0.13 (0.04)***	
Low*Survey year			0.17 (0.06)***	
High				0.33 (0.07)***
High*Survey year				0.08 (0.10)
Education (c: no studies)				
Primary	0.79 (0.08)***	0.62 (0.08)***	0.70 (0.06)***	0.8 (0.08)***
Secondary	1.35 (0.09)***	1.09 (0.10)***	1.25 (0.07)***	1.36 (0.10)***
University	1.70(0.10)***	1.38 (0.10)***	1.56 (0.07)***	1.69 (0.10)***
Doctorate/Postgraduate	2 (0.34)***	1.08 (0.23)***	1.43 (0.2)***	1.80 (0.32)***
Native	0.09 (0.14)	- 0.0001 (0.15)	0.05 (0.11)	0.005 (0.16)
Age	0.008 (0.002)***	0.006 (0.002)	0.007 (0.002)***	0.009 (0.003)***
Native*Age	-0.00003 (0.0002)	-0.0007 (0.003)	-0.0003 (0.002)	0.0005 (0.003)
Interest on regional issues (c: not at all)				
Little	1.33 (0.05)***	1.51 (0.05)***	1.42 (0.03)***	1.47 (0.05)***
Somewhat	2.26 (0.06)***	2.72 (0.06)***	2.48 (0.04)***	2.56 (0.06)***

Table 4.11. Ordered Probit Analysis for Model 2 and Model 3 (Continuation)

Explanatory Variables (Cont.)	**MODEL 2 (1) (1998)**	**MODEL 2 (2) (2002)**	**MODEL 3 (3) (Region group: Low)**	**MODEL 3 (4) (Region group: High)**
Interest on regional issues (c: not at all) (Cont.)				
Very Much	3.13 (0.09)***	3.77 (0.10)***	3.36 (0.07)***	3.53 (0.09)***
Work				
Student	0.05 (0.09)	-0.01 (0.09)	0.05 (0.07)	0.05 (0.09)
Work	0.23 (0.04)***	0.31 (0.04)***	0.28 (0.03)***	0.26 (0.05)***
Electoral participation				
Voted	0.28 (0.04)***	0.27 (0.04)***	0.29 (0.03)***	0.24 (0.04)***
cut 1	1.53 (0.17)		1.52 (0.13)	1.72 (0.19)
cut 2	4.46 (0.18)		4.47(0.14)	4.62 (0.20)
cut 3	7.69 (0.20)		7.80 (0.15)	8.08 (0.22)
Pseudo R^2	0.15	0.17	0.16	0.17
N	9597	9894	17167	9027
Estimation method	Ordered probit model	Ordered probit model	Ordered probit model	Ordered probit model

Note: Standard error of parameter estimates are in parentheses. Levels of statistical significance are ***p<.001; **p<0.5; *p<.10
c: control category

However, despite residents from regions in group 3 have increased their level of knowledge over time, the effect is not strong enough to make the differences between residents in group 3 and group 2 disappear. The former are still significantly less informed, as it is exemplified by the negative and significant coefficient of the dummy *Low*. Finally, as expected, in regression (4) there are no significant differences across time in the level of knowledge of residents in high decentralized regions (the interaction between *High* and *Survey Year* is not significant). As for control variables, all of them show the predicted sign but Native and Age, which are also statistically insignificant. Therefore, a higher level of education, electoral participation, being employed and (except for the first category) having interest on regional issues is positively correlated with self-reported knowledge on regional political issues.

4.5. Concluding remarks

Elections can only guarantee that governments are accountable when citizens are able to hold governments responsible for their past actions. This requires, first and foremost, that citizens are capable of distinguishing who is responsible for what, which I define as clarity of responsibilities. In a decentralized context there exist information problems to make accountability an effective control mechanism because responsibilities are shared across levels of government. The main purpose of this chapter has been to explore whether different institutional designs of decentralization makes possible to reduce those information problems. The study uses data from Spain to evaluate whether the existence of different cross-regional levels of decentralization has an impact on citizens' ability to ascribe responsibilities for policy areas.

The overall results show that the structure of tax and expenditure powers in a region has an impact on its population's ability to allocate responsibilities across levels of government. As hypothesized, the relationship between the degree of decentralization and clarity of responsibilities has a u-shape, which means that residents from regions with high and low levels of decentralization perform better than residents from regions with intermediate levels of decentralization. In addition, the analysis exhibits that an increase of regional powers and authority has a positive effect on the individuals' (self-reported) level of information on regional policy issues. However, results also point out the boundaries within which the impact of decentralization on information should be framed. High and low levels of decentralization do not yield sophisticated citizens that correctly identify the most responsible level of government for each policy area. Rather, citizens in those regions are more capable to identify the most responsible level of government for *overall* policy areas.

CHAPTER 5. DECENTRALIZATION AND ELECTORAL EXTERNALITIES ACROSS LEVELS OF GOVERNMENT

5.1. Introduction

This chapter seeks to study electoral interdependences among party copartisans at different levels of government. In the theoretical framework developed in Chapter 3 I assumed that there was a causal relationship between decentralization, electoral externalities across levels of government and the internal organization of political parties. From these assumptions I derived general hypotheses 1 and 2. In this chapter I further elaborate on the causal mechanisms that link decentralization and electoral interdependences among party copartisans. Theoretical arguments therefore explore the relationship between subnational representatives from state-wide parties and their national counterparts. No other actors come into play in the analysis. Hypotheses are tested for the Spanish case using both quantitative and qualitative analysis.

Electoral externalities (or spillovers) across levels of government exist when the electoral fates of national politicians are correlated with those of their local and regional counterparts. I hypothesize that as decentralization increases electoral externalities become weaker. There are two types of causal mechanisms that account for this hypothesis. The first has to do with citizens' voting behavior. In a decentralized context citizens gradually learn to correctly ascribe responsibilities across levels of government. Voters become more capable of linking policy outcomes with the responsible level of government. Citizens increasingly regard national and local elections as independent electoral contests and, accordingly, vote in a different way across elections held at different levels of government. As a result, subnational leaders' electoral fate becomes gradually unrelated to that of their co-partisans at the center. This is what I call a *learning process*. In addition, the particular design of decentralization - that is, the extent to which central government transfers expenditure and fiscal powers downwards – may amplify (or shrink) the effect of the learning process. In a context where subnational governments accrue high fiscal and expenditure powers, subnational policy responsibilities become more visible to citizens. A large concentration of power at the subnational level gives rise to a neater distribution of power. This enhances citizens' capacity to correctly reward (or punish) the corresponding administration for policy outcomes. In sum, voters are more capable of identifying the group of people who are responsible for policy in a decentralized context and which level of government should be made accountable.

The second causal mechanism is related to subnational representatives' strategies. When regional governments are endowed with a high level of authority and greater expenditure powers, issues at stake in subnational electoral contests are fundamentally of a local nature. Subnational representatives increasingly ground their electoral platforms and pledges on local terms. These actions foster the formation of differentiated constituencies for the subnational branches of state-wide parties. In this context local representatives have incentives to maximize their autonomy in designing their policy and electoral agenda, even at the expense of departing from national headquarters' issues. The argument goes as follows: a downward transfer of expenditure and fiscal authority empowers subnational leaders. This introduces centrifugal pressures within the organization of parties, as subnational co-partisans increasingly put within-party powers on the level with their assigned government responsibilities. They are able to select the candidates that run for national and subnational elections or to help shape the party's political agenda. As a result, the potential costs that stem from pursuing *off-the-(national) path* policy agendas decrease. Or, in other words, they face decreasing costs of adopting policy and electoral strategies that differ from the party headquarters' guidelines. Differentiation strategies are also more likely to arise when the national branch of a state-wide party faces an electoral downturn. In addition, regional leaders with strong preferences for autonomy will have more incentives to depart from the national policy agenda.

The chapter is structured as follows. Section 2 deals with theoretical arguments and hypotheses. It is structured from general hypothesis on subnational vote to more concrete arguments on the effect of a decentralized setting on electoral externalities. Section 3 examines the empirical evidence of hypotheses. In section 4 some empirical evidence on the impact of decentralization on the structure of the Spanish Socialist Party (PSOE) is presented. This evidence is based on in-depth interviews with eight socialist leaders. Finally, section 5 concludes with a summary of the theoretical arguments and the empirical evidence that supports it.

5.2. Electoral Externalities

5.2.1. National referendum or subnational economic voting?

How are electoral results linked across levels of government? Are different tiers of government influenced by the same systematic factors? or rather are the electoral outcomes of each level of government independent from each other (or in other words, that what happens at one electoral level does not have an impact on other tiers)? How important are national conditions for understanding subnational electoral contests? Are subnational elections insulated from national political and economic forces?

There are electoral spillovers across levels of government when subnational officials are held responsible for national policy successes or failures. On the other hand, electoral externalities are low when subnational co-partisans' fate depends on policy performance at the subnational level. The responsiveness of the vote to subnational policy performance has important implications on the link between policy responsibility and electoral accountability. These are particularly relevant in a context where subnational governments have control over a high percentage of overall expenditures.[1]

There has been considerable study on the effects of economic voting across levels of government. This literature takes as a theoretical point of departure two retrospective voting hypotheses: the national referendum hypothesis and the economic retrospective hypothesis. The first explains electoral outcomes in terms of the success or failure of the incumbent presidential administration. This means that electoral results at the subnational level are dependent on considerations other than their policy performance. The second refers to subnational economic voting and states that the electoral fortunes of state/provincial representatives are determined by the economic conditions at subnational level. State (gubernatorial and legislative) and Senatorial elections in the United States have taken up a significant part of the hypothesis-testing empirical work. However, results point in different directions so that the question on exactly which factors account for subnational electoral performance remains open to debate.[2] Some studies based on aggregate data confirm the national referendum

[1] When subnational governments have wide-ranging over public expenditure but their electoral fortunes depend on considerations other than their policy performance, this poses a serious problem in making subnational representatives accountable for their expenditure decisions and it may give rise to soft-budget constraints.

[2] See also Remmer and Gélineau (2003) who study the Argentinean case and introduce a good review of the literature.

hypothesis,[3] whereas other researchers find that state electoral outcomes are determined by state-level policy performance (Lowry, Alt and Ferree 1998). Survey data illustrates different patterns on citizens' evaluation of subnational policy performance. There is empirical evidence that citizens are not able to draw accurate distinctions between public officials' responsibilities across levels of government. Consequently, subnational policy performance is linked to presidential administration's performance (Carsey 1998, Simon 1989, Stein 1990). Other scholars find that when citizens cast their vote in subnational elections they take into account performance in both national and subnational policy (Svoboda 1995; King 2001). Finally, there is empirical evidence to suggest that citizens seem to make distinctions across subnational administrations, as senators' fortunes are linked to the successes or failures of the president; whereas governors are held accountable for perceived state economic conditions and are not shown to be held responsible for presidential approval fluctuations (Atkeson and Partin (1995)). In summary, there is no conclusive empirical evidence on the explanatory factors of subnational vote and a better understanding on how citizens evaluate subnational policy performance is needed.

One of the shortcomings of the articles reviewed is that the empirical work has been often carried out using cross-section data. Analyses have mainly focused on explaining what factors determine subnational vote in a particular electoral contest. Theoretical and empirical work exploring whether the effect of those factors varies over time has lagged behind.[4] I seek to cover this theoretical and empirical gap by focusing on electoral interdependences among party co-partisans at different levels of government. One of the premises of my analysis is that *there is* an impact of national electoral dynamics on subnational electoral

---

[3] See Chubb (1988), Peltzman (1987), Piereson (1975) and Simon *et al.* (1991)

[4] As Simon (1989: 293) points out, *"the literature on voting has yet to offer any rationale explaining why the estimated impact of relevant factors (that account for subnational vote) should change over time."*

contests. This is what I define as electoral externalities across levels of government. Then, taking that assumption as a starting point, my theoretical contribution consists in developing hypotheses on defining the factors that make electoral externalities become weaker or stronger over time. I hypothesize that citizens' experience with a multi-government system; the particular design of fiscal and policy decentralization; and the strategies' followed by subnational politicians determine the level and evolution of electoral externalities.

5.2.2. Citizens' learning and subnational politicians' strategies

5.2.2.1. Citizens' learning

There are several reasons why citizens' evaluation of subnational performance may change over time. First, as a consequence of a learning process that follows the (re)emergence of the subnational level of government. It takes time for citizens to become familiar with the existence of a new level of government and/or with a new allocation of policy responsibilities across administrations. Second, factors that enter into citizens' considerations when casting their vote in subnational contests may vary if there is an ongoing upward or downward transfer of authority across levels of government. As this happens, the visibility of subnational actors' actions is either increased or blurred. For instance, in a decentralized context where local governments are endowed with high authority over taxes and expenditures subnational representatives become more visible. This is the result of local officials being responsible for key public policies and their financing. When subnational politicians have greater powers over policy issues, then citizens are more capable of identifying subnational officials' responsibility and hold them accountable. At the same time the impact of national factors on subnational representatives' electoral outcomes gradually shrinks.[5] The importance of subnational factors against national ones in explaining subnational electoral outcomes may also turn on the allocation of policy issues/areas that voters care about. For instance, if citizens closely identify with policies that are in the hands of subnational officials (such as health care, education or environmental policies) then it is arguable that subnational performance is more salient to voters that are national issues such as Defense or Foreign Affairs (Squire and Fastnow 1994).

Decentralization does not always give rise to a neat distribution of powers across levels of government where citizens are capable of linking policy responsibilities with policy outcomes. The particular design of decentralization determines the visibility of subnational representatives' actions, which in turn impacts upon citizens' ability to associate policy outcomes with the corresponding responsible level of government. This approach was followed in chapter three. Empirical results in that chapter showed that in regions where subnational officials had been transferred a lower level of responsibilities citizens tended to ascribe central government the bulk of policy responsibility. Likewise, in regions were greater tax and expenditure responsibilities had been taken on, higher levels of issue responsibility were accordingly attributed to subnational governments. Citizens' ability to ascribe responsibility was worst in regions where the allocation of powers across levels of government was more intertwined. In this chapter I take this argument one step further and hypothesize that citizens' ability to correctly ascribe policy responsibilities impacts upon electoral externalities. More specifically, citizens are more capable of identifying subnational officials' responsibility and holding them

[5] This seems to be the case, for instance, in the US. To explain why gubernatorial elections may be influenced by the state's economy more today than in the past Svoboda (1995) points out that *"the rejuvenation of (US) federalism in the 1980s have increased the visibility of the state chief executives and, in turn, have reduced the effect of national factors."*

accountable. Therefore, the impact of national factors on subnational representatives' electoral outcomes gradually shrinks.

So far I have described the link between national and subnational policy performance and electoral accountability as if the political world was largely devoid of strategic politicians. Citizens' evaluation of subnational policy performance has therefore mainly depended on the structure of expenditure and fiscal responsibilities and on a learning process. Political autonomy and self-rule foster *per se* the differentiation of policy implementation across subnational jurisdictions. Differentiation then is the result of having different levels of government with authority over distinct policy areas. However, subnational politicians are strategic and their actions may be aimed at increasing differentiation across levels of government, as well.

5.2.2.2. Subnational politicians' strategies

Subnational representatives from state-wide parties may have incentives to enhance their political visibility against the influence of national electoral externalities. That is, their actions may also reduce or increase electoral externalities. I argue that subnational representatives' incentives to pursue enhanced-visibility strategies depend on several factors, namely: potential electoral benefits, potential within-party costs and intensity of preferences over autonomy.

- *Electoral benefits*: let us assume that subnational electoral performance is threatened by negative electoral spillovers (or failed national performance). In this context subnational politicians may want to isolate policy outcomes for which they are responsible from actions carried out by national co-partisans. Stressing political visibility and autonomy may allow local leaders to accrue higher electoral benefits than leaving their electoral fates in the hands of national spillovers. They may decide to follow a strategy of "bickering" whereby they blame the national administration for negative policy outcomes while stressing the policy achievements of the subnational administration. As a consequence of enhanced-visibility strategies, the distance between national and subnational co-partisans' electoral fate is likely to increase.[6]

- *Within-party Costs*: Subnational representatives' incentives to follow a visibility-enhancing strategy will largely depend on costs. Consider a situation where subnational politicians seek to pursue a bickering strategy with a party affiliated central incumbent (that is, when the same political party rules the subnational and national government). The potential costs associated to this strategy have to do with the worsening of subnational representatives' within-party careers. If party leaders (party brokers) that control nominations for both subnational executive offices and national legislative offices come from the national party's headquarters, it is likely that daring subnational politicians face high costs - in terms of future political career - as a result of pursuing a bickering strategy. Alternatively, costs may be low if party brokers come from party subnational branches. As authority and decision-making powers are devolved to subnational governments, the structure of state-wide parties undergoes a process of *centrifugation*. This means that subnational leaders

[6] For the sake of the argument I only take into consideration a context where subnational electoral prospects are good and national electoral externalities are bad. However, subnational politicians may follow strategies that purposely blur the existing allocation of powers across levels of government. For instance, assume subnational incumbents' policy performance is bad so that they face low electoral prospects before elections. In this context they may have incentives to ascribe central government responsibility for policy outcomes that are in practice a direct result of the subnational government's actions. This strategy would therefore misrepresent the real distribution of responsibilities across levels of government. Likewise, when the electoral support of subnational representatives takes a downturn whereas national counterparts face an electoral upturn, subnational representatives may then have incentives to link their electoral fate on national electoral coattails.

become more powerful.[7] They gain influence within the party structure to select the candidates that run for national and subnational elections or to help shape the party's political agenda. If power structure within the party revolves around subnational leaders then subnational representatives face lower costs of drawing up policy agendas that differ from the party headquarters' guidelines.[8] National party co-partisans will not have incentives to punish those leaders for adopting such policy agendas if they depend on them for career promotion within the party.[9]

- *Intensity of preferences for political autonomy*: subnational politicians may believe the basics of their political autonomy are grounded on the link between policy responsibilities, policy outcomes and the corresponding evaluation of outcomes at the polls. Preferences for autonomy also create incentives for subnational representatives to increase their visibility. If their electoral fortune is determined by successes or failures other than theirs (and over which they have no influence – as happens when there are electoral externalities) they will understand that their political autonomy is undermined. This argument has to do with subnational leaders' intensity of preferences over self-rule and autonomy. The idea is that those who have greater desire for

---

[7] See Montero (2005: 63). Also Chibber and Kollman (2004). In Chibber and Kollman's book the main purpose is to explain changes over time in the party system (number of parties) in countries with single member districts systems. Their basic hypothesis is that different levels of party aggregation will occur depending on in which level of government decisions are made. So 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.

[8] See Chandler (1987) who mades a similar argument about the consequences of "jurisdictional" decentralization.

[9] However, subnational leaders' incentives to pursue differentiation policy agendas might be tempered by the emergence of conflict in horizontal intergovernmental relations (among representatives from different subnational jurisdictions).

political autonomy will be more likely to stress a policy agenda grounded in issues affecting their region (issues over which they have decision-making power), even when these issues put them at odds with national co-partisans. Political autonomy may therefore enhance differences between national and subnational co-partisans' electoral fates. This would be the result of subnational leaders' efforts to distance their actions from decisions taken at the national level of government.

The consequences of visibility-enhancing strategies are policy differentiation across jurisdictions and heterogeneity in the electoral platforms with which state-wide parties compete in subnational contests. State-wide parties may incur important costs as a result of differentiation strategies of the regional representatives. Costs are related to increasing difficulties in drawing up a coherent national electoral agenda that does not come into conflict with subnational leaders' own policies. Differentiation strategies may put strain on the structure of state-wide parties and tensions may eventually develop into party disunity.[10]

Summing up, factors that shape the link between subnational voting and national administration's policy performance are namely two: citizens' knowledge and subnational officials' electoral strategies. Citizens' ability to accurately distinguish responsibilities across levels of government in turn depends on two factors. First, it is determined by the period through which

---

[10] Party disunity may eventually have a negative effect on party representatives' electoral support at all levels of government. When electoral externalities are low then subnational representatives' electoral fate is less permeable to national negative spillovers. Lower electoral interdependences in turn isolate subnational party members from the potential costs incurred to the party as a result of increasing disunity. In consequence, weak electoral externalities eventually reinforce subnational copartisans' differentiation strategies, as they reduce the costs that otherwise would have prevented subnational copartisans from adopting them.

they have experienced a politically decentralized structure. The subnational jurisdiction's population gains knowledge on the allocation of powers across levels of government in the day-to-day use of subnational public services and institutions. This may be described as a sort of unintended *learning process* (it is devoid of the effect of subnational politicians' strategies) through which citizens become gradually better informed about policy responsibilities. Second, the particular design of administrative and fiscal decentralization - that is, the extent to which the national government transfers expenditure and fiscal powers downwards – may amplify (or shrink) the effect of the *learning* process. When subnational governments are endowed with greater fiscal and expenditure powers, their actions unavoidably become more visible to citizens. In consequence, it is more likely voters hold subnational politicians responsible for past actions in subnational elections. On the other hand, in a more intertwined decentralized structure, citizens will face greater difficulties in determining the responsible level of government for each policy outcome.

Subnational politicians' strategies shape electoral interdependences across levels of government, as well. High levels of decentralization create centrifugal pressures within state-wide party's structure, whereby subnational leaders gain more influence in selecting election candidates and drawing up the party's policy agenda. Powerful party leaders that come from local branches will therefore be able to adopt policy agendas that depart from the headquarters' guidelines without incurring high costs in terms of their within-party future political careers. Therefore, I expect lower electoral externalities as subnational politicians' are endowed with increasing authority. In addition, a downturn in the state-wide party's electoral results and high intensity preferences for political autonomy will give rise to lower electoral externalities.

Hypotheses

The foregoing discussion suggests the following hypotheses:

*H_1: **Subnational economic voting hypothesis**: electoral fortunes of state/provincial representatives are determined by the economic conditions at subnational level.*

*H_2: **Learning hypothesis**: the longer citizens experience a decentralized structure, the lower electoral externalities across levels of government.*

*H_3: **Differentiation-strategies hypothesis**: the greater the levels of tax and expenditure powers that are transferred to subnational governments, the lower the electoral externalities across levels of government.*

*H_4 : **National electoral downturn**: all else being equal, when the national branch of a state-wide party experiences an electoral downturn, electoral externalities across party co-partisans will decrease.*

*H_5: **Intensity of preferences for political autonomy**: All else being equal, in subnational governments where representatives have an intense preference for political autonomy electoral externalities will be low.*

Hypotheses will be tested in section 5.3 using aggregated data on the percentage of votes of the Spanish socialist party (*PSOE*) in general (national) and regional elections from 1982 to 2005. In Spain regional elections do not ordinarily take place at the same time as national elections.[11] Consequently, the set of factors that affect the socialist vote in national elections may have changed by

[11] There is a remarkable exception for Andalusia, where national and regional elections were held the same day in 1986, 1996, 2000 and 2004.

the time regional elections are held. In order to minimize this mismatch I have compared pairs of national and regional elections that are closest in time. Table A.12 in the appendix illustrates pairs of national and regional election years that have been used in the analysis. I assume electoral externalities work downwards, that is, from national to subnational elections.[12]

The Socialist Party (*PSOE*) is a state-wide party that competes and wins votes in every region.[13] It has a federal structure – the federal executive committee and the regionalist branches (which are known as *federaciones* or federated regional parties). Socialist representatives in the national and regional legislative assemblies are members of a federated regional party. The *PSOE* is a good case study in which to analyze the explanatory factors of electoral externalities and its evolution over time. *PSOE* has seats in all regional parliaments, that makes it possible to explore the extent to which regional leaders turn on regional issues vs. national coattails to win elections. In addition, variation in national incumbency[14]

---

[12] Before the State of Autonomies was created, there was a rigid, authoritarian and highly centralized regime. In this context central government was the only responsible level of government for policy. Although political decentralization involved the creation of subnational levels of government democratically elected, regional elections have been traditionally regarded as a second-level electoral contest. Citizens have long perceived that the most important issues are decided at central level (Wert 1998: 510; Pallarés 1994: 211). This is why I argue that the electoral externalities in Spain work top-down (from the central administration to regional governments).

[13] As Brancati (2005) points out, state-wide parties tend to focus their agendas on issues affecting groups throughout a country; whereas regionalist parties' political agenda is focused on issues affecting the region and they only compete in one region of the country. The Basque National Party in Spain (PNV), the Bharatiya Janata Party (BJP) in India, or the Quebec Party in Canada are examples of regionalist parties.

[14] The Socialist party was ruling central government in four out of six regional electoral contests that make up the sample (1982-1996). The *Partido Popular* won the 1996 national elections and ruled central government until 2004.

makes it possible to study whether the impact of electoral externalities changes across different national incumbents. Finally, I use two different econometric models to test the hypotheses. Model 1 tests hypotheses H_1 and H_2. Model 2 tests the remaining hypotheses (H_3-H_5).

5.3. Model 1: Testing Subnational Economic Voting and Citizens' learning hypotheses

Are there electoral externalities across levels of government? Do they become weaker over time? How important are *national* electoral outcomes and *regional* economic conditions for understanding subnational electoral contests? Does their explanatory power change over time? These questions were directly addressed in two hypotheses presented above: the *subnational economic voting hypothesis* and *learning hypothesis*.

In order to test these hypotheses I create an econometric model where the endogenous variable is electoral performance of the socialist party in regions where it rules the regional government (either with a majority or within a coalition government). This variable is operationalized as the increase in the percentage of votes of the socialist party in two consecutive regional elections (ΔRV = regional vote share). An explanatory variable is the percentage of votes of the socialist party in the previous national election (ΔNV = national vote share). The correlation between these two variables measures electoral externalities. That is, correlation accounts for the extent to which national electoral outcomes impact upon subnational electoral results.[15] According

[15] Assume electoral externalities can be measured as a continuous variable that ranges from zero to one. Then when electoral externalities are coded as one party copartisans' electoral performance is identical across levels of government. This means that national issues have the same impact (with the same direction and with equal strength) on subnational electoral contests than in general elections. National and subnational copartisans are held accountable for the same perceived

to the *learning hypothesis*, I expect this correlation to be lower in most recent subnational contests, as compared to early regional elections.

Additional independent variables test the existence of subnational economic voting. These are regional economic indicators as exogenous variables such as unemployment rate, inflation, regional per capita income or net public capital stock. The argument goes as follows. If electoral results turn on subnational economic performance, then an increase of the unemployment rate or, similarly, a downturn in the jurisdiction's per capita income will decrease the electoral support of the regional incumbent. The unemployment variable has been calculated as the average unemployment rate of region *i* in each regional election year.[16] Data on per capita income has been calculated as the increase of regional per capita GDP,[17] regional inflation is operationalized through an index that measures the increase of prices in the month previous to regional elections.[18] Finally, public investment in infrastructures has been operationalized as the increase of regional net public capital stock for the period 1980-1998.[19,20]

(economic or other) conditions and in turn electoral results across levels of government are identical. In other words, a correlation of one confirms the national referendum hypothesis, which explains electoral outcomes in terms of the success or failure of the incumbent national administration. The correlation between national and subnational electoral results becomes lower as electoral externalities decrease.

[16] Source: National Institute of Statistics – *Instituto Nacional de Estadísitica* (www.ine.es).

[17] Constant prices with base in 1995 for the period 1980-2004. Source: National Institute of Statistics – *Instituto Nacional de Estadísitica* (www.ine.es).

[18] Source: National Institute of Statistics – *Instituto Nacional de Estadísitica* (www.ine.es).

[19] Source: Database of *Fundación BBVA* and *Ivie* (*Instituto Valenciano de Investigaciones Económicas*). The net public capital stock is defined as the market value of productive assets (depreciation is discounted). It represents the volume of available capital in the

In Table 5.1 I present correlation coefficients between the increase in regional electoral support of the socialist party and the five independent variables. The increase of unemployment and per capita income show the highest correlation coefficient (-0.56 and 0.42, respectively). Their sign is shown as predicted. The impact of the unemployment rate over regional electoral support is negative, whereas per capita income is positively associated with the dependent variable. The remaining independent variables show the expected correlation sign, as well. An increase in the inflation index has a negative impact on electoral support. On the contrary, higher levels of regional public investment are positively associated with the dependent variable. The increase in national electoral gains in previous general elections is moderately correlated (0.22) with the increase in regional electoral support, providing a clue about the existence of national electoral spillovers. Finally, the correlation coefficient for the public investment variable is very low. In addition, the inclusion of this variable in the regression model decreases the sample size. For this reason I have decided to exclude this variable from the regression model. The modified econometric model is as follows:

$$\Delta RV_{it} \textit{ (socialist incumbent's regional vote share)} = \alpha + \beta_1 \Delta NV_{it-k} + \beta_2 \Delta U_{it} + \beta_3 \Delta PCI_{it} + \beta_4 \Delta INF_{it} + u_i \qquad (1)$$

Each variable in the model is observed for Autonomous Community i in the year of regional elections t except for the

---

productive process that can be used in the economic system at a certain point in time. The calculation of public capital stock is made over the following functions: road, urban and hydraulic infrastructures; ports, coasts and maritime signs; health care; education; airports; railways and toll roads. These functions have been selected to calculate public capital stock because investment in these sectors has high economic growth-enhancing properties.

[20] There is only available data on regional net public capital stock until 1998. This means that the econometric model cannot include observations from the last regional electoral contest.

national share variable, which is observed in year *t-k*, where *k* is the number of years between regional and previous national elections. I estimate the model with fixed-effects[21] (see summary statistics in Table A.10 in the appendix).

Table 5.1. Correlation coefficients

	ΔRV	ΔNV	ΔPCI	ΔU	ΔINF	ΔSTK
ΔRV	1.0000					
ΔNV	0.3012	1.0000				
ΔPCI	0.3635	-0.3039	1.0000			
ΔU	-0.4742	0.3705	-0.6344	1.0000		
ΔINF	-0.1831	0.1338	0.1657	0.0346	1.0000	
ΔSTK	0.0790	-0.0531	-0.1537	0.1963	-0.0237	1.0000

Number of Observations: 40
ΔRV = dependent variable = increase in regional vote of the socialist party in regional elections at time *t* (only in regions where the socialist party rules the regional government at time *t*)
ΔNV = increase in national vote of the socialist party in region *i* in general elections at time *t-k*
ΔPCI= increase in per capita income in region *i* at time *t*
ΔU= increase in the unemployment rate in region *i* at time *t*
ΔINF= increase in the inflation index in region *i* at time *t*
ΔSTK = increase in net public capital stock in region *i* at time *t*

A first exploration in testing equation (1) is displayed in Table 5.2. Results show the effect of the independent variables on the socialist regional incumbent's electoral support throughout the

---

[21] In the dataset I use regions (Autonomous Communities) as the unit of analysis. I cannot assume that the observations are independently distributed across time. There are unobserved factors in each unit (for instance, demography) that are constant over the analyzed period (or roughly constant) and that are correlated with the explanatory variables in all time periods. I cannot therefore use OLS estimators, as to be valid they require that the errors (unobserved factors) are uncorrelated with explanatory variables (the strict exogeneity assumption). This unobserved heterogeneity is removed with the fixed-effects estimator (see Wooldridge 1999: chapters 13 and 14).

analyzed period. They are very similar to correlation coefficients in Table 5.1. The econometric model accounts for 41% of the variation in the endogenous variable and all coefficients are significantly different from zero.

Table 5.2. Effect of regional economic conditions on the vote for regional incumbent candidates

Variables	Coefficients
ΔNV	.824(.276)***
ΔPCI	3.185(1.565)*
ΔU	-.450(.186)**
ΔINF	-.372(.171)**
Cons	2.614(2.648)
R-sq	0.41
Obs	47
Estimation	FE

Coefficient results (standard errors in parenthesis). *** if $p < 0.001$ ** if $p < 0.005$ * if $p < 0.01$
Dependent variable = ΔRV = increase in regional vote of the socialist party in regional elections at time *t* (only in regions where the socialist party rules the regional government at time *t*)
Independent variables:
ΔNV = increase in national vote of the socialist party in region *i* in general elections at time *t-k*
ΔPCI= increase in per capita income in region *i* at time *t*
ΔU= increase in the unemployment rate in region *i* at time *t*
ΔINF= increase in the inflation index in region *i* at time *t*

Independent variables have the predicted sign according to subnational economic voting hypothesis, indicating that regional incumbents' electoral support turns on regional economic conditions. An increase in per capita income has a positive effect on electoral support, whereas an upturn on the unemployment or inflation rate has a negative impact on votes. In addition, there are strong electoral externalities from national to regional electoral contests. A one percent increase in the national incumbent party's vote share corresponds to a gain of 0.82 percent in votes for the regional incumbent in subsequent regional elections. To sum up, an initial analysis of the data indicates that regional incumbents' electoral fortunes are strongly affected by both regional economic conditions and the electoral performance of the central incumbent in previous national elections. These results give rise to a kind of paradox since regional government representatives seem to be as influenced by national electoral results as by regional (economic) conditions. In fact, some objections can be raised as to the use of subnational economic conditions as an indicator of regional policy performance. As Lago and Lago (2001: 169) point out, regional economies in Spain are highly interdependent. The effect of regional economic performance over subnational governments' electoral results might not be independent of economic activities undertaken by neighbouring regions or from economic actions taken by the national government. Regional economic indicators might be the result of economic activities taken at other levels of government. As a result, the effect of regional economic indicators on the dependent variable might simply not be capturing voters' evaluation of subnational economic performance. Voters' evaluations of regional economic conditions may not be isolated from assessments related to the national administration's economic performance. In the next section I explore this question and analyze the extent to which regional economic indicators capture individuals' assessment of national administration's economic performance. In the next section I explore this question and analyze the extent to which regional economic indicators capture individuals' assessment of the national administration's economic performance.

5.3.1. Subnational economic voting or national referendum hypothesis?

According to the subnational economic voting hypothesis, the electoral fortunes of regional incumbents turn on fluctuations of regional economic indicators. A first exploration of the data has provided empirical evidence that supports subnational economic voting. In order to corroborate these preliminary findings in this section I carry out further empirical analysis.

The hypothesis on subnational economic voting carries further empirically-testable predictions. For instance, if this hypothesis is true, then changes of incumbency in the national administration will not have any effect on the explanatory power of economic indicators. That is, let us assume that voters' evaluations on economic conditions are isolated from assessments related to the national administration's performance. Then the relationship between regional economic indicators and the electoral fortunes of regional incumbents will always be positive for economic upturns and negative for economic downturns, regardless of party-affiliation links between the national incumbent party and subnational governments.

Alternatively, citizens may not regard the state of regional economy as an indicator of regional economic performance but assess it as the result of economic decisions taken at central level. This is what I define as the national-referendum hypothesis. Accordingly, in subnational electoral contexts citizens evaluate regional economic indicators in terms of the success or failure of the national administration's economic performance. I then expect the correlation between regional economic indicators and the dependent variable to vary with changes in the incumbent party at the central level. That is, if voters regard the national administration as responsible for regional economic conditions, then an economic upturn will benefit the central incumbent and, through electoral externalities, it will (positively) impact upon votes in elections for affiliated regional governments. More specifically, when the *PSOE* holds power at the central level, then good economic indicators will correspond to a gain in votes for socialist regional incumbents. On the other hand, when a non-socialist party controls the central administration, socialist incumbents at the regional level will benefit at the polls from bad economic indicators, whereas their electoral support will erode if there is an economic upturn.

To test if changes in the incumbent party at the center have any impact on the explanatory power of economic variables I run three different econometric models. In each model I interact a dummy variable that is coded as 1 when the incumbent party at the central level is non-socialist (*Partido Popular = PP*), and as 0 when the socialist party rules the national government. The interaction term will capture any variation in the explanatory power of economic indicators that results from a modification of the national incumbent party.

The three econometric models are as follows:

$$\Delta y_{it} \textit{ (socialist incumbent's regional vote share)} = \alpha + \beta_1 \, \Delta national\ share_{it} + \beta_2 \, \boldsymbol{\delta PPincumbent{*}\Delta unemployment_{it}} + \beta_3 \, \Delta per\ capita\ income_{it} + \beta_4 \, \Delta inflation\ rate_{it} + u_i \qquad (2)$$

$$\Delta y_{it} \textit{ (socialist incumbent's regional vote share)} = \alpha + \beta_1 \, \Delta national\ share_{it} + \beta_2 \, \Delta unemployment_{it} + \beta_3 \, \boldsymbol{\delta PP\ incumbent{*}\Delta per\ capita\ income_{it}} + \beta_4 \, \Delta inflation\ rate_{it} + u_i \qquad (3)$$

$$\Delta y_{it} \textit{ (socialist incumbent's regional vote share)} = \alpha + \beta_1 \, \Delta national\ share_{it} + \beta_2 \, \Delta unemployment_{it} + \beta_3 \, \Delta per\ capita\ income_{it} + \beta_4 \, \boldsymbol{\delta PP\ incumbent{*}\Delta inflation\ rate_{it}} + u_i \qquad (4)$$

H_o: Subnational economic hypothesis
H_1: National referendum hypothesis

H_o: $\beta_2 = 0$ $\quad$ H_1: $\beta_2 > 0$
$\beta_3 = 0$ $\quad$ $\beta_3 < 0$
$\beta_4 = 0$ $\quad$ $\beta_4 > 0$

Table 5.3 displays regression results for equations (2), (3) and (4). The interaction between the incumbent type and the unemployment and inflation variables (*Model b* and *Model c*) shows a positive and significant coefficient, indicating that it is *not* possible to reject the national referendum hypothesis for β_2 *(per capita income)* and β_3 *(inflation)*, as indicated above. Regarding per capita income variable, the sign for the interaction term is positive but not significantly different from zero. This means that there is no significant variation in the explanatory power of regional per capita income across different types of central incumbents (socialist and non-socialist). In accounting for the variation of the dependent variable *Model a* performs worst, whereas *Model b* shows high significant coefficients and a moderate-to-high R-squared (0.54). In summary, the explanatory power of regional economic indicators does show variation across different national incumbents. This indicates that economic conditions affect subnational politicians' electoral performance through hanging on to the central administration's coattails.

As for the remaining (non-interacted) independent variables *(ΔPCI, ΔU, ΔINF*), the sign of their coefficients is the same as in Table 5.2. I previously stated that results in Table 5.2 indicated the existence of subnational economic voting. However, hypothesis-testing in *Model b* and *Model c* shows that the effect of economic conditions works through evaluations of the central administration performance.

These findings may modify the interpretation of non-interacted coefficients, as well. If voters regard regional economic indicators as by-products of national economic decisions, then the explanatory power of non-interacted variables might be capturing voters' assessments of the national incumbent party. Or, in other words, although economic indicators show the same sign as in

Table 5.1, new empirical findings provide an interpretation that departs from subnational economic voting.

Table 5.3. Effect of regional economic conditions on the vote for regional incumbent candidates across different central incumbents

Variables	Model a	Model b	Model c
ΔNV	.811 (.308)**	.865(.261)***	.881 (.273)***
ΔPCI	3.21(1.68)*	3.51 (1.44)**	2.88 (1.51)*
ΔU	-.406 (.246)	-.544 (.223)**	-.300 (.230)
ΔINF	-.397 (.248)	-.284 (.162)*	-1.33 (.466)**
Cons	2.72 (4.40)	.869 (2.56)	16.6 (7.01)**
PP	.110 (7.75)	15.06 (5.82)**	-14.1 (7.31)*
PP*ΔPCI	.595 (6.09)		
PP*ΔU		2.70 (1.002)**	
PP*ΔINF			1.09 (.500)**
R-sq	0.41	0.54	0.51
Obs	47	47	47
Estimation	FE	FE	FE

Coefficient results (standard errors in parenthesis). *** if p < 0.001 ** if p < 0.005 * if p < 0.01
Dependent variable = ΔRV = increase in regional vote of the socialist party in regional elections at time *t* (only in regions where the socialist party rules the regional government at time *t*)
Independent variables:
ΔNV = increase in national vote of the socialist party in region *i* in general elections at time *t-k*
ΔPCI= increase in per capita income in region *i* at time *t*
ΔU= increase in the unemployment rate in region *i* at time *t*
ΔINF= increase in the inflation index in region *i* at time *t*
PP = dummy variable (coded as 1 when the ruling party at the central level is the Popular Party, and 0 otherwise)

The new explanation is that economic indicators impact upon subnational incumbents' electoral fortunes through national administration economic coattails. In the next section I further elaborate on the implications of the subnational economic hypothesis and the national referendum hypothesis for non-incumbent representatives. I derive some hypotheses and test them to corroborate the results shown in Table 5.3.

5.3.1.1. Regional leaders in the opposition

What are the implications of H_0 (subnational economic voting) and H_1 (national referendum hypothesis) on non-incumbent regional representatives? Let us assume that the null hypothesis is true. In this case I would expect non-incumbent regional leaders to be affected by regional economic indicators in the opposite way to regional incumbent representatives. That is, good regional economic indicators will mean vote gains for the regional incumbent and losses for the parties in opposition. Alternatively, under the national referendum hypothesis the effect of regional economic indicators on subnational votes is mediated through voters' assessment of the central administration. If this is so, the electoral performance of both incumbent and non-incumbent socialists at the regional level will turn on voters' assessment of the incumbent party at the center. In other words, when the ruling party at the central level is *PSOE*, voters will make this party responsible for regional economic indicators. Therefore, the electoral outcomes of party affiliated subnational representatives will fluctuate in the same direction – regardless of their incumbent/non-incumbent position.

In testing these hypotheses I run the basic econometric model (equation (1)) on a smaller sample, which only includes regions where socialist leaders are in opposition. The new econometric model is as follows:

Δy_{it} *(non-incumbent socialist vote share)* = $\alpha + \beta_1$ *Δnational share*$_{it}$ + β_2 *Δunemployment*$_{it}$ + β_3 *Δper capita income*$_{it}$ + β_4 *Δinflation rate*$_{it}$ + u_i *(5)*

H_o: Subnational economic hypothesis
H_1: National referendum hypothesis

H_o: $\beta_2 > 0$	H_1: $\beta_2 < 0$
$\beta_3 < 0$	$\beta_3 > 0$
$\beta_4 > 0$	$\beta_4 < 0$

Table 5.4 displays the results of testing equation (5). In *Model a* the sample includes regional governments where socialists are in opposition throughout the period. Regression results show that national elections have a positive and significant effect on the electoral fortunes of non-incumbents.

National electoral spillovers seem therefore to be at work for the socialist leaders in opposition at the regional level, although the effect is lower than for incumbent representatives. This might indicate that the electoral fortunes between national and regional co-partisans are stronger for regional socialist incumbents. What about regional economic indicators? The sign of correlation coefficients support the national referendum hypothesis, although only the effect of the unemployment variable is significantly different from zero.

This may be accounted for by the fact that the model does not control for changes in the incumbent party at the central level. I expect the correlation of economic indicators with the dependent variable to show opposite signs across different national incumbents. In consequence, non-significant regression coefficients of economic variables might be the result of opposite effects that cancel each other out.

Table 5.4. Effect of regional economic conditions on the vote for regional non-incumbent candidates

Variables	Model a	Model b[1]
ΔNV	.489 (.184)**	2.30 (.320)***
ΔPCI	1.92 (1.13)	-.859 (1.55)
ΔU	-.369 (.212)*	-1.71 (.428)**
ΔINF	-.148 (.140)	-1.31 (.390)**
Cons	-.180 (2.14)	20.9 (6.56)**
R-sq	0.43	0.33
Obs	42	17
Estimation	FE	FE

[1] Sample: observations from the period where the Socialist party is ruling central government.
Coefficient results (standard errors in parenthesis). *** if $p < 0.001$ ** if $p < 0.005$ * if $p < 0.01$
Dependent variable = ΔRV = increase in regional vote of the socialist party in regional elections at time *t*
Independent variables:
ΔNV = increase in national vote of the socialist party in region *i* in general elections at time *t-k*
ΔPCI= increase in per capita income in region *i* at time *t*
ΔU= increase in the unemployment rate in region *i* at time *t*
ΔINF= increase in the inflation index in region *i* at time *t*

In *Model b* the sample only includes observations for the period when the incumbent at central level was socialist. This restriction reduces the sample considerably, as only 17 observations remain. Regression results indicate that it is not possible to reject H_1, that is, the existence of national economic spillovers on non-incumbent regional socialists. Empirical evidence corroborates the idea that regional economic indicators are assessed as the result of national economic conditions. A national *ascription*, therefore, mediates the relationship between regional levels of unemployment, inflation and per capita income and the electoral support of non-incumbent socialists representatives.[22] In addition, electoral spillovers increase, indicating that the electoral fates of national and subnational co-partisans are more closely related when the party rules central government.

Finally, there is only one scenario that remains unexplored: the impact of regional economic conditions on regional socialist leaders that are in opposition when the incumbent at the center is a non-socialist party. In this scenario predictions are not straightforward since the impact of national coattails on non-incumbent regional representatives is very indirect. The argument would go as follows: good economic indicators benefit the national incumbent and hamper electoral support of the opposition parties at central level. The electoral support of regional politicians from the party that is in the opposition both at central and regional level will be negatively affected by national spillovers. Or, in other words, when the *Popular Party* runs central government, then Socialist politicians at central level will be negatively (positively) affected when the state of the regional economy is good (bad). This effect translates into electoral gains or losses for non-incumbent socialist representatives at regional level.

In order to test these implications I interact a dummy variable that is coded as 1 when the incumbent party at the central level is non-socialist (*Partido Popular = PP*) and 0 when the socialist party is in charge of the national government. As in the sample with incumbent politicians (see equations (2), (3) and (4)) the interaction term will capture any variation in the explanatory power of economic indicators that results from a modification of the national incumbent party. Predictions are the same as in the sample with regional incumbents:

---

[22] As the number of observations in Model b is low, I have also estimated equation (5) with Ordinary Least Squares. Results do not show significant differences from the Fixed-Effect estimation (results not shown).

Δy_{it} *(socialist non-incumbent's regional vote share)* = $\alpha + \beta_1$ *Δnational share*$_{it}$ + β_2 *δPPincumbent*Δunemployment*$_{it}$ + β_3 *Δper capita income*$_{it}$ + β_4 *Δinflation rate*$_{it}$ + u_i *(6)*

Δy_{it} *(socialist non-incumbent's regional vote share)* = $\alpha + \beta_1$ *Δnational share*$_{it}$ + β_2 *Δunemployment*$_{it}$ + β_3 *δPP incumbent *Δper capita income*$_{it}$ + β_4 *Δinflation rate*$_{it}$ + u_i *(7)*

Δy_{it} *(socialist non-incumbent's regional vote share)* = $\alpha + \beta_1$ *Δnational share*$_{it}$ + β_2 *Δunemployment*$_{it}$ + β_3 *Δper capita income*$_{it}$ + β_4 *δPP incumbent *Δinflation rate*$_{it}$ + u_i *(8)*

H_o: Subnational economic hypothesis
H_1: National referendum hypothesis

H_o: $\beta_2 = 0$	H_1: $\beta_2 > 0$
$\beta_3 = 0$	$\beta_3 < 0$
$\beta_4 = 0$	$\beta_4 > 0$

Table 5.5 displays results of testing equations (6), (7) and (8). Econometric models perform worse than in Table 5.3, where the sample was made up of regional socialist incumbents. The interaction terms show the predicted sign although coefficients are not significantly different from zero. Results therefore indicate that economic electoral externalities are weaker when party members occupy the opposition at both levels of government.

Table 5.5. Effect of regional economic conditions on the vote for regional non-incumbents candidates across different central incumbents

Variables	Model a	Model b	Model c
ΔNV	.599 (.197)***	.601 (.264)***	.605 (.189)***
ΔPCI	3.91 (2.05)*	2.21 (1.17)*	2.19 (1.12)*
ΔU	-.098 (.279)	-.274 (.396)	-.167 (.259)
ΔINF	-.068 (.153)	-.067 (.158)	-1.07 (.707)
Cons	-3.87 (3.23)	-2.40 (2.97)	
PP	5.31 (3.50)	3.15 (2.78)	-11.9 (10.4)
PP*ΔPCI	-2.36 (2.34)		
PP*ΔU		.188 (.604)	
PP*ΔINF			1.01 (.698)
R-sq	0.51	0.47	0.50
Obs	42	42	42
Estimation	FE	FE	FE

Sample: observations where the socialist party is in opposition at the regional level.
Coefficient results (standard errors in parenthesis). *** if $p < 0.001$ ** if $p < 0.005$ * if $p < 0.01$
Dependent variable = ΔRV = increase in regional vote of the socialist party in regional elections at time *t*
Independent variables:
ΔNV = increase in national vote of the socialist party in region *i* in general elections at time *t-k*
ΔPCI= increase in per capita income in region *i* at time *t*
ΔU= increase in the unemployment rate in region *i* at time *t*
ΔINF= increase in the inflation index in region *i* at time *t*
PP = dummy variable (coded as 1 when the ruling party at the central level is the Popular Party, and 0 otherwise)

5.3.2. Citizens' learning hypothesis

According to the *learning hypothesis*, electoral externalities will be significantly lower in most recent regional elections than in early regional electoral contests. In Spain citizens have experienced a decentralized political system for more than two decades, a period long enough for a learning effect to have an impact. In addition, we know that the particular design of decentralization may amplify (or shrink) the effect of the learning process. Fiscal intergovernmental relations have evolved towards better correspondence between subnational expenditure responsibilities and taxing authority. Lower vertical imbalances may amplify the learning effect, as it makes subnational policy responsibilities more visible to citizens. In addition, regional governments have been given authority over policy areas with which citizens are closely identified (such as health care or education), which makes subnational performance more important to voters. Following these considerations I expect the electoral fate of regional socialist incumbents to become less affected by previous national electoral performance over time.

To test that prediction I take the basic econometric model of equation (1) and introduce a dummy variable (RE = *recent elections*). This variable is coded as 1 for most recent regional elections (elections that take place in pairs 4, 5, 6 – see Table A.12 in the appendix[23]) and is coded as 0 for earlier elections (elections held in pairs 1, 2 and 3). I then interact this variable with ΔNV (*national vote share*). I expect the interaction term (β_1) to show a negative sign.

The *learning hypothesis* states that citizens learn to ascribe responsibilities across levels of government. But there is another process that unfolds in line with citizens' learning: the gradual decentralization of expenditure responsibilities. As I stated above (in the *decentralization hypothesis*), this process impacts upon

---

[23] In the Basque Country the *recent elections* (RE) variable is coded as 1 for pair 7, as well (regional elections of 2004).

electoral externalities across levels of government. For this reason in equation (9) I need to control for expenditure decentralization (PCF = per capita regional financing). Otherwise, the effect of the interaction term ($\beta_1 RE{*}\Delta NV_{it\text{-}k}$) could be contaminated by the effect of expenditure decentralization (as expenditure decentralization is greater in most recent electoral contests than in earlier ones):

$$\Delta \mathrm{RV}_{it}\ \textit{(socialist incumbent's regional vote share)} = \alpha + \beta_1 RE{*}\Delta NV_{it\text{-}k} + \beta_2 \Delta U_{it} + \beta_3 \Delta PCI_{it} + \beta_4 \Delta INF_{it} + \mathrm{PC}F_{it} + u_i \qquad (9)$$

The results of estimating equation (9) are shown in Table 5.6. In *Model a* the sample includes only regional incumbents, which amounts to 46 observations. The interaction term shows, as predicted, a negative coefficient. However, its level of significance is above 10%, which indicates that the effect is not significantly different from zero. In *Model b* the sample consists of regional socialist representatives in the opposition. The interaction term continues to show a negative sign and its level of significance is below 10%. This indicates that regional leaders in the opposition become *faster* less affected by national elections' results than incumbent representatives (which corroborates previous findings). Finally, in *Model c* I include observations from both incumbent and non-incumbent representatives of the Socialist party. The coefficient of the interaction term exhibits a negative sign and it is significantly different from zero at a 5% level. Results therefore support the argument that the most recent regional electoral contests show weaker electoral externalities across levels of government. Or, in other words, the impact of national elections' results over the electoral performance of socialist regional incumbents is significantly lower for most recent regional elections[24].

---

[24] I have also tested *Model c* with the *recent elections* (RE) variable coded as 1 for pairs 6, 7 and 8 and coded as 0 for the remaining regional elections years (pairs 1, 2, 3, 4 and 5). Results are basically the same,

Table 5.6. The impact of national electoral results on regional vote across different samples

Variables	Model a[1]	Model b[2]	Model c[3]
ΔNV	1.08 (.583)*	1.01 (.328)**	.973 (.280)***
ΔPCI	2.62 (1.86)	1.27 (1.21)	.958 (.897)
ΔU	-.326 (.213)	-.134 (.339)	-.523 (.167)***
ΔINF	-.284 (.173)	-.836 (.439)*	-.302 (.139)**
PCF	.004 (.002)*	.002 (.003)	.002 (.001)
Cons	-.106 (3.61)	10.3 (6.93)	2.08 (2.61)
RE*ΔNV	-.812 (.761)	-1.00 (.511)*	-.859 (.404)**
RE	-5.70 (4.09)	-5.63 (3.80)	-4.82 (2.37)**
Adj-R2	0.50	0.35	0.46
Obs	46	40	86
Estimation	FE	FE	FE

[1]Sample: incumbent regional representatives from the Socialist Party
[2]Sample: non-incumbent regional representatives from the Socialist Party
[3]Sample: incumbent + non-incumbent regional representatives from the Socialist Party
Coefficient results (standard errors in parenthesis). *** if $p < 0.001$ ** if $p < 0.005$ * if $p < 0.01$
<u>Dependent variable</u> = ΔRV = increase in regional vote of the socialist party in regional elections at time *t*
<u>Independent variables:</u>
ΔNV = increase in national vote of the socialist party in region *i* in general elections at time *t-k*
ΔPCI= increase in per capita income in region *i* at time *t*
ΔU= increase in the unemployment rate in region *i* at time *t*
ΔINF= increase in the inflation index in region *i* at time *t*
RE= recent elections (is coded as 1 for regional elections that take place in pairs 4, 5, 6[25] and is coded as 0 for regional elections held in pairs 1, 2 and 3 (see pairs in Table 1 in the Appendix).
PCF= per capita financing in region *i* at time *t*

---

though standard errors are higher due to problems of multicollinearity with the new codification of *recent elections* variable.

[25] In the Basque Country the *recent elections* (RE) variable is coded as 1 for pair 7 (regional elections of 2004).

However, concerns about these findings need to be raised. To test the learning hypothesis I have to measure the impact of electoral externalities over time. However, measuring "time" with a dummy explanatory variable becomes a much too blunt indicator. The dummy variable RE (= recent elections) is aimed at capturing citizens' higher levels of knowledge on the basis of a decentralized political system. The problem is that the effect of the dummy variable may also originate in other factors that are at place in the period that I code as 1 ("most recent regional elections"). Those factors that are correlated with the RE dummy variable. For instance, the RE dummy is highly correlated (0.71) with the PP (*Partido Popular*) variable (that is coded as 1 for the period where the central incumbent is PP and 0 otherwise). In consequence, the interaction term ($\beta_1 RE* \Delta NV_{it\text{-}k}$) of equation (9) might be capturing the effect of variation of the national incumbent. The problem is that in equation (9) the $\Delta NV_{it\text{-}k}$ variable (vote percentage increase in national elections) can only be interacted once. In consequence, it is not impossible to test for alternative explanations. That is, the econometric model does not allow interacting other factors with the $\Delta NV_{it\text{-}k}$ variable in the same equation. In summary, it is necessary to interpret results in Table 6 while bearing these considerations in mind.

In the next section I introduce the second econometric model to test hypotheses related to the impact of subnational representatives' strategies on electoral externalities.

5.4. Model 2: Testing Subnational representatives' strategies

In the second model I use as a dependent variable absolute differences between the percentage of votes gained by the socialist party in regional elections at time *t* and the percentage of socialist vote in the previous national elections at time *t-k*, where *k* is the number of years between elections. I label this variable as *distance*. If electoral externalities are high, socialist vote share across close electoral contests will be very similar and, accordingly, absolute differences will be small. Low electoral externalities will translate into an increase of absolute distance. I predict that as decentralization increases electoral results in subnational contests will gradually become less correlated with previous performance in national elections (*decentralization hypothesis*). As in Model 1, I measure decentralization as regional per capita financing, since it captures changes in the level of goods and services that are provided by Autonomous Communities (*PCF*).

Control variables namely are: first, the increase in regionalist parties' vote sharing (Δ*REGV*).[26] The existence of regionalist parties that compete in subnational elections modifies the electoral arena where parties compete in general elections. It is less likely that national parties' vote sharing in subnational elections remains the same in subnational electoral contests, as the existence of regional parties gives rise to more fragmented electoral support.

Second, I introduce a continuous variable that measures the number of months between the date of regional elections and previous national elections (*Months*). There is some evidence that concurrence of electoral contests across regions and different levels of government has homogeneizing effects on electoral participation. For instance, in Spain, the concurrence of local and regional elections in some Autonomous Communities involves positive externalities on turnout that operate upwards, that is, from local to regional electoral contests (Wert 1998: 509). In addition, it seems that regions that hold regional elections separately (with respect to both the *common* electoral schedule[27] and electoral contests at other levels of government) foster heterogeneity, as a result of the predominant regional nature of issues being at stake in the electoral competition process (Pallarés 1994: 178).

---

[26] See Table A.13 in the appendix the list with the name and the percentage of votes of each regionalist party in every Autonomous Community.

[27] All Autonomous Communities except Andalusia, the Basque Country, Catalonia and Galicia celebrate regional and local elections on the final Sunday of May every four years.

The regression model also includes a categorical control variable (*incumbency*) that is coded as 0 if the socialist party has not been part of the regional incumbent government; 1 if the socialist party has been a member of a regional coalition government; and 2 if the incumbent majority government that runs for re-election is socialist. The direction of causality of the *incumbency* variable is not straightforward. On the one hand, incumbency may enhance the effects of electoral externalities where there is party affiliation across levels of government (that is, when the region is governed by the ruling political party at central level). The regional incumbent may therefore be more exposed to spillovers from the national administration, as compared to co-partisans that are in opposition. On the other hand, however, regional incumbency involves higher policy responsibilities (than being in opposition) and politicians' actions are more visible to citizens. Visibility may work as a check on national spillovers, as it emphasizes policy differentiation across levels of government. I would expect incumbent socialists to be less liable to national spillovers than non-incumbent co-partisans, whose electoral results would turn on national coattails. But these predictions do not take into account regional politicians' strategies. As was mentioned in Section 5.2.2.2, subnational representatives from state-wide parties may have incentives to enhance their political visibility against the influence of national electoral externalities or, alternatively, they may decide to hang on the electoral coattails of national co-partisans. These considerations prevent us from coming to straightforward conclusions so that the direction and explanatory power of the *incumbency* variable will be uncovered through empirical analysis.

The number of parties that compete in national and regional elections may affect parties' vote-share. The pool of votes is distributed between competing political parties in a zero-sum game. Accordingly, a system with a high number of competing parties involves a more fragmented distribution of votes. The regional competition arena is characterized by the existence of regionalist parties (known as *PANE – Partidos de Ámbito No*

Estatal – Non statewide parties). Some *PANE* parties have gained representation in the national Parliament, though all of them perform better in regional elections (Wert 1998: 518). As a result, fragmentation is lower in national than regional elections. I introduce as a control variable fragmentation in national elections, measured as the increase in the number of competing parties between two consecutive national elections. As the number of parties that compete in national elections increases, national fragmentation will approach regional fragmentation levels. As a result, differences between national and regional electoral results will shrink (see summary statistics in Table A.11 in the appendix).

The econometric model is:

$$y_{it} = \alpha + \beta_1\, \textit{regionalist parties}_{it} + \beta_2\, \textit{months}_{it} + \beta_3 \textit{incumbency}_{it} + \beta_4 \textit{fragmentation}_{t-k}\ \beta_5 \textit{pcfinancing}_{it} + \textit{yeardummies}_{it} + u_{it} \qquad (1)$$

<u>*Dependent variable*</u> = y_{it} = (socialist electoral results in national elections in region i at time $t\text{-}k$) – (socialist electoral results in regional elections in region i at time t), where k is the number of years between elections.

The results are displayed in Table 5.7. The overall fit of *Model a* is good and the sign for all exogenous variables appears as predicted. As for the *decentralization hypothesis* test, there is a positive and significant correlation between regional per capita financing and the dependent variable. Per capita financing measures the level of expenditure powers in the hands of each Autonomous Community. It indicates the extent to which central government has transferred power downwards, or in other words, it measures the level of expenditure decentralization. Results corroborate the decentralization hypothesis. As regions are endowed with powers over the provision of goods and services– measured through per capita financing – subnational electoral results gradually bear less resemblance to national electoral performance in previous general elections.

Table 5.7. Testing Model 2: Subnational leaders' strategies

VARIABLES	Model a	Model b	Model c
ΔREGP	.136 (.056)**	.128 (.057)**	.122 (.054)**
ΔFRAGMENTATION	-2.01 (.854)**	-1.83 (.953)*	-1.75 (.844)**
PCF	.003 (.001)**	.003 (.001)*	.002 (.0009)**
Months	.274 (.091)***	.276 (.111)**	.120 (.062)*
Incumbent (ref. non-incumbent socialist)			
Incumbent 1 (coalition)	-1.79 (1.38)	-2.50 (1.87)	-1.38 (1.27)
Incumbent 2 (majority)	-.555 (1.33)	-1.69 (1.46)	-.781 (.968)
PP		-.778 (3.74)	
Incumbent1*PP		1.22 (2.82)	
Incumbent2*PP		3.83 (1.92)**	
Intensity			-.136 (.412)
Time dummies (ref. Pair 1)			
Pair 2	27.0 (7.68)***	26.92 (7.69)***	19.1 (6.62)***
Pair 3	17.9 (6.80)**	18.07 (6.79)**	11.8 (5.69)**
Pair 4	15.5 (5.43)**	16.17 (5.68)**	11.0 (4.25)**
Pair 5	10.5 (6.27)*	10.82 (6.99)	8.21 (5.15)
Pair 6	12.1 (7.21)*	11.83 (7.78)	9.76 (5.83)*
Pair 7	8.69 (7.63)	7.03 (9.33)	5.79 (6.01)
Cons	-20.4 (7.13)*	-19.71 (7.52)	-10.4 (5.58)*
Obs	84	84	84
R-sq	0.29	0.33	0.35
Estimation method	FE	FE	RE

Coefficient results (standard errors in parenthesis). *** if p < 0.001 ** if p < 0.005 * if p < 0.01

Dependent variable = *difference* = (socialist electoral results in national elections in region *i* at time *t-k in region i*) – (socialist electoral results in regional elections in region *i* at time *t*), where k is the number of years between.

Independent variables:

ΔREGV = increase in vote share for regionalist parties in region *i* at time *t*

ΔFRAGMENTATION= increase in the number of parties that compete in national elections.

PCF= regional per capita financing in region *i* at time *t*

Months = increase in the inflation index in region *i* at time *t*

Incumbent = coded as 0 for regions where socialist are in opposition; 1 when they form part of a coalition government; and 2 when socialists have majority at the regional level.

PP = dummy variable (coded as 1 when the ruling party at the central level is the Popular Party, and 0 otherwise)

Intensity = continuous variable that measures the number of years between the approval of the Spanish Constitution (1978) and the approval of the Statute of Autonomy in each region.

In accordance with the theoretical arguments presented above, the percentage of votes regionalist parties accrue is positively correlated with the endogenous variable. It seems plausible that as the percentage of votes collected by regionalist parties increases, the distance between national and subnational electoral results becomes greater. Additionally, the number of parties that compete in national elections is, as predicted, negatively correlated with the dependent variable. Results show that, as expected, the span of time between regional and previous national elections accounts as well for variation of the endogenous variable. Electoral externalities across different levels of government are higher the closer the dates in which electoral contests take place. Finally, the sign for type of incumbency is negative, indicating that subnational incumbents' electoral performance is more liable to national electoral fluctuations than regional leaders in opposition. However, coefficients are not significantly different from zero.

In *Model b* I test H_4 (*National electoral downturn*). The argument is that subnational politicians will have incentives to isolate their electoral performance from national electoral coattails when co-partisans at central level face an electoral downturn. Stressing policy differentiation and autonomy from national party representatives may allow local leaders to accrue higher electoral benefits than hanging on damaging electoral externalities.

As a consequence of enhanced-visibility strategies, I expect that distance between national and subnational co-partisans' electoral results will increase. To test this hypothesis I introduce in equation 1 a dummy variable (PP) that is coded as one when the ruling party at the central level is the *Popular Party*, and zero otherwise. I interact this variable with the regional *incumbency* variable (*incumbency***PP*). The Socialist Party lost the national incumbency in the general election of 1996. Following H_4 I expect regional socialist incumbents to follow thereafter policy *differentiation* strategies aimed at preventing being turned out of government - like their national counterparts. Results show a positive interaction term for socialist leaders that rule a majority regional government (category 2 of the *incumbent* variable). This means that the electoral fate of regional socialist incumbents becomes more independent from electoral results in national elections after the Socialist party loses central government. This finding corroborates H_4: where regional representatives hold power in subnational governments and expect negative electoral externalities from their national counterparts, they will follow strategies that highlight differentiation and autonomy from the national branch of the party.[28]

Finally, in *Model (c)* I purport to test H_5. This hypothesis states that those with higher intensity for political autonomy will be more likely to stress a policy agenda grounded in issues affecting their region (issues over which they have decision-making power), even when these issues pit them against national co-partisans. I measure intensity of preferences as the span of years between the approval of the Constitution (1978) and the approval of the Autonomous Community's Statute of Autonomy. The sooner the region passes its Statute of Autonomy the higher the intensity of preferences over autonomy (so positive values of the intensity variable should be interpreted as lower preferences for autonomy).[29] I label this variable as *intensity* and introduce it in equation (1). The Model is estimated with Random Effects

---

[28] An alternative explanation to this result is that it is the consequence of having higher levels of expenditure decentralization during the period when the incumbent at the central level is *non-socialist*. That is, when the national incumbent is the *Partido Popular*, the distance between national and regional electoral results increases (for regional incumbents). This negative effect may be the consequence of an upturn in expenditure decentralization during the period when *PP* holds power at the central level. In summary, the effect of the interaction between regional *incumbency* and type of incumbent at the center may be mediated through the effect of variation in expenditure decentralization. However, this effect is controlled in *Model b* through the introduction of the variable *per capita financing*.

[29] For instance, Catalonia and the Basque Country approved their Statutes of Autonomy in 1979 so that observations from these regions will be coded as "1".

(since the intensity variable does not vary over time). Results show that the *intensity* variable, as predicted, displays a negative sign. This means that in regions with lower preferences for autonomy electoral externalities are higher. However, the coefficient of the intensity variable is not statistically significant (it is far above a 10% level of significance). I have also tested the same model with a different measure of intensity of preferences. I have introduced a dummy-variable that is coded as 1 for those regions that accessed autonomy through the fast-track process and 0 for the ordinary regions (that accessed autonomy with a lower level of expenditure powers and authority). Results are the same as in *Model c* (results not shown).

The non-explanatory power of the *intensity* variable may be accounted for in the following way. It is likely that measuring preferences for autonomy through time-constant variables becomes a too blunt measure. The way regions accessed autonomy (fast-track or slow-track) gave rise to significant differences in expenditure powers and authority across regions in the early years of the State of Autonomies. These initial asymmetries, though, do not capture subsequent changes in regional leaders' demands for autonomy. Less than ten years after passing the most recent Statute of Autonomy ordinary regions were demanding an extension of their authority and expenditure powers. These demands resulted in the 1992 *Pactos Autonómicos* (Autonomous Agreements) whereby slow-track regions where granted the same authority powers than fast-track Communities. Preferences for autonomy among regional leaders from slow-track regions arose in line with the gradual development of regional institutions. Although these dynamics on demands for autonomy are important to understand the implementation of policy-differentiation strategies (as stated in H_5), they are not captured through time-constant variables (as *intensity* or *fast-track* variables).

In summary, coefficients displayed in Table 5.7 support H_3 and H_4. As for H_3, *Model a* shows there is a significant and positive correlation between the level of expenditure decentralization and distance between national and regional electoral results. The rationale is the following: as subnational representatives are granted higher authority and expenditure responsibilities they gradually gain more influence within the state-wide party. Empowered subnational governments create centrifugal forces within the party structure, as they gain more influence in selecting candidates and drawing up the party's policy agenda. This decreases the costs that would have prevented subnational leaders from following a *differentiation* strategy in policy formulation and implementation.

Results using *Model b* indicate that when the national branch of the state-wide party experiences an electoral downturn, national electoral spillovers across party co-partisans diminish. The causal mechanism that accounts for such correlation is found in the electoral strategies of subnational representatives. In order to isolate their electoral fates from negative electoral externalities, subnational politicians will try to appear before voters as independent as possible from their national counterparts.

5.5. Interviews

In this section I provide supportive empirical evidence on the effect of decentralization on the structure of a state-wide party as well as on the *electoral downturn* and *preferences for autonomy* hypothesis. The case I have analyzed closely in the foregoing quantitative analysis is that of the Spanish Socialist Party (PSOE). In this section quantitative evidence draws on in-depth interviews with Socialist leaders who closely followed the decentralization process.[30]

If the hypothesis on decentralization is correct, the transfer of tax and expenditure powers towards subnational governments should be associated with centrifugal pressures within the internal

[30] See Table A.1 in the appendix, where you will find a list of the politicians interviewed and their corresponding party and/or governmental responsibilities.

organization of a state-wide party. The PSOE offers strong evidence that the structure of the party gradually changed as regional institutions became more entrenched. All interviewed politicians agreed that the institutional structure of the State impinged upon the internal organization of the party. A repeated argument was that the PSOE only achieved a truly federal structure as a result of the dynamics that the expansion and consolidation of regional governments triggered off. Although the PSOE had formally adopted a federal structure, in the early years of the democratic period it was in practice a highly centralized and disciplined party. As regional institutions consolidated, regional representatives steadily became more experienced politicians. In addition, the average level of education of people working for the regional administration increasingly rose. So did the number of people who were initiating a political career within regional institutions. In consequence, the political status of regional politicians gradually took gradually a turn for a better. They eventually went from being regarded as second-level representatives to being considered as respectable leaders who were able to maintain long-lasting incumbencies. This change in regional politicians' reputation and experience is well demonstrated in the dynamics of intergovernmental bargaining. I asked the former Secretary of Economy, Miguel Ángel Fernández Ordóñez, to characterize the current process of intergovernmental bargaining in regional financing, as compared to the negotiation dynamics in the early eighties. He answered:

> "There are differences…as regional governments were gaining power and relevance, their role became more important…their intellectual role (…) I have been here (in the Treasury Department) for more than 15 years…And what was there at that time? Then you were hardly battling with the ACs…you were battling with the Treasury…regional representatives were nobody…Now it is different…Now they come to negotiate (…) with research

> reports…they have enlarged their capacities (…) they are better educated."[31]

The most important influential factor in consolidating regional government experience and know-how was the fact that some of them had long-lasting incumbencies with the support of a majority of voters.[32] These regional leaders were known as "*barones*" (barons) and they were usually in charge of both a regional government and a regional party federation. The emergence of regional constituencies represented a new source of power for these leaders. They soon began to claim greater responsibilities within the party, arguing that their authority within the party organization had to be on a level with their electoral support and institutional responsibilities. Tomás De la Quadra provided the best account of the nature of those regional claims:

> "There was opposition…and that opposition was supported, not by leaders of regional party federations without power, or just with authority that stemmed from the party machine, but by regional leaders who had been democratically elected by the people, that were aware of their political power, and who felt they had strong authority to decide on issues concerning his region."

Centrifugal pressures within the party emerged in the mid-eighties. In the 30th Congress of the PSOE, in 1984, regional

---

[31] A very illustrative example was also provided by Félix Pons, who stated that *"A regional president who has been three terms in office does not meet the Ministry of Finance or (…) the Ministry of Education as a regional newcomer (…) This is evident. Even when they belong to the same party…he (the regional president) will be assertive…or more assertive than the first day (he meets the Ministry). He arrives (to the Ministry) with a reverential attitude…and now he feels more important than the Minister himself."*

[32] In Madrid, Andalusia and Castilla la Mancha regional leaders had been helped into office by the central party apparatus. However, subsequent attempts from these leaders to gain autonomy from the center found strong opposition in the party apparatus (Gillespie 1992).

leaders[33] made themselves felt for the first time. They proposed the creation of a new organ, a political council (*consejo poltico*) formed by regional secretaries, and attempted to gain higher levels of representation in the executive.[34] However, the general secretary of the Socialist Party, Felipe González, and a majority of members from the party's central executive (*ejecutiva federal*) opposed the creation of this organ.[35] This illustrates that, although in the early eighties regional leaders had begun to argue for higher levels of authority within the party, the party machine was able to silence these centrifugal pressures. This argument, repeated to me by several politicians that I interviewed, was well illustrated by Félix Pons:

> "Initially, when the PSOE assumes institutional responsibilities the party tries to implement a model in which regional institutions are dominated by the party machine. Therefore, party members that have institutional responsibilities must follow what the apparatus dictates."

The model that Félix Pons describes impacted upon intergovernmental relations, as well. This is illustrated by how Joaquin Almunia characterizes intergovernmental bargaining process that in the mid-eighties brought about the first definitive agreement on regional financing. He says:

> "At that time the Socialist party dominated a majority of regions but the party still had a strong and cohesive party structure that predominated over specific regional demands."

---

[33] The most demanding regional party federations were Andalusia, Comunidad Valenciana and Madrid.

[34] "*El País*" newspaper, 14th of December 1984.

[35] "*El País*" newspaper, 15th of December 1984. González said that the creation of the political council would create disjuncture within the party and proposed as an alternative the establishment of periodical meetings with regional representatives.

During the first half of the nineties, two different series of events resulted in increasing powers for regional secretaries. On the one hand, the second decentralization wave that took place as a result of the 1992 Autonomous Agreements endowed ordinary regions with higher levels of authority, which in turn boosted centrifugal pressures within the party. On the other hand, internal divisions within the federal executive and the increasing rift between the socialist government and the party apparatus significantly eroded party unity and cohesion.[36,37] These dynamics are well reflected in how things developed in the XXXI Congress (1990), one of the most conflicting ones. The federal executive of the party was enlarged and some regional *barones* entered the executive organ, indicating that regional leaders were gradually succeeding in achieving power share. As for government-party relations, in the closing speech Felipe González made an urgent appeal for a strict division between the government's sphere of action and that of the party machine.[38]

---

[36] The general secretary of the PSOE and Prime Minister, Felipe González appealed for party unity and discipline in the two congressional meetings that took place in the eighties. For instance, in the 1984 Congress he stated that the party structure *"must remain as solid as a stone"* ("*El País"* newspaper, 17th of December 1984). Again, in the 1988 Congress González made a general appeal for party discipline ("*El País"* newspaper, 25th of January 1988). Internal divisions became more pronounced at the beginning of the 1990s.

[37] The federal executive was divided between those who were defending a modification of the party's discourse and style (known as *renovadores*) and the so-called *guerristas,* followers of Alfonso Guerra, the Secretary of Organization and vice-prime minister from 1982 until 1991. As Méndez (2000: 148) states, *"it is difficult to characterize these divisions.* Renovadores *were a very heterogeneous group who were in favor of adapting the socialist discourse to the new circumstances and, in general, less fearful of adopting liberal policies than* guerristas.*"* These internal divisions became particularly strong in the early 1990s, when the central party apparatus, led by Alfonso Guerra and the *guerristas* group became openly critical of the González and his cabinet.

[38] "*El País"* newspaper, 12th of November 1990.

The first half of the nineties witnessed growing divisions within the PSOE's internal organization, together with a steady electoral downturn.[39] Weaker party central offices worked at an advantage to regional leaders, who gradually took the central party apparatus on.[40] The explanation for why the Socialist government eventually accepted the integration of regional leaders in the federal executive comes from Joaquin Almunia:

> "There is no doubt that regional leaders have been endowed with high powers that are very relevant in the structure of the State and in the distribution of power. But the overweighed influence of the territorial cleavage in the internal distribution of power is directly related to the emptiness of power at the federal level (…) Felipe González uses territorial leaders to counterbalance the power of the party apparatus (…)(when) it begins to challenge the power of the government and the General Secretary of the party."[41]

A common statement among interviewed leaders is that the emergence of regional powers had important costs in terms of party cohesion as well as in coordination failures between central government and socialist ACs and among regions. The party lost to a great extent its "cohesive" nature, that is, the capacity to force socialist regional representatives to come to an agreement on policy issues. At the same time regional leaders were following policy strategies that often departed from the national party's guidelines. In so doing, they were exploiting their more influential role within the party organization, knowing full well that the

---

[39] The Socialists lost their majority in the 1989 general election. In 1993 the Primer Minister Felipe González called early general elections that the PSOE won with a minority.

[40] Regional leaders increasingly gained responsibilities within the party. In the 1994 Congress the federal executive was enlarged with the introduction of some regional leaders. In the 1997 Congress a Political Council was created, where regional party federations were represented (see also Méndez 2000: 141).

[41] In fact, González himself had started having regular meetings with the regional leaders (see Gillespie 1992).

central apparatus was not able to force compliance anymore. Another shared view among the people who I interviewed about regional leaders' preferences is that they increasingly gave priority to regional constituencies' demands over advancing a common national party agenda. Or, in other words, regional leaders began to owe more allegiance to regional voters than to the central party apparatus. These dynamics are well illustrated in the words of Carlos Solchaga:

> "Everybody (every regional leader) has his own plan (…) and those plans are compatible with the general project to a greater or lesser extent (…). Problems arise because compatibility is not, by far, perfect. This happened in 1991 and, from that year onwards, it has always happened (…) Belonging to the same party is not a guaranteed way to prevent contradictions (between plans). In these conditions: is it reasonable to think that it is possible and desirable to run national policy using affiliated regions to form a united front (against the national opposition)? I believe this is a mistake because contradictions will surely arise. And when you believe that you have disciplined your boys (affiliated regions) they will make a pact on their own if they have an electoral or political advantage, or however they think they maximize their function." And he follows: "The idea that those people (regional leaders) - who are in power, who want to stay in power and happen to be the base that allows you (the central apparatus) to have institutional grounds in society – will comply with following your strategy in opposition instead of doing what is convenient for them, is ridiculous."

There are no major differences between regions in terms of allegiance to their constituency. In fact, interviewees agreed that regions gradually converge in demands for increased autonomy. Homogeneity seemed to characterize the pattern of regional claims, which basically consisted in demanding higher transfers of monies from the regional government. ACs converged in expenditure decentralization, as well. One of the leading politicians in devising the Autonomous Agreements of 1992 stated that a majority of slow-track regions wanted to access higher levels of autonomy.[42] None of them wanted to be the laggard in receiving competences and, above all, in getting resources from the center to finance them. Preferences for autonomy, therefore, were focused on demanding more resources. As Félix Pons states:

> "All regions wanted full political autonomy. As for autonomy in financing…yes (they wanted autonomy) but not to use it."

Slow-track regions that were in the last batch to access autonomy turned out to be as demanding as those ACs who had traditionally shown stronger preferences for autonomy. Some of these slow-track regions happened to be ruled by the *Partido Popular*. Carlos Solchaga characterized their demands in the following way:

> "I could see that (…) once the Partido Popular was ruling a regional government, it turned out to be as centrifugal as any other nationalist (party)…Demands (…) (from) Aragon, Murcia were no lower than nationalist leaders or even higher…it was impossible to distinguish which region was claiming more…"

These statements corroborate the results of testing the hypothesis on *preferences for autonomy*. Quantitative analysis showed that regions that first accessed autonomy were not significantly less influenced by electoral externalities than the rest. My argument was that initial asymmetries did not capture subsequent changes in regional leaders' demands for autonomy. I was assuming that slow-track regions' demands had arisen in line with the development of regional institutions. Qualitative analysis seems to corroborate this assumption, as those interviewed report that regions gradually converged in their demands for autonomy.

Regional leaders have proved to be more successful over time in asserting their autonomy from the centre. Policy issues that have pitted regional leaders against the central executive have had different endings. For instance, in 1983 Joaquin Leguina (the

[42] Interview with Juan Manuel Eguiagaray.

president of Madrid's regional government from 1983 until 1995) proposed the creation of a regional surcharge on the Personal Income Tax that would finance local governments. The Socialist central government did not support this initiative and maneuvered until it was dropped. Although the Spanish Constitutional Court eventually dictated the constitutional nature of the surcharge, it was never implemented.[43] Subsequent regional *assertive* initiatives unfolded in a different way. For instance, in 1994 José Bono (the president of Castilla la Mancha's regional government from 1983 to 2004) confronted the Socialist central government with regard to route design. The planning of national roads was the responsibility of the national administration but the regional government opposed the Ministry plans, arguing that a route design cut across a regional nature reserve.[44] Finally, the original road plan was modified and the regional administration scored a goal in the battle with central government. This example indicates that as regional leaders are empowered with new authority, party affiliation does not prevent regional leaders from following a bickering strategy with central government. Once regional heterogeneous policy agendas emerge, seeking to impose homogeneity or to silence regional demands is an unworkable strategy for the central party apparatus.

Electoral fluctuations of the PSOE in general elections impinged upon regional leaders' strategies, as well. Several interviewed leaders stressed that the PSOE's electoral downturn in general election boosted regional differentiation strategies. Therefore, two related processes - party internal divisions and electoral downturns - account for regional leaders' takeover. These are well summarized by Carlos Solchaga:

> "It is evident that when you create new centers of power (the regional administration) then of course the previous structure teeters (…) Despite the fact that the leadership of Felipe González is very strong, you cannot pretend that the power structure will remain the

[43] See Iglesias (2003: 351).
[44] See Iglesias (2003: 297-298).

same…it is not true…And well, you can deal with it in a reasonable way when electoral success (…) acts as a unitary force. (…) (Differentiation strategies) arise in a more transparent way, with greater relevance, when central authority becomes weaker (…) or when you are in opposition."

According to the electoral downturn hypothesis regional leaders will attempt to isolate their electoral fortunes from that of their national counterparts when the latter face an electoral downturn. That is, regional electoral strategies will be aimed at asserting their autonomy from the center to minimize negative electoral externalities. The characterization of regional leaders' strategies made by some of the interviewed politicians supports these predictions. For instance, Abel Caballero puts those arguments in the following terms:

> "Yes, (regional electoral campaigns are) more autonomous than before…this happens because of the loss of power at central level. That is, when the Socialist party loses power and (you have) regional leaders with increasing power, what happens? Then the regional leader designs his own electoral campaign…he may not even want national leaders to come (to the region during the electoral campaign). "I do not want them (national leaders) to come because they are detrimental (to my electoral results)" (…) Now diversity and complexity are higher. There were periods when elections were won with Felipe González throughout the country: in Madrid, in the Autonomous Communities, in the local governments. And when this is over, then the process becomes more complex. I mean, during Gonzalez's last years (in power) and during the *Partido Popular* incumbency political projects (from regional leaders) are more autonomous (…) They are autonomous, above all, when you are not in power (at the central level) anymore."

In sum, qualitative evidence gives reasonable support to the *decentralization* and *electoral downturn* hypotheses. As a consequence of fiscal and political decentralization, empowered socialist regional leaders increasingly took the party apparatus on. In the early to-mid nineties centrifugal demands increased.

Regional leaders exploited their more influential role within the party organization, knowing full well that the central apparatus was not able to force compliance anymore. Regional leaders gave priority to their own electoral agendas over advancing a common national party program, which resulted in weaker party unity and cohesion. Finally, the PSOE's steady electoral downturn in general elections since the late eighties boosted regional differentiation strategies. The fear of negative electoral externalities rushed regional leaders into electoral strategies aimed at asserting their autonomy from the center.

5.6. Concluding remarks

The main purpose of this chapter was to analyze electoral externalities across levels of governments. I contend that there are two causal mechanisms that link decentralization with the electoral fortunes of party copartisans. The first has to do with the distribution of authority and powers across levels of government and citizens' ability to distinguish them and vote accordingly. The second is related to subnational politicians' *differentiation* strategies, which are driven by a cost-benefit calculus. Both mechanisms account for a negative correlation between decentralization and electoral externalities. Theoretical arguments give rise to six hypotheses that are tested with both quantitative and qualitative data from the Spanish case.

Results show that regional economic indicators impact upon the electoral performance of regional leaders through the national administration's economic coattails. This means that regional electoral contests correspond with a national economic referendum (corroborating the national referendum hypothesis), as voters evaluate regional economic indicators as the result of central government's economic activities. The empirical analysis revealed that the effect of national electoral spillovers on the electoral performance of *affiliated* subnational representatives is weaker when the latter are in the opposition, as compared to regional affiliated incumbents. In addition, data analysis showed that electoral externalities across levels of government were weaker in most recent regional electoral contests, as compared to earlier ones. I stated this is the result of the *citizens' learning* process whereby individuals vote differently in national and regional elections as they learn to distinguish responsibilities across levels of government.

There empirical evidence that supports hypotheses related to subnational politicians' strategies. The empirical analysis shows a significant and negative correlation between expenditure decentralization and electoral externalities. I contend that this negative relationship is the result of subnational politicians' having more incentives to pursue differentiation policy strategies from the national party's agenda. As a result of political and administrative decentralization, a centrifugation of the party structure unfolds, which diminishes within-party costs of pursuing a differentiated regional policy agenda, which in turn weakens electoral externalities. The impact of decentralization on the party structure has been corroborated with data collected from in-depth interviews to leaders of the Spanish Socialist Party. Finally, both quantitative and interview-based data supported the *national electoral downturn* hypothesis. Subnational politicians' differentiation strategies are more likely to arise when their national counterparts face an electoral downturn.

CHAPTER 6. THE DESIGN OF INTERGOVERNMENTAL TRANSFERS IN TWO DIFFERENT INSTITUTIONAL SETTINGS. THE CASE OF SPAIN

6.1. Introduction

In this chapter I aim to test the hypotheses presented in chapter 2 on the Spanish case. Following these hypotheses, I then explore whether the different strategies politicians adopt in the use of intergovernmental grants vary according to the structure of incentives that stem from distinct decentralized contexts. The Spanish case provides variation in the main explanatory variable of the model - two different institutional settings characterized by different levels of decentralization - while other factors are controlled for. This allows us to analyze whether the design and allocation of unconditional transfers has varied as a consequence of the increase in decentralization. I use as a dependent variable the distribution of unconditional financing among the Spanish Autonomous Communities[1] from 1987 to 2001.

One of the main characteristics of the Spanish process of devolution is the role that political agreements have played in the configuration and dynamics of the regional financing system. The

---

[1] I only analyze regions that are regulated through the common regional system of financing. Consequently, Navarre and the Basque Country are excluded from the empirical analysis.

Constitution establishes the basic regulatory framework for the evolution of the territorial organization of the State and its regional financing. However, the unique *open* nature of these provisions has left room for their gradual development and modification.

Bilateral and multilateral political agreements have played a very important role in filling that space, together with several organic laws and Constitutional Court judgements. Many scholars argue that the structure of political competition and political parties have shaped the dynamics of intergovernmental fiscal relations in Spain, and define the evolution of regional financing as a *politicized* process (Moldes 1996; Ramallo and Zornoza 2000). However, systematic measurement of such arguments (that is, *who benefits from what* in the system) lags behind. This chapter takes up that empirical task and, more importantly, places it within the theoretical framework described in chapter two.

6.2. The Spanish system of regional financing

The legal basis for the establishment of the *common* system[2] of regional financing was approved in the *Autonomous Communities Finance Act* (LOFCA, hereafter) in 1980. This Act envisaged that services transferred to ACs would be *sufficiently* financed. That is, regions would be granted an amount equal to the actual costs of service provision at the moment that the services were transferred. Funding to cover these costs would come from three sources: regional ceded taxes,[3] service fees and unconditional transfers (in

[2] The *common* system of regional financing applies to fifteen out of seventeen Autonomous Communities. Navarre and the Basque Country are financed through special regimes known as *Convenio Navarro* and *Concierto Vasco*, respectively.

[3] Ceded taxes were entirely owned by the State and ACs were allowed to administrate them. Regions were accruing yields according to the taxes paid in their territory. Ceded taxes are, thus, similar to a transfer from central government. The only difference is that ACs received a

the form of revenue-sharing).[4] Through revenue-sharing each AC would receive a percentage of revenues collected by central government through direct and indirect taxes and social security and unemployment contributions. This percentage would amount to the costs of service provision that are not covered through ceded taxes and fees, namely:

$UT_i = AC_i - CT_i - SF_i$,

UT_i = unconditional transfers (percentage of revenue-sharing in region *i*)

AC_i = costs of service provision before decentralization

CT_i = normative calculation of revenues from ceded taxes

SF_i = service fees (fees that were decentralized to regions along with the transfer of services)

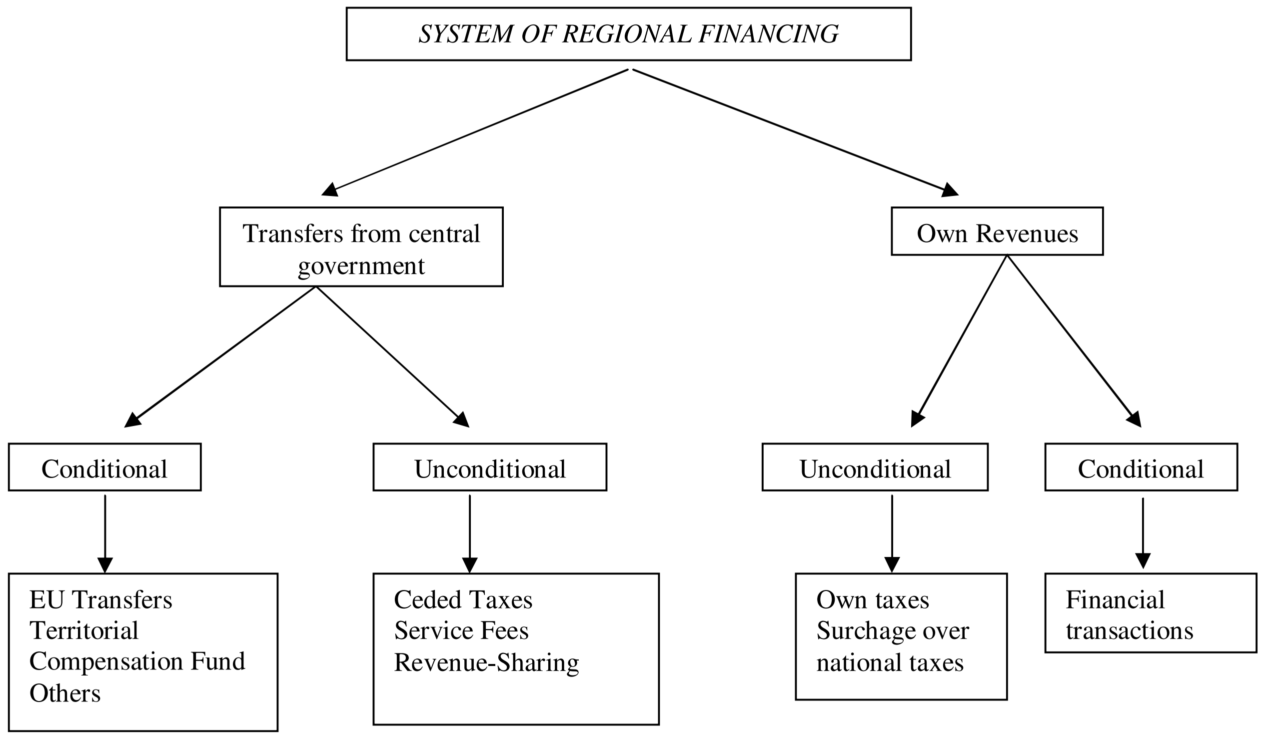
Figure 6.1 shows the main components of the regional system of financing. Transfers from central government also include conditional grants (Inter-territorial Compensation Fund and Development Funds from the European Union). However, the

---

yearly forecasted amount and if the actual yield turned out to be eventually higher than forecasted, the regional government accrued those "extra" funds (see Ruiz Almendral 2002: 15 and ff) (see Table A.3 in the annex).

[4] The LOFCA established that the calculation of the revenue-sharing percentage for each Autonomous Community would be made according to a procedure agreed on by the *Finance and Tax Policy Council* (FTPC, Consejo de Política Fiscal y Financiera). In 1982 the Council reached its first Agreement and adopted a method to calculate the revenue-sharing percentage for each regional government (Agreement 1/1982 on February 18th). However, the percentage could not be applied until all regional governments had been transferred ceded taxes, which was accomplished through the 30/1983 Cession of Taxes Act.

Figure 6.1. The system of regional financing in Spain



empirical analysis only deals with the allocation of unconditional funds.

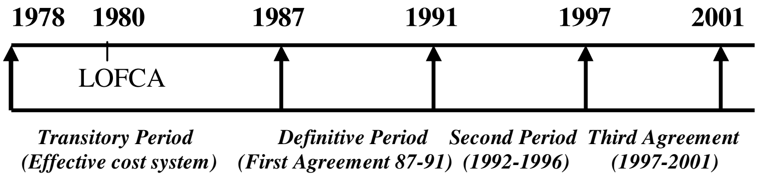
The early development of the regional financing model was carried out in two periods: the "transitory period" (which spans from the first transfers of authority to regions from 1979 until 1986, when all ACs had approved their Statutes of Autonomy) and the so-called "definitive period" (that began in 1987). Multilateral bargaining was encouraged by the LOFCA through the creation of a multilateral bargaining body (the Finance and Tax Policy Council,[5] FTPC hereafter). During the "transitory period" regional financing was annually determined through bargaining between each region and central government in bilateral commissions (Mixed Parity Commissions - *Comisiones Mixtas Paritarias*).[6] In

[5] The FTPC is a consultative body that was created to coordinate intergovernmental financing activities. The Council is composed of the national Ministry of the Treasury, the national Ministry of Economy and representatives from the regional Treasury offices. Despite the fact that Agreements at the FTPC have played a very important role in the evolution of the regional system of financing; Agreements are only binding on the regions if they ratify them in bilateral commissions. Otherwise, ACs *opt out* from the financing system that has been approved in the FTPC.

[6] In the early stages of the decentralization process the transfer of authority towards subnational governments was negotiated by each AC and central government in bilateral commissions (the so-called Mixed Parity Commissions for the Transfer of Services). In these commissions the transfer of authority came together with the corresponding financing. Central and regional representatives had to come to an agreement on the amount of material and human resources that had to be transferred for an effective provision of public goods and services. LOFCA regulations and the Statutes of Autonomy provided for bilateral bargaining bodies to regulate regional financing Mixed Parity Commissions, (which for some ACs would be the same as the Mixed Parity Commissions for Transfers). Accordingly, these Commissions would be responsible for the definition of a revenue-sharing system by which regional governments would be transferred a percentage of the taxes collected by central government. In addition, they would set up the conditions under which national taxes

these Commissions costs of service provision (before decentralization) were calculated and the resulting amount was then transferred to regions together with the responsibility for service provision.[7]

Figure 6.2. The evolution of the system of regional financing until 2001



From 1987 onwards, agreements lasting for a five-year period were established (see Figure 6.2) and a weighted formula to allocate resources across Communities was introduced. Formula parameters included socio-economic indicators, which were meant to measure regional financing needs. The resulting distribution of monies was then financed through regional ceded taxes and fees and unconditional transfers from central government (revenue-sharing percentages). In addition, regions were granted revenue guarantees. For instance, each Community was receiving under a new financing system at least as much as under the former one. Besides, from 1992 onwards, the distribution of resources was subject to modulation rules that would soften cross-regional

---

would be ceded towards Autonomous Communities (see Ramallo and Zornoza 2000: 61).

[7] During the transitory period of financing not all the services that had been transferred were included in the effective cost calculation and, in turn, in the revenue-sharing percentage. This gave rise to the creation of *ad hoc* transfers, the so-called conditioned subsidies and self-government subsidies (*subvenciones condicionadas* and *subvenciones de autogobierno*) that also financed expenditure that was not linked to transferred services (Ramallo and Zornoza 1995: 18).

disparities in per capita financing. Finally, the introduction of (limited) tax autonomy was approved together with a set of revenue guarantees aimed at covering the potential risks associated with the implementation of fiscal autonomy, which eventually became a disincentive for regional governments to make an effective use of their fiscal powers.

Table 6.1 summarizes the main characteristics of the regional system of financing throughout the analyzed period.[8] Firstly, regional financing has been based on a twofold asymmetric system. On the one side, fifteen out of seventeen regions receive resources through the common system of financing, whereas Navarre and the Basque Country are financed through special regimes that give them much larger taxation powers than the other Communities. On the other side, Autonomous Communities do not face the same financing needs, as those that accessed autonomy through the fast-track process gained higher levels of authority.

Table 6.1. Main characteristics of the regional common system of financing

1. ASSYMMETRIC
2. UNSTABLE
3. LOW FISCAL DECENTRALIZATION
4. BILATERAL AND POLITIZICED

A second characteristic of the system of regional financing is its instability. Although the FTPC 1986 Agreement marked the

[8] In this chapter I summarize the main features of the regional financing system since there is a more general description of the financing system in chapter 6.

beginning of the so-called "definitive period", the system of regional financing has been periodically revised. Reforms have not only taken place every five-years but important modifications have been introduced in the midst of the implementation of a financing agreement. Thirdly, transfers have played a far more important role than regional taxes in regional financing, which has resulted in a low level of fiscal co-responsibility and in the Communities' financial dependence on transfers from the central administration.

Finally, political agreements have been particularly relevant in accounting for the allocation of financing resources between different levels of government and across regions. For instance, many scholars state that during the "transitory period" costs of service provision were actually negotiated rather than calculated through bilateral bargaining. Transfers therefore seemed to be more based on a "bargained cost" criterion than in a real assessment of the costs of services involved[9] (Corona et al. 1999; Perulles 1988; Garcia-Mila 2004; Ruiz-Almendral 2003). Later, the establishment of the allocation formula was also the object of sharp criticism from different sectors. Some scholars have highlighted the *ad-hoc* nature of the distribution formula and criticized the lack of justification in the selection of the formula parameters and weightings. Overall the negotiation process has been defined as highly discretional, as agreements have taken place behind close doors and results have been made public only partially (Ruiz-Almendral 2003; Castells et al 2005: 73; Herrero 2005: 153).

---

[9] The existing accounting systems of the State were inadequate in calculating the actual costs of service provision, so the actual cost of services before decentralization was never actually determined. One of the problems of the "actual cost" calculus was that it perpetuated the inequalities in the provision of services that existed before central government transferred responsibilities. The calculus assumed that the existing distribution of resources before the process of decentralization had started was acceptable (Garcia-Mila 2004; Moldes 1996).

The importance of political agreements is directly related to the strong role of bilateralism in the bargaining process between the central administration and the Communities. Despite the fact that regional financing agreements were approved by a multilateral body, applicability was subject to the ratification of bilateral commissions. Negotiations between the State and regions usually proceeded in the following way. Firstly, regional representatives coordinated their demands in the multilateral meeting to obtain a higher *overall* amount of transfers from central government. Secondly, in bilateral negotiations, each regional representative tried to modify formula parameters so that the allocation would provide them with higher resources (Corona et al. 1998:59). Finally, apart from intergovernmental negotiations, bargaining between different political parties played a very important role in the configuration of regional financing, as well (see Aja 2003: 237; Grau 2000: 69). For instance, the dynamics of electoral competition impinged upon the reforms of the regional system of financing in 1993 and 1996.

In spite of the general agreement that the configuration of the regional system of financing in Spain has become a very *politicized* process, there is scant empirical evidence available that identifies the factors that have made some regions more powerful in influencing financing agreements. Did Communities whose bargaining position was weaker get less monies to exercise their authority? Which regions won the lions' share from the bilateral process? In summary, what do politicization and bilateralism mean? Bilateralism has been embedded in the regional financing system since its inception, but this tells us nothing about the main beneficiaries of political agreements. It may eventually empower central government against regional joint pressures as part of a "divide and conquer" strategy. Alternatively, bilateral negotiations may improve the bargaining position of regional governments ruled by the incumbent party at the central level. I use the theoretical framework presented in chapter two to explore the meaning and consequences of politicization and bilateralism in regional financing. More specifically, following hypotheses 1 and

2 I predict that central government will adopt different strategies in the allocation of regional financing depending on variations in the institutional context. Before testing these hypotheses I next describe the main features of the regional system of financing in each five-year period.

6.2.1. The regional system of financing for the definitive period: 1987-1991

In 1986 a regional financing agreement (1/1986 Agreement) marked the beginning of the "definitive" system of regional financing that lasted until 1991. A major innovation in the system was the introduction of an allocation mechanism to distribute resources according to regional needs. It was based upon a distribution formula that integrated the following variables: population, fiscal effort, relative wealth, administrative units, insularity and area. The weight of each indicator in the formula was different depending on whether regions had been transferred powers on education (See Table 6.2). Some of the formula variables had not been foreseen in the LOFCA regulations[10] (namely number of provinces,[11] area and insularity[12]) nor the weight given to each variable. For instance, a large weighting for the population variable converted the allocation of grants into a virtual per capita distribution, which for some scholars represents a clear deviation from LOFCA legal provisions. In addition, the

---

[10] The LOFCA enumerates some parameters that would form part of the allocation formula. However, at the same time it left room for the introduction of any other indicator of regional needs as *"any other criteria that are considered legitimate"* (article 13.1 of the LOFCA).

[11] Number of provinces within one region.

[12] The introduction of area and insularity could be justified on services provision's costs basis. However, these variables were redundant, as they had been already included in the allocation formula of the Interregional Compensation Fund (*Fondo de Compensación Interterritorial*) (Monasterio and Suárez 1993: 63).

Agreement introduced an automatic revision of the system on a five-year basis, although there was not such a provision in the LOFCA regulations (Ramallo and Zornoza 1995: 20, 23; Moldes 1996: 139).[13]

Table 6.2. Variables and their corresponding weight in the allocation formula for the period 1987-1991

Variables that measure financing needs	Regions with Powers on Education	Regions without Powers on Education
	Weight in the formula	Weight in the formula
Population	84.4	59
Area	15	16
Administrative Units	0	24.3
Insularity	3.1	0.7
Relative Poverty(*)	0.4	4.2
Fiscal Effort (*)	1.7	5
Constant for Adjustment	-2.5	0

Source: Finance and Tax Policy Council, 1986 Agreement.
(*) Redistributive variables

Finally, formula parameters were meant to measure costs of service provision (and therefore regional financing needs). However, the inclusion of redistributive indicators - relative

[13] The *Autonomous Communities Act* provides that, five years after the completion of the transitory period, regional governments or central government *may* request a revision of the system. But this is different from an *automatic* revision of revenue-sharing percentages. However, there is one exception: the Statute of Autonomy of one region – Comunidad Valenciana – does provide for a revision of regional financing every five years.

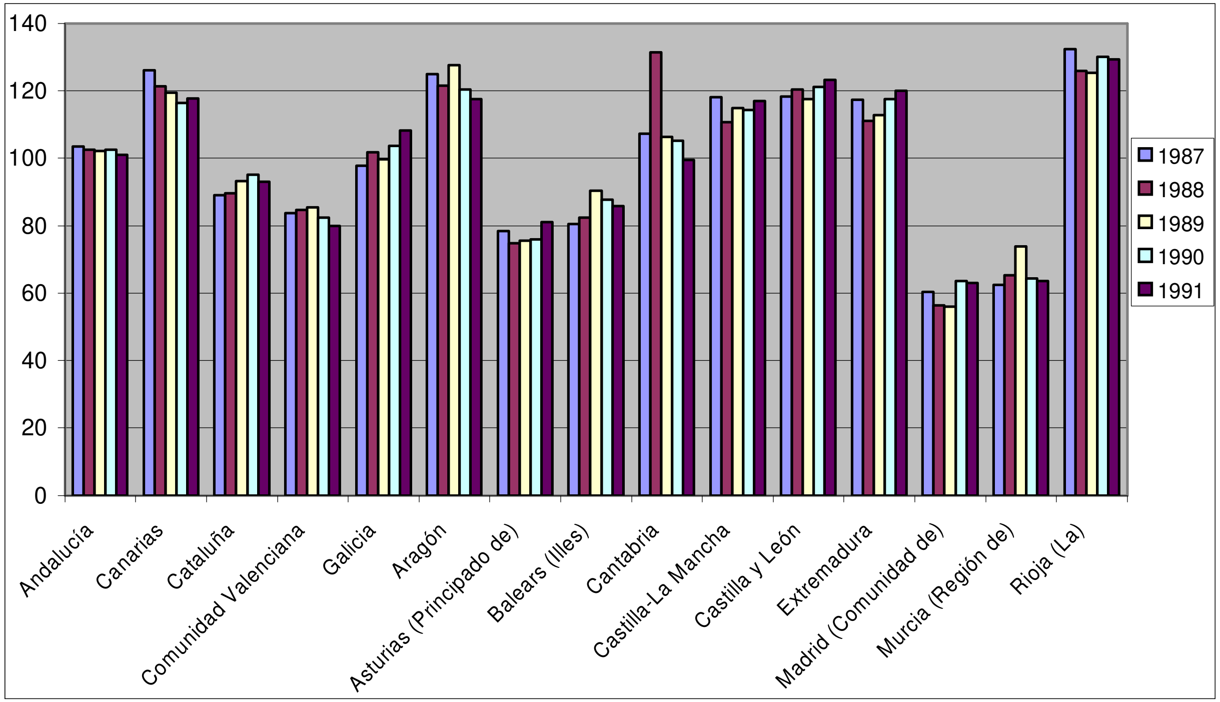
poverty and fiscal capacity – questions the idea of having an allocation mechanism that is a function of regional needs. All these deviations from LOFCA dispositions have probably much to do with the political nature of negotiations that gave rise to financing agreements. As a result, the calculation of regional needs is often defined as the consequence of a bargaining process whereas the allocation formula is accounted for as the outcome (and not the origin) of the resulting distribution of resources.

Figure 6.3 shows per capita unconditional financing across regions for the 1987-1991 period. Regional per capita financing is calculated as distance to the mean, which is standardized at 100. As Communities have accessed autonomy with different powers (fast-track vs. slow-track regions), per capita financing is a relative measure, as I only compare data among regions that have had the same level of authority transferred. For instance, regional financing in the Canary Islands is above the mean as compared to the other Communities that accessed autonomy through the fast-track process. There are also important differences across regions in per capita unconditional financing. The Communities that most benefited throughout the period are the Canary Islands, Aragon, La Rioja and Castilla-León. On the contrary, Madrid, Murcia, Comunidad Valenciana, Baleares and Asturias show below-the-average per capita financing rates. Standard deviation is higher across regions than over time (within each region). This means that the evolution of regional financing over time shows lower differences than variation across regions. Besides, cross-regional variation is higher among the slow-track regions than among fast-track Communities.

6.2.2. The regional system of financing for the second definitive period: 1992-1996

In 1992 the Autonomous Communities and central government reached a new Agreement in the FTPC that gave rise to the second "definitive" model of regional financing. Among the

Figure 6.3. Per capita unconditional financing (in euros) for the 1987-1991 period



new regulations provided for in the Agreement there are some that deserve special mention, namely the introduction of new formula parameters and weightings to calculate regional needs (see Table 6.3). More specifically, an indicator of "disperse population" was introduced and the weight given to the redistributive variables was modified. In addition, regional governments were granted a minimum funding equal to what they had received in the base year 1990 through revenue-sharing, ceded taxes and other subsidies.

Table 6.3. Variables and their corresponding weight in the allocation formula. 1992/1996 Regional Financing Agreement

Variables	Regions with Powers on Education	Regions without Powers on Education
	Weight in the formula	Weight in the formula
Population	94	64
Area	3.5	16.6
Administrative Units	0.4	17
Insularity	1.5	0.4
Dispersed Population	0.6	2
Relative Poverty	2.7	2.7
Fiscal Effort	1.82	1.82
Constant for Adjustment	0	0

The 1992 Agreement explicitly excluded the possibility of increasing the number of ceded taxes but regions agreed on the creation of a study group that would evaluate the possibilities of increasing regional fiscal autonomy. Immediately, in October 1993, regional and central government representatives reached a new Agreement in the FTPC (Agreement 1/1993 October 7th). This Agreement was aimed at increasing regional governments' fiscal co-responsibility. In practice, however, the financing system virtually remained the same and regions continued to be predominantly financed through transfers from central government. Regional governments were granted 15% of the personal income tax yield collected by the central administration within their territory. Communities only accrued the difference between the amount of regional income tax yield *forecasted* by central government and the *actual* income tax yield. In consequence, regions were only obtaining extra funding when the actual income tax yield turned out to be eventually higher than the amount forecasted by central government. This can hardly be interpreted as a result of tax autonomy. In addition, even if the actual yield was higher than forecasted, the Agreement set up a limit on the extra funding.[14] In summary, the new system of financing was meant to advance regional fiscal co-responsibility. However, limits imposed on regional fiscal autonomy widely questioned the supposed aim of the reform. In addition, regional governments lacked control over the fiscal tools that would eventually make the income tax yield higher than the amount forecasted by central government. For instance, powers over income tax regulations or fiscal inspection remained at the central level and as operation of the Tax State Agency (Ramallo and Zornoza 1995: 27; Ruiz-Huerta 1993: 538).

The modification of the system of regional financing through the 1993 Agreement is directly linked to the distribution of power triggered by the dynamics of electoral competition. More specifically, in the 1993 general elections, the Socialist Party won the elections without an absolute majority. This obliged the Socialists to form an alliance with nationalist parties - *Convergencia i Unio* and *Partido Nacionalista Vasco* - that had representation in the national parliament. These parties agreed to give parliamentary support to the Socialists in return for a modification of the regional system of financing.

[14] Monies received through the income tax yield could not be higher than the revenue-sharing percentage calculated according to the 1992 Agreement regulations. If this were the case, then regional governments would receive the amount accrued through the revenue-sharing percentage method.

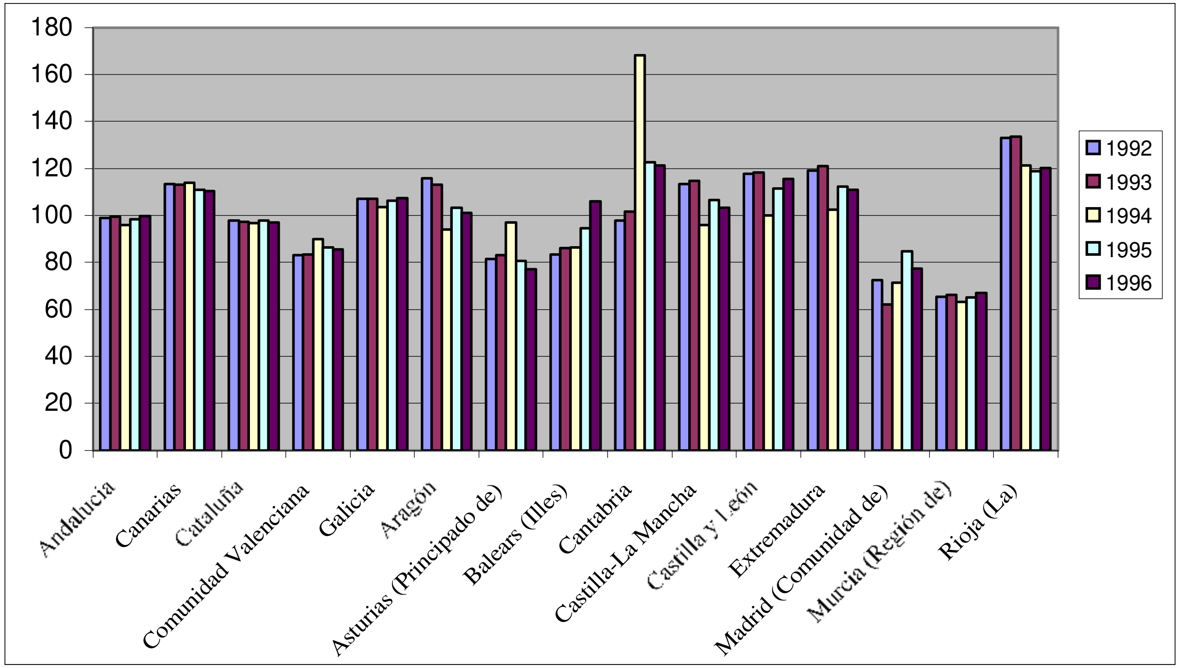
Figure 6.4 exhibits regional per capita unconditional financing for the 1992-1996 period. Communities with per capita financing above the group mean are the same as in the former five-year period (Canary Islands for the fast-track group and La Rioja, Cantabria, Extremadura, Castilla-León and Castilla la Mancha for the slow-track group) except for Galicia, which was not included among the regions with highest per capita financing in the previous system of financing.

As for below-the-mean per capita financing, Madrid and Murcia yield the lowest rates again. Cross-regional variation in per capita financing as well as variation over time continues to be higher among slow-track regions. In sum, as far as per capita relative positions are concerned, continuity is the most defining characteristic of this period. However, regions that accessed autonomy with lower powers show higher levels of variation across time than in the former period. Marked upturns and downturns over time may be accounted for by several factors: the transfer of authority towards slow-track regions over university-level education and social services (these powers were decentralized between 1995 and 1996) or the introduction of the (limited) cession of 15% of personal income tax (see Tables A.2 and A.3 in the annex).

6.2.3 The regional system of financing for the definitive period: 1997-2001

In September 1996 a reform of the regional finance system was introduced that gave regions more tax powers. First, the personal income tax partially became a ceded tax. Secondly, regionalgovernments were endowed with powers to regulate some aspects of ceded taxes – mainly tax brackets, tax rates and some tax credits. Revenues from ceded taxes still accrued to the Communities on the basis of taxes paid by their residents but regions could use tax autonomy to raise revenues from ceded

Figure 6.4. Per capita unconditional financing (in euros) for the 1992-1996 period



taxes.[15] These reforms represent a considerable change to the former models, where Communities' legislative powers on taxes were virtually non-existent.

The main objective of the 1996 reform was to make Communities more responsible for the financing of expenditure powers that they had already assumed. Factors that lay behind the reform included the increasing imbalance between regional spending responsibilities and their limited powers on taxation. However, the implementation of the new system of financing during the five-year period did not create incentives for regions to exercise taxation authority.[16] On the contrary, regions tended to use tax authority to introduce tax exemptions, from which regional governments could obtain electoral benefits (Monasterio 2002: 22; Ruiz Almendral 2002). Finally, three regions – Andalusia, Extremadura and Castilla la Mancha - did not ratify the financing agreement so that they remained financed through the former system.

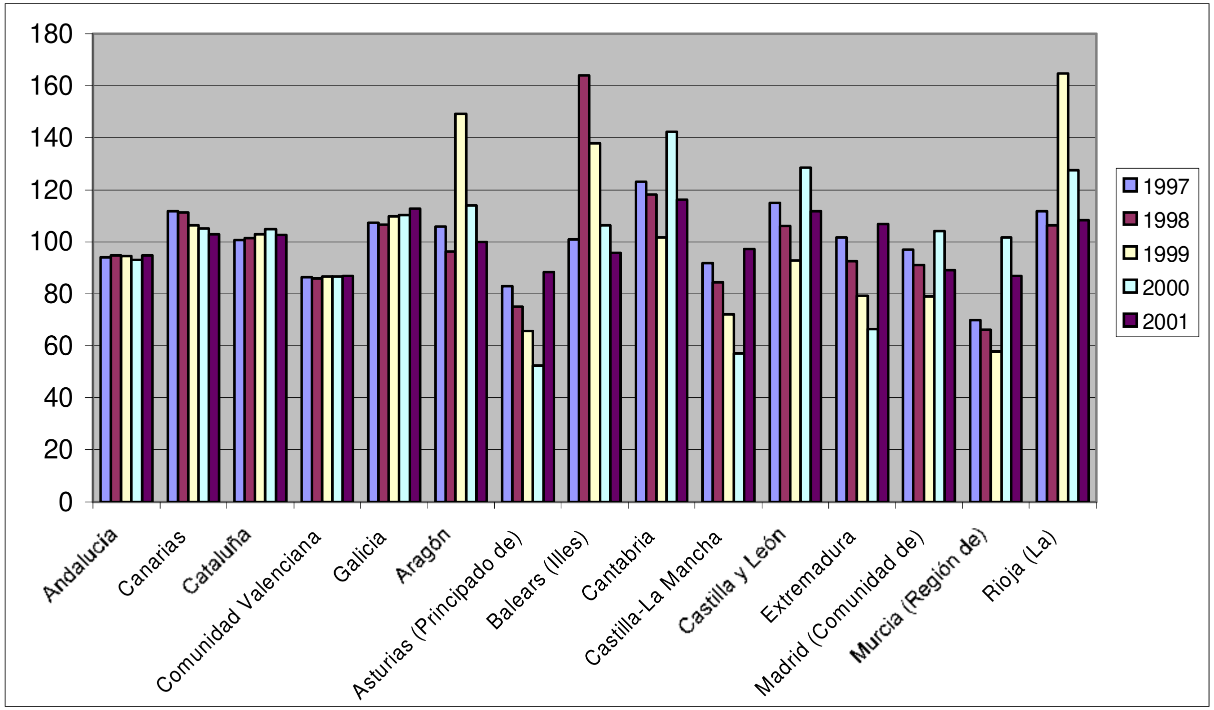
Figure 6.5 shows per capita regional unconditional financing from 1997 to 2001. As compared to Figures 6.3 and 6.4, coefficients show higher variation across time and regions and significant changes in the relative position of some Communities

---

[15] Fifteen per cent of the Personal Income Tax rate was ceded to Communities. The ceded percentage was meant to increase to 30% once the transfer of powers on Education towards regional governments was completed. However, after the process of decentralization of Education powers was finished, the ceded percentage of the personal income tax was not modified (Monasterio 2002: 20).

[16] The reform established a set of revenue guarantees aimed at covering the potential risks that the exercise of taxation powers could involve. Regions were granted a yearly increase of (the ceded percentage of) income tax revenues equal to GDP growth (or equal to 90% of income tax revenues of the State if GDP growth was higher than the increase of State income tax revenues). However, in 1998 a new agreement was reached in the FTPC by which regions were granted an increase of income ceded revenues equal to nominal GDP growth. As a result, regions lacked of incentives to exercise taxation authority.

Figure 6.5 Per capita unconditional financing (in euros) for the 1997-2001 period



can be observed. Galicia takes up the leading position in the fast-track group whereas Comunidad Valenciana continues to show the lowest coefficient. Per capita financing in Catalonia has increased so that for the first time this region displays an above-the-mean coefficient. On the other hand, per capita financing in Andalusia has slightly decreased below the group average. As for slow-track Communities, major changes have occurred. La Rioja and Cantabria still display the highest coefficient together with Baleares, a newcomer to the-above-average positions. At the lower end of the distribution Murcia remains the laggard and Madrid – which was in the last but one position in former financing systems – ranks close to the group average. The most remarkable changes occur in Extremadura and Castilla la Mancha. By opting out from the 1996 financing agreement these regions rank worse, as their coefficients fall below the group mean. Per capita financing shows notable upturns within the slow-track group. This is the result of some high-spending services being transferred during this period (such as non-university education – see Table A.2 in the annex).

6.3. Introducing the theoretical framework

In the previous section I have described the main features of regional financing agreements and the consequent distribution of unconditional funds. On the one hand, we know that financing rules have been subject to both intergovernmental political bargaining and negotiations between political parties. On the other, outcomes in terms of per capita unconditional financing show remarkable differences across regions. In order to establish a link between regional financing rules and the resulting distribution of funds we need to introduce theoretical arguments. These arguments have been discussed in Chapter 2 and provide us with the causal mechanisms to account for what regions get the lion's share of unconditional funds in each five-year period. These mechanisms have to do with the political characteristics of regions and the structure of incentives that stem from the degree of decentralization.

In the next section I use this theoretical framework and the corresponding hypotheses to carry out the empirical analysis. I explore whether the design of regional financing rules from 1987 until 2001 corresponds to any one of the allocation strategies set up in Hypothesis 1 (H_1) and Hypothesis 2 (H_2). [17]

The institutional context in Spain has significantly varied between the first and third regional financing agreement. In order to test whether this variation has had any effect on the allocation of funds I assume that the first model of regional financing (1987-

---

[17] According to H_1 in a centralized context central government politicians will have incentives to distribute more transfers to swing regions, regardless of their party affiliation. H_2 states that in a decentralized context central government politicians will have incentives to skew more resources towards affiliated regions and, among them, towards the ones whose political support and resources are crucial to win national elections. The basic argument is that in a highly decentralized context central government politicians are not fully capable of designing and using transfers according to what I have defined as *supply* characteristics because there are other factors that shape politicians' decisions. These factors fall within the *demand-side* approach, where the allocation of transfers results from the capacity of subnational politicians to successfully press central government for more monies. The difference between the supply-side and the demand-side approach basically lies in the leverage that subnational governments can exert over national politicians to shape the distribution of resources. In the first hypothesis supply-side mechanisms are in place in the allocation of unconditional funds. This means that politicians fully incorporate the political characteristics of jurisdictions into their calculations and subnational politicians' particular demands play no role in this process. On the other hand, in a decentralized context the demand-side approach predominates and intergovernmental transfers reflect the unequal bargaining power of subnational executives to press central government for their demands. Those jurisdictions that combine both an affiliated executive and high Party power will be the most favoured in the allocation of unconditional financing.

1991) took place in the low decentralized context from which I derived H_1 in Chapter 3 (see Table 6.4). A second assumption is that the institutional setting where the third definitive system of financing was enacted and implemented applied (1997-2001) is equivalent to the high-decentralized context from which I derived H_2. As decentralization is a gradual process, the institutional context in the 1992-1996 period falls into intermediate levels of decentralization. Empirical work will reveal whether the allocation pattern of unconditional funds in this period follow predictions in H_1 or H_2.

Table 6.4. The institutional context in each model of regional financing and corresponding hypothesis

Model of regional financing	Institutional setting	Hypothesis
Model (1987-1991)	Centralized	H_1
Model (1992-1996)	Transition	¿?
Model (1997-2001)	Decentralized	H_2

It is not easy to draw a neat line between different degrees of decentralization during the relatively short period of time in which the devolution process has taken place.[18] Additionally, it has occurred gradually and proceeded in different paths for distinct policy areas. Nevertheless, in spite of these considerations, it is possible to draw some distinctions between the institutional context in the mid eighties and the context in the mid to late nineties. When, in November 1986, a new regional system of financing was agreed in the FTPC, the institutional setting was characterized by a highly disciplined and centralized party system

[18] The measurement of decentralization continues to be a highly discussed topic among scholars (see Chapter 4).

and a powerful central government (as the devolution of expenditure powers was not finished for fast-track regions and slow-track regions had limited powers over expenditures). In addition, at that time regional institutions had been recently created so that their salience and level of entrenchment was low.[19] This context fits with the low decentralized institutional setting from which I derived H_1. When the second definitive system of financing was approved, the system was about to undergo some important changes. In 1992 regions that had accessed autonomy with lower level of competences were formally granted the same level of expenditure powers as fast-track regions, although the bulk of new services were transferred in the mid to late 1990s (starting in 1995, when several ordinary ACs received powers on university-level education). Spain gradually became a more decentralized country, and this is not only reflected in the level of expenditure powers transferred to regional governments but also in some other features, such as the weakening of electoral externalities across levels of government (see chapter 5). Finally, the period when the third definitive model of regional financing is

[19] There is some empirical evidence that supports the assumption about the level of entrenchment of regional institutions when the regional allocation system was agreed. The analysis of several opinion polls shows that citizens' interest and knowledge of regional institutions was very limited during the 1980s. For instance, in 1984, 64% of people interviewed considered that those political decisions made by the regional government either hardly affected them or not at all. In addition, between local, regional, national or international political issues, the regional level is the one that raised least interest among interviewees. Besides, regional administration is consistently regarded as worse than central government's administration (24% of people interviewed considered regional administration as 'bad' or 'very bad' while for central government's administration the percentage is 14%) (See Cis 1390 - January 1984 (Questions 2 and 10); Cis 1406 - March 1984 (Questions 10, 11 and 13); Cis 1517 - February 1986 (Question 11)). The analysis provides similar results for regional samples (Madrid, Andalusia and Extremadura) (See Surveys coded as Cis 1859, 1425, 1451, 1544, 1775, 1512, 1547).

implemented (1997-2001) parallels the completion of the decentralization process that put slow-track regions' competences on a level with fast-track ACs. Authority over health care services and primary and secondary education were transferred towards slow-track regions while the third definitive model of financing was being implemented.

Before assessing the empirical analysis, two questions are worth raising here. First, the main purpose of the empirical work I undertake in the next section is to understand whether the distribution of unconditional funds is the result of central government's strategies. The distribution of funds formally responds to an allocation formula based on indicators of needs. Virtually all formula variables can be justified and rationalized on a criterion of "need", that is, on socio-economic and geo-demographic regional characteristics by which regions may require additional funding for the provision of services and goods (such as disperse population or insularity). Nevertheless, my empirical analysis starts from the assumption that the selection of these variables and their corresponding weight in the formula conceal hidden objectives and that the actual distribution of unconditional funds is the resulting *outcome* of implicit goals. For that reason there are no variables from the allocation formula included as exogenous factors to account for the allocation of unconditional transfers. Instead, I use a different set of explanatory variables that measure political and electoral regional characteristics. I assume these regional features enter into the consideration of politicians when having to decide on the distribution of monies.

Secondly, regions were supposed to receive unconditional funds as calculated through the allocation formula. This percentage was fixed for the five-year period – unless tax cession or new transfers occurred. Regional funds were yearly updated according to the evolution of central government revenues from direct and indirect taxes and social security and unemployment contributions.[20] Therefore, in designing the model of regional financing, politicians had an effect on the distribution of unconditional funds in a twofold way. On the one hand they chose the static elements of the financing system (such as the allocation mechanism: selection of variables and weighting of indicators in the allocation formula). One could then argue that a cross-sectional analysis would be the best estimation method for analyzing static financing features. Accordingly, analysis of the allocation of unconditional financing in 1987 would provide the distribution pattern for the remaining years of the period (as subsequent increases would simply respond to automatic financial updates). In this case differences across units (regions) would theoretically remain the same over time while differences within units would only be the result of revenues' yearly updates.

However, politicians agree on the factors that determine the evolution of the model, as well. These are the *dynamic* elements of regional financing, such as modulation rules or the selection of an index to update unconditional funds on a yearly basis. Political bargaining also affects regulations on the evolution of regional financing over time. Informational asymmetries between levels of government exist that provide some informational advantages to central government in designing the evolution of regional financing over time. For instance, the index to update regional unconditional funds has traditionally been linked to economic indicators such as the evolution of the central administration's revenues or GDP growth. Regional governments lack information on these indicators whereas central government is more capable of predicting the shape of the economy in the future. To explore how

[20] The evolution of regional financing was limited to an upper and lower limit. The increase of revenue-sharing percentages could not be less than the annual increase in the level of expenditures of the central Administration (calculated as expenditures on selected central government Departments and Autonomous Organizations (*Organismos Autónomos*)) and could not be higher than the annual increase of nominal GDP (section 3.2 of the 1986/Agreement and section II.6 of the 1992/Agreement).

political bargaining has impacted upon the evolution of regional financing over time it is more appropriate to use cross-sectional time-series analysis.

In sum, cross-sectional data analysis is the proper estimation method to account for the design of *static* features in each financing Agreement. However, problems in the estimation of econometric models arise as a consequence of the small sample (15 observations). On the other hand, cross-sectional time-series data analysis allows us to estimate the impact of dynamic factors on the distribution of unconditional financing over time. We count on a larger sample with this estimation method (75 observations in each five-year period), though a disadvantage is that it cannot adequately pinpoint reforms that take place within each five-year period (for example, for reforms in 1993 or in 1998). Following these considerations, I have estimated econometric models with both cross sectional and cross-sectional time-series data. The key results are presented in section 5.

6.4. Data, variables and econometric model

6.4.1. The econometric model

The dependent variable is regional *per capita* unconditional financing from 1987 to 2001. Data comprises the first, second and third *definitive* models of regional financing and involves a total of 225 region/year observations (75 observations in each system of financing). Regional unconditional funds consist of three main sources of regional revenues: ceded taxes, fees and the revenue-sharing percentage.[21,22]

---

[21] Unconditional funds vary across models of regional financing. In the 1987-1991 period unconditional financing comprises revenues from ceded taxes, fees, the revenue-sharing percentage and the so-called “extraordinary compensation funds” (*Compensaciones Extraordinarias*). Compensation funds were subsequently integrated within the general revenue-sharing percentage. In consequence, for the 1992-1996 period

The main independent variables in the analysis measure political features of ACs. First, I have operationalized regional electoral characteristics through a dummy variable (***Swing***) that is coded as 1 for regions *at risk* (that is, regional governments that were either at risk of being lost or won by the incumbent party at the center in regional elections).[23] Party affiliation (***Affiliation***) is an indicator of political affiliation that equals 1 when the incumbent at the central level and the incumbent at the regional level are copartisans (when they belong to the same party), and 0 otherwise. A third political variable measures the percentage of votes that regional representatives from the incumbent party at the center receive in national elections. I assume that the internal organization of the party is embodied by (and led by) politicians who come from regions where the party is traditionally strong in elections. Members from the party organization want central government to skew resources towards regions that represent

---

unconditional revenues include ceded taxes, fees and the enlarged revenue-sharing percentage. Finally, unconditional funds for the 1997-2001 consist of ceded taxes, fees, the revenue-sharing percentage and revenues from the so-called Security Fund (*Fondo de Garantía*).

[22] In Spain provinces represent an intermediate level of government between municipalities and the regional administration. Seven ACs are composed of only one province and, therefore, funds to finance the provincial administration are integrated within regional financing. Up to 1994, one-province regions were receiving provincial funds through conditional grants. However, in 1994, provincial grants in *Cantabria* and *Madrid* were included in the general revenue-sharing percentage. In order to homogenize financing across one-province regions between 1994 and 2001, I deducted the amounts corresponding to provincial funds from general entries of unconditional financing in *Madrid* and *Cantabria*.

[23] I code swing regions by taking into account three factors: first, electoral results of the incumbent party at the center in previous regional elections. Second, I measure whether there is a potential winning coalition that allows the incumbent at the center either to win a regional government or to lose it. Third, I compare electoral results of the central incumbent party in the previous general election.

electoral strongholds. Therefore I call this variable ***Party Power,*** as it is aimed at measuring whether central government's allocation strategies are influenced by distributional preferences from the party apparatus. I expect the influence of the party apparatus to be higher as regional elites gain power within the internal organization of the party. In a centralized context, members from core-support regions align with the party's national guidelines. But we know from theoretical and empirical work in Chapter 4 that the internal organization of a political party is modified as a result of political and fiscal decentralization. Regional elites gain more authority within the party apparatus. In consequence, in a decentralized institutional setting the *Party Power* variable will capture demands from the party apparatus, which basically consist in demands from regional party leaders that control core-support regions.

I need to control for other non-political factors that account for differences in per capita financing across time and regions. As was explained above, ACs differ in the level of powers that were transferred to them. Per capita financing will accordingly be higher in those regions that took on broader powers, as they face higher financial needs. For this reason I introduce a dummy variable that controls for the level of expenditure powers that regions assumed when accessing autonomy (***Competences***). This variable is coded as 1 for fast-track regions (with higher levels of competences) and 0 for slow-track regions. In addition, this variable also controls for the fact that slow and fast-track regions, until 1994, applied different indexes for the yearly update of unconditional funds.[24]

Although regions accessed autonomy through different legal proceedings, slow-track regions were granted the same level of authority in the *Autonomous Pacts* of 1992. These pacts resulted in a steady drip of tax and expenditure transfers from approximately the mid-1990s approximately. To control for the ongoing devolution process I have created a variable called ***New transfers***

[24] See Utrilla (2002).

that is coded as 1 when there is a modification of regional unconditional financing due to a transfer of service provision and 0 if no transfer takes place. Finally, variation across-time and regions in per capita unconditional financing may originate in ceded taxes, as their actual yield could be higher/lower than the normative amounts used to calculate the revenue-sharing percentage. I therefore control for the evolution of ceded taxes' yield (a variable defined as ***Ceded Taxes***).[25]

---

[25] In controlling for the decentralization of new services or the yield of ceded taxes I assume that these variables are exogenous to the political process. However, some of the characteristics of transfers or ceded taxes could be potentially endogeneized. For instance, as for ceded taxes, regions were accruing the difference between a normative forecasted amount and the real tax yield. This amount varied according to two factors. The first factor is regional administration of ceded taxes. Higher yields could result from a successful regional administration of the ceded tax, which is unrelated to regional political features. The second factor has to do with bilateral negotiation of ceded taxes. Before taxes were ceded, central government and the corresponding region had to come to an agreement on the (forecasted) tax yield that would be discounted from unconditional transfers. A low forecasted tax yield would grant regions higher resources through unconditional grants. In addition, this would allow regions to accrue higher revenues from real tax yields. Following these considerations we could say that ceded taxes were the result of regional bargaining power and in turn of political strategies, as well. In consequence, ceded taxes should not be included as exogenous variables in the econometric model. A similar argument could be used regarding decentralization of new services. As it was explained above, costs of service provision were negotiated in bilateral commissions. Regions had incentives to raise costs, as this strategy would grant them more revenues through unconditional grants. However, with existing data it is impossible to measure if costs of service provision were overvalued. In sum, one may believe that transfer of expenditure powers and cession of taxes respond to a political strategy as well. That is, that they may be endogenous to the electoral and partisan variables in the specified model. However, if I do not include them in the regression as control variables, then I omit the effects of non-political factors (such as the administration

Following the theoretical assumptions, incumbents at the central level are strategic and forward-looking so that, when having to decide on the allocation of transfers, they adopt a distributive strategy that can immediately advance their electoral goals. Electoral and party features of regions enter their calculations, which come on stage during the intergovernmental bargaining process. Per capita financing at time *t* is then the result of the existing electoral and party regional features at time *t-1* (when the bargaining process takes place). This tries to represent as accurately as possible how the process unfolds in reality. For instance, unconditional transfers figure in the State Budget Act, which is enacted at the end of each year (December) and regulates the terms of the budget for the following year. In consequence, regional financing is an outcome of the political and institutional setting in which the drawing-up of financing provisions evolve.

The basic econometric model is the following:

$$\textbf{\textit{Per capita financing}}_{it} = \beta_0 + \beta_1 Swing_{it-1} + \beta_2 Affiliation_{it-1} + \beta_3 Party\ power_{it-1} + \beta_4 Compentences_{it} + \beta_4 New\ transfers_{it} + \beta_5 Ceded\ Taxes_{it} + u_{it} \qquad (1)$$

In the interest of grounding empirical findings in as much empirical evidence as possible, I have calculated the dependent variable in two additional ways: first, as *relative* per capita unconditional financing.[26] This variable measures regional per

---

of ceded taxes or (non-overvalued) resources to finance decentralized services) that account for differences in per capita regional financing.

[26] The most important advantage in calculating unconditional financing as a relative measure is that it allows testing hypothesis with fixed-effects estimation. Fixed-effects do not permit the use of explanatory variables that do not vary over time (as is the case with the *Competences* variable). Therefore, the econometric model of equation 1 cannot be estimated with fixed-effects, as the Competences variable would drop from the regression. Alternatively, the elimination of the

capita financing as compared to the group average (slow-track group vs. fast-track group). Second, I calculate the increase of unconditional funds on a yearly basis.[27]

Relative per capita financing$_{it}$ = β_0 + β_1*Swing*$_{it-1}$ + β_2*Affiliation*$_{it-1}$ + β_3*Party power*$_{it-1}$ + β_4*Compentences*$_{it}$ + β_4*New transfers*$_{it}$ + β_5*Ceded Taxes*$_{it}$ + u_{it} *(2)*

Yearly increase in per capita financing$_{it}$ = β_0 + β_1*Swing*$_{it-1}$ + β_2*Affiliation*$_{it-1}$ + β_3*Party power*$_{it-1}$ + β_4*Compentences*$_{it}$ + β_4*New transfers*$_{it}$ + β_5*Ceded Taxes*$_{it}$ + u_{it} *(3)*

6.5. Empirical analysis

6.5.1. Cross-sectional data

6.5.1.1. First definitive system of financing (1987 – 1991)

Table 6.5 displays regression results for the estimation of equation (1) on cross-regional data from the first model of regional financing (1987-1991). Results give reasonable support to H_1. There is a positive and significant correlation between the amount of transfers each region receives and the swing nature of the regional government. This means that, as predicted, regions *at risk* received a higher amount of per capita transfers than regions that were not at risk, that is, where the Socialist regional incumbent was not challenged or where the likelihood of taking

---

Competences variable from the econometric model would generate an omitted variable problem.

[27] The introduction of this variable aims at controlling for *financing inertia*. Each regional financing agreement gives rise to an allocation of funds that might be modified during the implementation period. These modifications may not be captured through the relative per capita financing variable (or through raw per capita financing of equation 1).

Table 6.5. Cross-sectional analysis on unconditional financing (from 1987 to 1991)

Variables	R1: 1987	R2: 1988	R3: 1989	R4: 1990	R5: 1991
Competences	135.27 (15.75)***	157.84 (12.56)***	176.35 (15.10)***	211.95 (22.08)***	236.06 (17.79)***
Affiliation	26.45 (14.22)	-13.68 (11.43)	-16.45 (12.06)	-35.08 (25.67)	-77.62 (26.36)**
Party Power	-.586 (1.41)	1.76 (1.12)	2.54 (.788)**	4.57 (1.92)**	7.49 (1.67)***
Swing	35.60 (11.15)**	54.25 (9.33)***	63.40 (13.78)***	57.85 (24.10)**	78.80 (21.17)***
Revision		-15.44 (12.01)		2.24 (25.07)	
Ceded Taxes	1.67 (.777)	-.209 (.229)	.882 (.507)	1.63 (1.46)	1.31 (1.05)
Constant	61.73 (48.15)	43.60 (52.28)	-7.92 (35.31)	-42.91 (76.14)	-104.37 (61.12)
R2	0.92	0.96	0.96	0.94	0.95
N	15	15	15	15	15
Method	OLS	OLS	OLS	OLS	OLS

Note: Robust standard errors are in parentheses. Levels of statistical significance are *** $p < 0.001$ ** $p < .005$ $p < .1$

over was very low. As predicted in H_1, swing regions obtain higher resources regardless of their party affiliation. There are 34 observations coded as swing during the five-year period and a majority of them (21) belong to non-affiliated regions. In consequence, the coefficient of the *Affiliation* variable is negative in most years, although only significantly different from zero in regressions 3 and 5.

There is a positive and significant effect of the *Party power* variable in regressions 3, 4 and 5, although it is considerably smaller than the effect of the *Swing* variable. This result indicates that in a centralized context central government favors electoral strongholds when designing the model of regional financing. I assumed that party members who come from electoral strongholds dominate the party apparatus. Therefore, the coefficient of the *Party Power* variable reveals that the party apparatus allocation preferences enter central government's allocation strategies. Finally, the coefficient of the *Competences* variable shows a strong and significant effect over the dependent variable. This is the result of fast-track regions having higher financing needs (as they had accessed autonomy with broader expenditure powers than slow-track regions).

As for the yearly increase in per capita financing (Table 6.6), cross-regional results corroborate H_1, as well. As was explained above, each regional financing agreement gives rise to an allocation of funds that might be modified during the implementation period. These modifications may be captured through variations in the yearly increase of per capita financing. Results in Table 6.6 corroborate the fact that swing regions have benefited from modifications subsequent to the 1986 financing agreement.

In summary, cross-sectional analyses show that politicians design and use transfers taking into account regional electoral and political characteristics. Results corroborate H_1: in a centralized context the swing nature of regional jurisdictions entails a higher amount of per capita unconditional grants. In addition, core-support regions receive higher per capita transfers than the rest,

Table 6.6. Cross-sectional analysis of increases in per capita unconditional financing (from 1987 to 1991)

Variables	R1: 1987	R2: 1988	R3: 1989	R4: 1990	R5: 1991
Competences	21.36 (7.17)**	26.17 (2.49)***	20.05 (2.31)***	28.56 (5.70)***	40.48 (6.34)***
Affiliation	14.33 (13.95)	4.71 (3.31)	-2.51 (2.44)	-13.56 (8.44)	-14.62 (7.27)*
Party Power	-.247 (.618)	.100 (.232)	.152 (.149)	1.34 (.662)*	1.07 (.501)*
Swing	21.36 (22.30)	13.67 (2.50)***	5.35 (2.49)*	9.65 (6.30)	13.28 (6.47)*
Revision		-.923 (3.42)		8.40 (6.19)	
Ceded Taxes	1.72 (.838)**	.364 (.053)***	.791 (.134)***	1.27 (.386)**	1.02 (.345)**
Constant	2.23 (35.82)	-12.58 (10.54)	-5.738028 7.15	-33.54 (28.92)	-29.70 (20.31)
R2	0.37	0.96	0.97	0.83	0.90
N	14	14	14	14	15
Method	OLS	OLS	OLS	OLS	OLS

indicating that the distribution of power in the internal organization of the party enters central government's allocation strategy.

6.5.1.2. Second definitive system of financing (1992 – 1996)

Table 6.7 displays cross-sectional regression results for the second definitive system of regional financing (1992-1996). Overall, results show continuity with the former allocation pattern and therefore support predictions from a centralized context (H_1). However, the econometric model performs worse, as variables show fluctuating levels of significance across regressions. As compared to results in Table 6.2, the sign of political explanatory variables remains the same in regressions 1, 2, 3 and 4. That is, the *Affiliation* variable has a negative sign, whereas the *Swing* and *Party Power* variable continues to have a positive impact on the dependent variable. A significant change occurs in regression 5, where the coefficient of the affiliation variable turns positive. This may represent the first sign that the allocation pattern begins to react to a more highly decentralized context.

After the 1993 general elections a modification of regional financing was agreed in the FTPC. New regulations were implemented in 1994 and 1995 (and were extended for 1996). The allocation of transfers in 1994 and 1995 was established according to different proceedings for each region, as there were three ACs that did not accept the new system.[28] The implementation of the new model brought more resources to non-affiliated regions, as the estimated coefficient of the *Affiliation* variable shows a significant and negative coefficient (regression 3). This continues to be the allocation pattern for subsequent years, except for regression equation 5, where the affiliation variable shows a

[28] These regions were *Extremadura*, *Castilla-León* and *Galicia*. In 1995 the only region where transfers were allocated according to the first model of regional financing (approved in 1986) was *Extremadura*.

Table 6.7. Cross-sectional analysis on unconditional financing (from 1992 to 1996)

Variables	R1: 1992	R2: 1993	R3: 1994	R4: 1995	R5: 1996
Competences	291.24 (24.75)***	326.33 (27.27)***	285.34 (21.74)***	295.02 (23.75)***	349.99 (28.86)***
Affiliation	-48.35 (33.86)	-37.83 (31.39)	-110.98 (22.03)***	93.22 (24.95)***	179.51 (74.52)**
Party Power	3.21 (2.86)	2.89 (2.68)	7.78 (2.30)**	4.75 (2.81)	-10.77 (4.59)**
Swing	92.19 (34.02)**	64.44 (27.59)**	100.63 (43.49)**	52.77 (34.36)	8.79 (21.66)
Revision					
Ceded Taxes	-3.18 (1.16)**	4.59 (1.40)**	1.23 (.151)***	.273 (.601)	4.83 (2.05)**
Constant	107.53 (111.55)	116.10 (102.45)	-2.10 (88.33)	134.44 (105.67)	648.65 (158.82)***
R2	0.94	0.94	0.93	0.94	0.93
N	15	15	15	15	15
Method	OLS	OLS	OLS	OLS	OLS

Note: Robust standard errors are in parentheses. Levels of statistical significance are ***p<.001 **p <.005 *p<.10

positive and significant coefficient. To explain regional financing in 1996 (regression 5) I need to introduce the political context of the previous year, when fiscal intergovernmental bargaining takes place. In the 1995 regional elections the Socialist party lost control of many regional governments. As a result, only three Autonomous Communities remained in the hands of the Socialist Party: *Extremadura*, *Andalusia* and *Castilla la Mancha*. These ACs represent the electoral strongholds of the Socialist party and therefore have high levels of authority within the party organization.[29] An estimated positive coefficient for the *Affiliation* variable might be interpreted in two ways. On the one hand, it may indicate that the allocation strategy of central government is reacting to a higher decentralized context. On the other hand, results may also reflect the ability of empowered regional leaders - that in 1996 already exert authority within the internal organization of the Socialist party - in pressing central government for more monies.

As for yearly increases in per capita financing (Table 6.8), results do not show evidence that supports any hypothesis. Coefficients of political variables are not significantly different from zero and they exhibit fluctuating signs across regressions. In summary, the allocation of unconditional transfers in the second definitive model of financing (1992-1996) shows some continuity with the distribution pattern of the previous model. However, econometric models perform worse. This may be accounted for by the fact that this period falls into a transitional phase from a centralized to a decentralized institutional setting. An alternative explanation could be that, from 1993 to 1996, the Socialist Party was ruling a minority government supported by regionalist parties. Conflicting interests within the coalition government would make

[29] The fact that affiliated regions happen to be the electoral strongholds of the Socialist party may explain the negative and significant coefficient of the *Party Power* variable in regression equation 5.

Table 6.8. Cross-sectional analysis of increases in per capita unconditional financing (from 1992 to 1996)

Variables	R1: 1992	R2: 1993	R3: 1994	R4: 1995	R5: 1996
Competences	46.17 (6.84)***	22.52 (3.05)***	-5.51 (12.81)	25.55 (16.32)	22.62 (5.50)***
Affiliation	-.731 (6.00)	.144 (2.63)	-.329 (21.69)	6.34 (24.29)	20.42 (14.55)
Party Power	-.075 (.425)	.142 (.189)	-.844 (1.44)	1.09 (1.15)	-1.33 (1.00)
Swing	.626 (8.66)	-5.36 (2.11)**	.922 (18.44)	-3.49 (15.49)	-3.59 (4.33)
Revision					
Ceded Taxes	.557 (.472)	.930 (.191)***	1.42 (.197)***	2.78 (.64)***	1.77 (.344)***
Constant	20.80 (17.11)	4.88 (7.14)	52.50 (47.54)	-56.18 (35.48)	66.31 (35.80)*
R2	0.88	0.93	0.90	0.87	0.81
N	15	15	15	15	15
Method	OLS	OLS	OLS	OLS	OLS

*Not*e: Robust standard errors are in parentheses. Levels of statistical significance are ***p<.001 **p <.005 *p<.10

it more difficult for central government to implement a straightforward allocation strategy.

6.5.1.3. Third definitive system of financing (1997-2001)

Following Hypothesis 2 I expect the effect of the *Swing* variable to be either not significantly different from zero or smaller than the coefficient of the *Affiliation* variable.

Hypothesis 2 states that within-party power will only have an effect among affiliated jurisdictions. To test for this prediction an interaction term between the *Affiliation* and *Party power* variables should be introduced in the specified econometric model. Unfortunately, multicollinearity problems prevent the inclusion in the model of interaction terms, which makes it difficult to explore empirically whether affiliated and core-support regions receive more monies.

The estimated coefficients of econometric model (1) are exhibited in Table 6.9. Regression equations do not perform well in some regressions. Regressions 4 and 5 (year 2001) show a failed F test and multicollinearity problems within the set of independent variables impact upon all regressions. Consequently, the empirical analysis only partially serves as a test of Hypothesis 2 and no strong empirical conclusions can be derived from regressions in Table 6.9. Having said this, it is important to note that the affiliation variable, as expected, shows a positive sign and it is significantly different from zero in regression 1 and regression 3.

This means that, despite cross-sectional data limitations, the analysis gives us some hints that square with the direction of causality predicted in Hypothesis 2. In regression equation 1 and 3 the estimated impact of the *swing* variable is positive and significant, which does not correspond with predictions from H_2. However, further exploration shows that the effect of this variable is caused by regions that are both *swing* and *affiliated* (*Cantabria*

Table 6.9. Cross-sectional analysis on unconditional financing (from 1997 to 2001)

Variables	R1: 1997	R2: 1998	R3: 1999	R4: 2000	R5:2001
Competences	307.08 (45.10)***	296.23 (81.91)***	473.95 (80.90)***	180.45 (114.62)	-25.77 (122.14)
Affiliation	59.82 (20.74)**	75.84 (39.00)*	92.30 (26.58)**	269.31 (116.40)**	-74.87 (111.38)
Party Power	-1.73 (2.12)	-3.80 (3.64)	-.574 (3.92)		3.90 (4.65)
Swing	57.24 (26.56)**	35.00 (56.99)	179.31 (59.49)**	318.12 (96.64)**	-42.06 (70.18)
Revision			434.12 (45.20)***		-82.68 (100.35)
Ceded Taxes	-1.02 (.674)	5.90 (8.04)	16.97 (2.70)***	3.92 (4.53)	-5.34 (3.04)
Constant	432.54 (80.88)***	479.10 (117.06)***	90.71 (181.68)	572.90 (95.72)*	897.58 (244.82)***
R2	0.90	0.70	0.91	0.91	0.24
N	15	15	15	15	15
Method	OLS	OLS	OLS	OLS	OLS

Note: Robust standard errors are in parentheses. Levels of statistical significance are ***p<.001 **p <.005 *p<.1

and *Canary Islands*),[30] a result that corresponds with the strategy of favouring affiliated regions, as stated in H_2. Finally, the *Party Power* variable does not seem to be significantly correlated with the dependent variable, although this is probably the result of high levels of collinearity between *Party Power*, *Affiliation* and *Competences*.

Results of the estimation of econometric model (3) are displayed in Table 6.10. Predictions from Hypothesis 2 are only corroborated in regression 1 (1997) and regression 4 (1998),[31] where the estimated impact of the *Affiliation* variable is positive and significantly different from zero. Again, multicollinearity problems impinge upon all regressions and a failed F test shows that it is not possible to run the econometric model (3) with cross-regional data from 1998. In the remaining regressions (regression 3 and 5), political variables do not seem to be associated with increases in per capita financing and variation of the dependent variable is solely accounted for by new assignments of expenditure powers (measured through the *New Transfers* variable). In summary, the allocation strategies that follow from Hypothesis 2 seem only to be at work for the first implementation year of the new financing model. Or, in other words, political variables seem to explain which regions benefit most from reforms introduced in the 1997-2001 model of financing, but they do not account for the evolution of subsequent regional improvements in terms of per capita increase. To summarize cross-sectional analysis, I state that the first definitive model of regional financing

---

[30] Exploration consisted in dropping from the dataset observations from regions that were both swing and non-affiliated. I then run the econometric model (1) with cross-sectional data from 1997 and 1999. The estimated coefficient of the *Swing* variable remained positive and significant, indicating that the estimated impact for the *Swing* variable originates in affiliated regions.

[31] One must be cautious on the robustness of results in regression 4. Due to multicollinearity problems I dropped some explanatory variables, which may give rise to an omitted variable problem.

Table 6.10. Cross-sectional analysis of increases in per capita unconditional financing (from 1997 to 2001)

Variables	R1: 1997	R2: 1998	R3: 1999	R4: 2000	R5:2001
Competences	-21.64 (10.39)*		24.25 (15.56)	-135.06 (70.26)*	-.584 (16.91)
Affiliation	42.47 (14.46)**		-10.16 (14.04)	172.23 (79.42)*	14.12 (17.62)
Party Power	-1.58 (.944)		.686 (.980)		
Swing	15.74 (15.78)		-14.59 (13.99)	-49.49 (63.30)	38.75 (24.33)
Revision			412.83 (20.54)***		478.25 (30.74)***
Ceded Taxes	1.03 (.162)***		.621 (.556)	8.66 (2.84)**	.750 (1.403)
Constant	106.17 (40.39)**		7.41 (44.31)	53.77 (62.94)	30.26 (16.34)*
R2	0.75		0.99	0.72	0.98
N	15		15	15	15
Method	OLS		OLS	OLS	OLS

Note: Robust standard errors are in parentheses. Levels of statistical significance are ***p<.001 **p <.005 *p<.10

clearly supports Hypothesis 1. Swing regions consistently receive a higher amount of unconditional transfers.

The allocation of unconditional transfers in the second definitive model of financing (1992-1996) shows some continuity with the distribution pattern of the previous model, although the econometric model does not perform so well as compared to the former system. This may be accounted for by the fact that this period falls into a transitional phase, between a centralized and decentralized context. Finally, despite the fact that the econometric model performs poorly in cross-sectional analysis for the 1997-2001 period, results are closer to predictions from a decentralized context than to a centralized one.

Cross-sectional analyses have been useful in giving us some clues about the explanatory power of political variables to account for unconditional financing. However, severe limitations in testing the hypothesis have arisen as a consequence of the small sample. For instance, it was not possible to test for the interaction terms, which would have improved the specified econometric model for the 1997-2001 period. In the next section I pool cross-sections over time and create a cross-section time series database with 75 observations for each system of regional financing (15 regions, 5 years for each system of regional financing). As was presented above, in the econometric model independent variables (except *New Transfers*, *Competences and Ceded Taxes*) enter the regression equation as lagged variables. As time is small relative to the number of observations I include dummy variables for each year. Results from estimating equations (1), (2) and (3) are summarized in the following section.

6.5.2. A cross-sectional time-series analysis

6.5.2.1. First definitive system 1987-1991

Table 6.11 exhibits results of the estimation of a random effects model on the distribution of unconditional financing from

1987 until 1991. Estimated coefficients are similar to those from cross-sectional analysis and therefore corroborate Hypothesis 1. The coefficient of the *Swing* variable shows a positive and significant effect. This means that regions where the Socialist party could potentially lose or win received higher per capita unconditional financing than the rest. This exemplifies how, in a centralized context, the strategy of central government consists of skewing resources towards swing areas regardless of their political affiliation. Accordingly, the estimated impact of the *Affiliation* variable is negative and not significantly different from zero. *Party power* is positively associated to per capita financing, although the effect is significantly smaller than the coefficient of the *Swing* variable. Finally, expenditure decentralization accounts for the highest effect on the allocation of per capita transfers. Autonomous Communities that accessed autonomy through the fast-track process (which involved a higher level of expenditure powers) were transferred more resources than those regions that accessed autonomy via the slow-track path.

Results of the estimation of the econometric model (2) do not significantly support Hypothesis 1. Although estimated coefficients of political explanatory variables show the predicted sign, none of them is significantly different from zero. This might be accounted for by the use of fixed-effects estimates.[32] Finally, the estimated coefficients of econometric model (3) corroborate H_1.

[32] Fixed-effect models do not perform well when variables change slowly or only a little within units, as it is the case with some of the explanatory variables. Estimated coefficients are close to zero because variables that change little are highly collinear with the fixed effects.

Table 6.11. Cross-sectional time-series analysis of unconditional financing (1987-1991)

Variables	Econometric Model 1 Dependent variable: Per capita financing	Econometric Model 2 Dependent variable: Relative per capita financing	Econometric Model 3 Dependent variable: Increases in per capita financing
Competences	188.70 (14.54)***		27.89 (4.97)***
Affiliation	-17.83 (10.38)*	-.730 (1.56)	-.913 (4.89)
Party Power	2.79 (1.20)**	-.458 (.420)	.410 (.464)
Swing	46.37 (13.80)***	1.08 (2.77)	10.10 (5.41)*
New Transfers	6.58 (11.80)	-.493 (1.56)	4.23 (6.00)***
Ceded Taxes	.379 (.267)	.258 (.034)***	.655 (.140)***
Constant	dropped	118.76 (17.41)***	-39.73 (23.27)
Year Dummies	YES	YES	YES
R-sq[33]	0.90	0.54	0.61
N	71[34]	71	71
Method	RE	FE	RE

Note: Robust standard errors are in parentheses. Levels of statistical significance are *** p < .001 ** p <.005 and * p < .10

[33] R-sq of fixed-effect estimation correspond to overall R-sq, although it does not have all the properties of the OLS R-sq. In models estimated with random effects I report the R-sq *within* (which is an ordinary R^2) (see Stata Release 9. Longitudinal Panel Data p.289 and ff).

[34] There are no observations for Madrid with respect to the *Ceded Taxes* variable, as Madrid did not receive ceded taxes until 1990.

6.5.2.2. Second definitive system (1992-1996)

As with cross-sectional data, the econometric model performs worse in the second definitive system of financing (1992-1996) than in the previous system. As is shown in Table 6.12 (Model a), none of the political variables show coefficients significantly different from zero and, unlike the previous model, the *Affiliation* variable shows a positive effect. Having a positive effect would correspond to predictions from Hypothesis 2. To test how closely results follow this Hypothesis I interact the *Affiliation* variable with *Party Power*. According to Hypothesis 2, allocation strategies in a decentralized context will favour affiliated regions and, among them, those with stronger bargaining power within the party apparatus. Interaction coefficients in Model b show, however, the opposite result: on the one hand affiliated regions display a negative correlation with the dependent variable – which would correspond to predictions from a centralized context. On the other hand, there is a positive and significant effect of being both affiliated and a core-support region (a result that would follow predictions from a decentralized context). In addition, after testing regression equations (2) and (3) we come to the conclusion that political variables do not seem to impact upon the distribution of unconditional regional financing. Within and across units variation is mainly accounted for by dummy-years and differences in expenditure powers *(Competences variable).*

To sum up, the allocation of per capita financing that results from the second definitive model of financing does not seem to be driven by a clear-cut distribution strategy. Empirical evidence does not support predictions in any direction. This is so because hypotheses were elaborated in a particular institutional context, whereas the second model of regional financing was implemented in a *transition period* from a centralized to a decentralized institutional setting.

Table 6.12. Cross-sectional time-series analysis of unconditional financing (1992-1996)

Variables	Econometric Model 1		Econometric Model 2	Econometric Model 3
	Dependent variable: Per capita financing		Dependent variable: Relative per capita financing	Dependent variable: Increases in per capita financing
	Model a	Model b		
Competences	314.66 (29.17)***	310.98 (28.70)***		26.33 (4.65)***
Affiliation	6.01 (9.65)	-131.27 (78.00)*	-1.50 (3.01)	5.78 (6.49)
Party Power	.009 (1.44)	-2.59 (2.04)	.151 (.546)	-.113 (.493)
Swing	-.643 (8.81)	1.19 (8.74)	-.214 (2.76)	-1.01 (5.55)
New Transfers				
Ceded Taxes	1.12 (.129)***	1.12 (.127)	.357 (.039)***	1.72 (.127)***
Affiliation*Party Power		3.75 (2.12)*		
Constant	Dropped	Dropped	95.43 (21.88)	20.49 (19.51)
Year Dummies	YES	YES	YES	YES
R^2	0.88	0.88	0.61	0.61
N	75	75	75	75
Method	RE	RE	FE	RE

Note: Robust standard errors are in parentheses. Levels of statistical significance are *** p < .001 ** p <.005 and * p < .10

6.5.2.3. Third definitive system 1997 – 2001

As for the third system of regional financing (1997-2001), Table 6.13 shows the regression results of econometric models (1), (2) and (3). The estimation of equation (2) with fixed-effects corroborates predictions from Hypothesis 2. Affiliated and core-support regions get significantly higher per capita financing than the rest. Hypothesis 2 states that national politicians will skew resources towards regions that are both affiliated and core-support. The interaction coefficient of these variables shows the predicted effect: affiliated regions that represent electoral strongholds for the incumbent party at the center significantly obtain above-group average financing than affiliated regions that do not represent electoral strongholds. The estimation of equation (1) exhibits coefficients with the predicted sign (positive for *Affiliated* and *Party Power* variables) but not significantly different from zero. Finally, as was corroborated through cross-sectional regressions, political variables are not associated with yearly increases in per capita financing. The transfer of new expenditure powers is the most important variable to account for regional increases in per capita financing (*New Transfers*).

6.5.2.4. Pooling data

Finally, I pool data from the three different models of regional financing and obtain a sample of 225 observations. The main goal is to corroborate results from the previous analyses with a larger sample. To carry out the analysis I introduce dummy variables for the first (1987-1991) and third (1997-2001) models of regional financing. The first dummy is coded as one for observations that belong to the 1987-1991 financing model and 0 otherwise. As I assumed that this model is implemented in a centralized context I call this variable *Centralized context*. The second dummy is coded as 1 for observations that fall within the 1997-2001 period and 0

Table 6.13. Cross-sectional time-series analysis of unconditional financing (1997-2001)

Variables	Econometric Model 1	Econometric Model 2	Econometric Model 3
	Dependent variable: Per capita financing	Dependent variable: Relative per capita financing	Dependent variable: Increases in per capita financing
Competences	279.67 (76.85)***		55.64 (26.14)**
Affiliation	53.53 (56.18)	14.29 (6.07)**	-8.41 (27.46)
Party Power	2.82 (4.24)	2.04 (.803)**	.671 (1.63)
Swing	26.54 (44.95)	1.25 (4.20)	-17.16 (24.84)
New Transfers	160.41 (43.51)***	25.75 (3.91)***	331.38 (27.64)***
Ceded Taxes	-.650 (1.43)	.101 (.129)	.408 (.850)
Constant	699.35 (215.42)***	-18.67 (34.95)	31.77 (79.87)
Year Dummies	YES	YES	YES
R^2	0.77	0.59	0.74
N	75	75	75
Method	RE	FE	RE

Note: Robust standard errors are in parentheses. Levels of statistical significance are *** p < .001 ** p <.005 and * p < .10

otherwise, and is labeled *Decentralized context*. These dummies are interacted with political explanatory variables to check if the estimated impact of *Affiliation* and *Swing* variables varies across different models of regional financing and, in turn, across different institutional settings.

If results from the foregoing empirical analysis are true, then I expect to find a positive and significant interaction coefficient between *Centralized context* variable and *Swing,* which would corroborate Hypothesis 1. Likewise, following Hypothesis 2 I predict that the estimation coefficient of the interaction term between *Decentralized context* and *Affiliation* will be positive. Or, in other words, I expect swing regions to obtain greater per capita financing in the first model of regional financing than in the remaining periods; whereas affiliated regions will obtain more funds in the third model of financing than under previous models.

Table 6.14 shows the results of the estimation of regression equation (1). The econometric analysis reveals that the interaction term between *Swing* and *Centralized context* (Model a) is positive, although not significantly different from zero. A low significance level might be caused by high collinearity between the interaction and the *Swing* variable. As for the interaction between *Affiliation* and *Decentralized context* the estimated coefficient shows a positive correlation and is significant at a 10% level (Model b). A fixed-effect estimation of the regression equation (2) provides more robust empirical findings. The estimated interaction coefficient between *Swing* and *Centralized context* (Model a) shows a positive and significant coefficient. Results, therefore, corroborate Hypothesis 1: swing regions receive more funds under the first model of financing (*Centralized context*) than under the second and third systems of financing. As for Hypothesis 2 (Model b), the interaction term shows a positive and significant coefficient, indicating that affiliated regions obtain greater funds through the reforms introduced in the third system of financing (*Decentralized context*) than under previous models.

Table 6.14. Pooled Cross-sectional time-series analysis of unconditional financing (1987-2001)

Variables	Econometric Model 1		Econometric Model 2	
	Model a	Model b	Model a	Model b
Competences	245.29 (22.09)***	244.58 (22.11)***		
Affiliation	22.52 (17.55)	4.17 (19.69)	8.79 (2.12)***	5.33 (2.55)**
Party power	2.28 (1.29)*	1.56 (1.33)	.168 (.162)	-.098 (.188)
Swing	-2.19 (18.75)	11.96 (16.19)	-6.49 (2.25)***	-.815 (2.14)
New Transfers	82.06 (21.77)***	80.59 (22.46)***	10.59 (2.58)***	11.27 (2.57)***
Ceded Taxes	.579 (.460)	.514 (.459)	.328 (.053)***	.322 (.054)***
Centralized Context	-856.18 (42.77)***		-19.92 (4.93)***	
Centralized Context*Swing	25.88 (30.32)		15.71 (3.59)***	
Decentralized Context		9.03 (42.82)		-3.12 (5.70)
Decentralized Context*Affiliation		58.67 (34.19)*		10.30 (5.12)**
Constant	766.11 (66.66)	229.51 (57.32)	84.88 (8.01)	82.73 (9.16)
Year Dummies	YES	YES	YES	YES
R^2	0.90	0.90	0.38	0.34
N	221	221	221	221
Method	RE	RE	FE	FE

Note: Robust standard errors are in parentheses. Levels of statistical significance are *** p < .001 ** p <.005 and * p < .10

Overall, empirical evidence corroborates that the design of the regional system of financing in different periods respond to different political strategies.

6.6. Interviews

In this section I present further empirical evidence on the dynamics of fiscal intergovernmental negotiations in Spain. More specifically, I aim to test with qualitative data how strongly political strategies have impacted upon fiscal intergovernmental bargaining. The results come from in-depth interviews with Socialist leaders who have closely followed fiscal intergovernmental negotiations.[35]

As was stated in the introduction, the Spanish process of devolution is characterized by the role that political agreements have played in the configuration and dynamics of the regional financing system. The foregoing quantitative analysis has revealed that the distribution of financing resources across regions from 1987 to 2001 responds to different political strategies. This means that the selection and weighting of the parameters in the allocation formula is of a political nature. Statements from interviewed politicians that participated in the creation of the allocation formula largely confirm these arguments. According to their experience, the design of the formula was the outcome (and not the origin) of a distribution of resources – that had been previously negotiated. The logic behind the design of the allocation formula is well summarized by Tomás de la Quadra[36] Minister of Territorial Administration from 1982 to 1985:

---

[35] See Table A.1 in the annex.

[36] Other interviewed politicians made similar statements on the allocation formula. For instance, in the words of Abel Caballero: *"The process (of calculating financing needs) was, first, to calculate how much we give to each Autonomous Community…and then (to choose) the allocation formula that would reproduce it…It is amazing but it was like this…(…) Basically it was a political agreement."* Joaquin Almunia's

> "The logical way (of designing the allocation formula) would have been to select parameters…(for instance) population dispersion…"how much do we think it affects (the cost of service provision)?"…"it increases costs by 20%"…and then take parameters to calculate the revenue-sharing percentage…well, in fact, it did not go like this. We politically negotiated setting aside those considerations…(…) we (first) negotiated with regions the amount of resources and later we looked for the proper parameters (…) once we had come to a political agreement we then agreed on the parameters (…) a posteriori."

I previously assumed that the first (1987-1991) and third (1997-2001) systems of regional financing were agreed in two different institutional settings. Intergovernmental fiscal bargaining that brought about the first model of regional financing took place in a centralized context. Central government had responsibilities over major expenditure and tax powers and the internal organization of state-wide parties was still free from serious centrifugal pressures. An exploration of the bargaining power of actors during intergovernmental fiscal negotiations provides further evidence of the centralized institutional setting of the mid-eighties. On the one hand, at that time there was a powerful central government that was reluctant to transfer (human and financing) resources and fiscal powers downwards. This is well summarized in the words of Carlos Solchaga, Minister of Economy and Finance from 1986 to 1993:

---

statement was made in similar terms: *"The allocation of resources (across regions) was irrational…the amount of resources had nothing to do with any understandable parameter…(…)The (financing) model was based upon a formula…an equation…based on parameters. People in the Ministry of Finance had computers that were able to make "n" simulations (and then they could) decide politically the final allocation of resources and find the equation, the parameters and weightings…In sum, (cross-regional allocation) was as rational as this."*

> "Central government wanted to control expenditure as much as possible and to transfer to ACs as few (powers) as possible."[37]

On the other hand, ACs had recently assumed the provision of a wide array of public services and their demands basically consisted in greater transfers from the central administration to finance their expenditure. In fact, regional financing claims were in general quite homogeneous until the debate on fiscal co-responsibility emerged. A crucial factor in understanding the outcome and dynamics of intergovernmental fiscal bargaining in this context was the capacity of the PSOE to force compliance and agreement on regional socialist leaders. The Socialist central government was using a disciplined and centralized party organization to weaken demands from regional leaders and to transform regional heterogeneous claims into a common position in multilateral negotiations (in the Finance and Tax Policy Council). In fact, before the FTPC met, the Socialist party apparatus was calling regional representatives together. These meetings were aimed at generating a basic consensus on regional financing. As is illustrated by Abel Caballero, who was the PSOE's Secretary of Institutional Policy from 1988 until 1993:

> "While I was the secretary of institutional policy there was no issue related to regional financing that was not previously discussed within the party organization (…). Everything was previously negotiated (before the FTPC multilateral meeting) (…) Then we (the party apparatus) had an enormous authority to force agreement. This was (the main asset) the party organization had at that moment…a very strong leadership and a very solid government (…). The party apparatus was a kind of "referee" between central government and each AC."

---

[37] Six more interviewees described in similar terms central government reluctances to transfers.

That the Socialist government was able to force compliance on regional leaders is further corroborated in the words of Félix Pons:[38]

> "The PSOE had to make an important and permanent effort to coordinate (regional demands) and integrate divergent interests (…) I believe that at that time the existence of a party apparatus that was able to coordinate affiliated regions was very important (…) the party apparatus was able to harmonize positions internally and bring to the FTPC a common position."

However, the capacity of central government to force compliance on regional leaders gradually shrunk. The party was no longer capable of hiding divergences among regional representatives. This had to do, on the one hand, with factors specific to PSOE's internal organization (such as fractionalization). On the other hand, this was the result of a broader process related to the emerging power of regional leaders as a consequence of ongoing decentralization. The effects of decentralization on the party organization is well characterized in the words of Abel Caballero:

> "(In the early to mid 1990s) The ability of the PSOE to homogenize within the party was lower. Why? Because (…) regional party federations had gained political power (…) Every period marked a transition (…) from a centralized model to a very decentralized model. And this affected political parties…a centralized party became more decentralized (…) Now I guess that the secretary of institutional policy gets socialist regional leaders together to talk…but he does not bring (the official) position (from the government)" And he continues: "Now (the bargaining process) is more discrete (…) because I believe that regional leaders themselves do not want show that there is a party apparatus that dictates (guidelines) to regional leaders."

---

[38] Carlos Solchaga, Joaquin Almunia and Tomás de la Quadra characterized bargaining power of the party apparatus in similar terms.

Heterogeneity among regional demands increased, which hampered coordination across ACs on regional financing matters. This is well illustrated by the fact that in 1993 and 1996 regions could not come to an agreement in the FTPC and three of them did not ratify reforms introduced in regional financing. In addition, the extension of expenditure decentralization towards slow-track regions boosted tensions both across levels of government and regions, as the administration of new services (for example, education services) involved a huge amount of resources. In consequence, there were more monies at stake in each bargaining process; whereas none of the regional leaders was willing to accept a new allocation of funds that would grant them a lower level of resources.

In sum, bargaining gradually became more complex. Bilateral negotiations in Mixed Commissions (*Comisiones Mixtas*) played a very important role in overcoming conflict. Several of the politicians interviewed said that conditional funds were crucial in order to get regional representatives to ratify the system of regional financing. That is, in order to reach consensus in bilateral negotiations central government representatives were often covering particular demands of regional representatives through conditional grants.[39] As Joaquin Almunia, Minister of Public Administration between from 1986 to 1989 puts it.[40]

> "Once the general allocation formula was agreed, (regional governments) had to ratify the agreement in a mixed commission (..). Then (regional governments) were claiming, "well, but…apart from the general formula I have this particular problem (…)" and there were some particular issues in each AC (…) and then you were

---

[39] Unconditional financing basically consisted in the so-called *convenios de inversion* (investment agreements) and the so-called *contratos-programa* (program contracts). Both types of conditional financing were agreed bilaterally and were not part of the system regulated through multilateral agreements.

[40] Carlos Solchaga and Francisco Fernández Marugán characterized bilateral bargaining in similar ways.

negotiating a micro-adjustment (of these particular demands) to get the vote of the regional government in the Mixed Commission."

Which other strategies were used in the bargaining process? The two hypotheses I formulated above stated that swing, affiliated and core-support regions would be favored in the allocation of financing depending on the institutional context in which politicians distribute resources. To what extent does qualitative empirical evidence support those hypotheses (and the corresponding quantitative evidence illustrated in section 5)? Interviewed politicians did not provide a clear-cut description about the existence of central government allocation strategies. When asked directly if central government representatives could have followed any particular allocation strategy, some of them were reluctant to acknowledge in a straightforward manner that financing could have been subject to manipulation.[41] This was in contradiction with some of their former statements, since - when characterizing intergovernmental bargaining - all of them uncovered different distributional patterns and revealed that actors had varying bargaining power. Their responses on allocation strategies were not precise, although all recognized that there was room for manipulation. This is well exemplified in the words of Juan Manuel Eguiagaray, Minister of Public Administration from 1991 to 1993:

> "Politicians were not – and are not – angels, right?…(…) Thinking that (…) unconditional financing is not "sensitive" to political pressures means believing in miracles, right?…this does not happen…(…) To what extent does it (politicization) occur?…well, within some limits, right?…because it is true that, fortunately, there

---

[41] This is well illustrated in the words of Tomás de la Quadra: *"When I was in the central executive I had a deep sense of government. I believed that it was a central government for all Spanish people and, therefore (…) I knew that what we were doing was an exceptional and important process (…) and it was not undertaken to favour some regions and penalize others."*

> are some compensating checks-and-balances mechanisms so that even those who have power cannot exert it disproportionately. But it is evident that there is a bias (in designing unconditional financing)."

As I mentioned above, responses on particular allocation strategies (swing vs. affiliated regions) were not as precise as formulated in my hypotheses. However, the most supportive evidence on Hypothesis 1 and Hypothesis 2 is found in Miguel Angel Fernández Ordóñez's statements. In his opinion, allocation strategies varied in line with the ability of the party organization to silence demands from affiliated regions:

> "In the past, when the regional cleavage (within the Socialist party) was not so important (…)(then) the party apparatus was able to force compliance among regions…among socialist regions…and then it (the party organization) was able to make them cede (in their demands). Throughout the (bargaining) process (strategies) vary…Insofar as you (the party apparatus or central government) have bargaining power then you calm (demands from) affiliated regions and you "buy" (with higher resources) non-affiliated regions…Now I believe it has become more difficult to silence demands from affiliated regions, that is, the party organization is gradually less powerful, right?…(…) Now it is more difficult…(…)(because) the regional cleavage has become increasingly more important."[42]

---

[42] In Francisco Fernández Marugán's view, the strategy of "buying" non-affiliated regions has taken place throughout the period. In describing intergovernmental bargaining when the PSOE rules central government he states: *"Being an affiliated region did not entail more bargaining power…(…)(on the contrary) central government was able to impose its position over regional representatives"* and he follows *"you (a member of the party apparatus) called the president of Murcia (who was socialist) (…) and told him "look, this is the position of the party apparatus, and this is the position of central government" (…) but if you were negotiating with Cantabria (a non-affiliated region) then the party apparatus (…) would give Cantabria more monies."*

Regions that represented electoral strongholds for the socialist party had strong bargaining power in fiscal negotiations. Several of my interviewees said that during intergovernmental bargaining process they "could not ignore" or that "there were sensitivities" (towards) regions that concentrated the majority of the PSOE's electoral support. This is illustrated in the following quote of Abel Caballero:

> "It is not the same to negotiate with a regional leader with strong political power in his region than with a regional leader who is in opposition and never wins (in regional elections) (…). In the negotiation process you have a mixture (of strategies) in your head that are difficult to distinguish. In your head you first know that you have to come to an agreement with all regional representatives, right?…Second, that you cannot make any concession; and third that there is no way that people (regional leaders) who gain a majority of votes in the PSOE are unsatisfied (with the outcome of the negotiation process)."[43]

Among electoral-stronghold regions, Andalusia is no doubt the one with the highest bargaining power. This is so because Andalusia was a core-support region and important leaders within the party apparatus (and the prime minister himself) came from this AC. The second most important region in negotiations was Catalonia, whose representatives held relevant positions within the PSOE's organization, as well. All interviewees agreed that intergovernmental bargaining was fundamentally driven by negotiations with Catalonia and Andalusia. This was not an easy task, as they had divergent interests in regional financing.[44] In

[43] Similar arguments were made by Miguel Ángel Fernández Ordóñez; Juan Manuel Eguiagaray and Carlos Solchaga.

[44] Among the leaders who were interviewed there are two (M. Ángel Fernández Ordóñez and Carlos Solchaga) who define the first definitive model of regional financing as hyper-redistributive. This means that regional financing benefited regions with low per capita income, such as Andalusia, Castilla la Mancha or Extremadura. On the other hand, this model granted Catalonia below-average per capita financing. Regional

addition, regional leaders from core-support regions were aware that their electoral support endowed them with authority within the party apparatus. And they used that power to press central government for more financial resources. Carlos Solchaga describes difficulties in bargaining with Socialist regional representatives in the following terms:

> "It was easier to bargain with non-affiliated regional representatives than with affiliated regional representatives. Because the latter did not understand that an affiliated central government could make decisions that would favor other regions and not theirs" And he continues: "When we were negotiating (regional financing) with socialist regions (…) (these regions) could believe that making a concession that was not favorable to socialist regions (…) meant that in the short-run the party was giving the image of being unable to improve financing of a particular (core-support) region."

6.7. Concluding remarks

Overall both quantitative and qualitative empirical evidence corroborates that the design of the regional system of financing in Spain responds to different political strategies for different periods. On the one hand, cross-sectional and pooled data reveals that swing Autonomous Communities do significantly obtain greater per capita resources in a centralized institutional setting; whereas affiliated regions (and among them, regions that represent electoral strongholds for the incumbent party at the center) get greater per capita resources in a decentralized institutional context.

On the other hand, qualitative empirical evidence gives strong support to the assumptions in which I grounded the theoretical

---

leaders from Catalonia demanded higher levels of fiscal co-responsibility, whereby regions could be granted greater tax-sharing percentages and higher authority over ceded taxes.

framework of this study. For instance, interviewed politicians' statements corroborated my basic premise: those politicians would design intergovernmental grants taking into consideration *political features* of regions, which I defined as the *commitment problem.* My interviewees acknowledged that building consensus on a regional financing model was not an easy task and, therefore, bilateral negotiation played a very important role in making regional representatives ratify the model. As for the assumption about the existence of two different institutional settings, from my interviewees' statements we know that the dynamics of intergovernmental bargaining changed as a consequence of the institutional change caused by decentralization. More specifically, the ability of the PSOE's party apparatus to force compliance on socialist regions decreased as party fractionalization and empowered regional leaders emerged. In addition, interviewed leaders agreed that, in designing the allocation of resources, central government was "sensitive" to demands from regions that represented electoral strongholds for the Socialist party. Finally, although politicians did not make statements on allocation strategies as precise as those formulated in Hypothesis 1 and Hypothesis 2, all of them acknowledged that there was room for a strategic distribution of funds and in their characterization of intergovernmental negotiations they revealed different allocation strategies (swing-oriented and affiliation-oriented).

CHAPTER 7. DECENTRALIZATION DYNAMICS AND INEFFICIENT OUTCOMES

7.1. Introduction

In this final chapter I seek to study the origins of the unstable nature of regional financing in Spain. In principle one might think that both the central and regional administration would be better off if they succeeded in establishing a stable system to finance regional expenditures. Having a steady and clear-cut model of regional financing would allow regional governments to anticipate the amount of monies to be transferred to them on a yearly basis and organize their regional budgets with less uncertainty about revenue sources. It seems paradoxical therefore to have a situation where central government and regions are not capable of agreeing a stable model of financing, despite the fact that it would make them better off in terms of greater budgetary foresight. The question can be stated as follows: why does the *rational*[1]

[1] My approach is based on the rational choice perspective. Accordingly, actors' actions are the result of rational calculations and collective outcomes are a product of individual choice between different alternatives. An individual is rational when through his actions he links means and outcomes in the most efficient way (Rogowski 1978). Individual choices take place within an institutional framework that imposes some restrictions on his actions. Or, in other words, the combination of incentives that stem from the institutional context of actors' preferences (objectives) determines the strategy that the individual adopts. Actors' choices may give rise to outcomes that are

behaviour of actors (central and regional governments) leads periodically to the renegotiation of regional financing?

My argument to account for such a paradoxical outcome is that the instability of regional financing is the result of a particular design of fiscal decentralization and, to a lesser extent, of administrative decentralization. As was explained in former chapters, Spain's decentralized system is characterized by: asymmetries in fiscal and policy responsibilities across regions, a prominent role of bilateral negotiations and the *open* nature of the territorial organization of the State. The idea is that these features have rushed national and subnational politicians into an ongoing renegotiation of fiscal intergovernmental arrangements. Or, in other words, the unstable dynamic of regional financing agreements is the result of the structure of incentives that stems from the particular design of fiscal and administrative decentralization in Spain.

This approach follows the theoretical framework presented in former chapters. The explanation of what seems to be a paradoxical outcome is grounded in the combination of actors' preferences and the structure of incentives where they make decisions. More specifically, the particular design of fiscal and administrative regulations have generated incentives that are incompatible with the establishment of a stable model of regional financing. Following these considerations I argue that if fiscal and administrative decentralization in Spain had been designed in a different way, then national and subnational politicians would have faced different incentives and that perhaps the instability of regional financing could have been prevented.

This idea of compatibility between incentives and rules is not new in this dissertation. As I stated in former chapters, some academics have previously explored this issue within the literature

---

collectively sub-optimal (Olson 1965) but this does not mean that individuals' behaviour is irrational. In fact, in this chapter my purpose is to explain how instability of regional financing is the result of a rational logic, that is, is the result of a combination of rational strategies from both the central and regional administration.

that deals with the consequences of decentralization. They have emphasized that decentralization processes need to be developed within an adequate structure of political and economic incentives (Ordeshook and Svetsova 1997; Rodden and Wibbels 2002; Bird et al. 1998; Ter-Minassian 1997).[2] As decentralization may take a multiplicity of forms, the particular institutional design of decentralization becomes crucial in understanding the effects that stem from the transfer of power and authority across levels of government. The main purpose of this chapter is connected with this approach, as I seek to explore the principal features of decentralization in Spain and their impact upon the dynamics of regional financing.

The structure of the chapter is as follows. In the next section I cover the main characteristics of fiscal and administrative decentralization in Spain and its implications on regional financing instability. Section 2.1 is the most comprehensive, as it deals with the role of bilateralism in intergovernmental bargaining. I formalize bilateral negotiations through an extensive-form repeated game and discuss the implications of introducing some variations into the original game. In addition, I study the extent to which regional financing in Spain has evolved according to the game's implications. In sections 2.2 and I explore the impact of asymmetries on fiscal and administrative decentralization upon fiscal intergovernmental arrangements. The effects of vertical fiscal imbalances over the instability of regional financing are

---

[2] As I showed in previous chapters, there is some empirical evidence that supports such arguments. In many countries decentralization did not give rise to the expected benefits ascribed to it by normative economic theory, such as democratization or economic efficiency. On the contrary, in some cases decentralization has been associated with higher levels of corruption (Treisman 2000) or higher deficits (Rodden 2002), above all in developing countries (Tanzi 1995; Prud´Homme 1995; Hommes 1995; Bird et al. 1998). These academics have stated that the design of decentralization arrangements must contain rules that generate the proper set of incentives so that the opportunistic behavior of sub-national governments is prevented.

introduced in section 2.3. Finally, a summary of the chapter is presented in section 3.

7.2. Fiscal and administrative decentralization in Spain

The development of the Spanish State of Autonomies has suffered from permanent instability with respect to regional financing.[3] The establishment of a definitive and stable model to finance ACs' expenditures has been one of the main objectives pursued every time a new system of regional financing has been approved.[4] But none of the financing agreements has been accompanied of an adequate structure of incentives. In consequence, incentives to revise periodically the financing model have remained. As a result, since the first *definitive* financing agreement was passed in 1986, it has subsequently undergone several reforms.

7.2.1. Bilateralism

In the early years of the State of Autonomies some institutions were created to *temporarily* regulate the transfer of services towards ACs and regional financing. These institutions were eventually integrated within the general proceedings that subsequently regulated regional financing. For instance, decree-

---

[3] I define instability as the ongoing modification of the set of rules that regulate regions' revenue sources, which affect both the overall amount of resources that are transferred towards ACs and the distribution of monies among regions.

[4] The system of regional financing passed in 2001 is being revised. This model was aimed at establishing stable revenue sources for ACs. This is the reason why for the first time an FTPC Agreement was subsequently approved as an Act (Act 21/2001 of 27th December) and the requirement for a five-year revision was removed. However, these measures did not prevent a major revision being planned in 2007.

laws that created (or re-established) pre-autonomous regional governments (that is, regions that had not approved their Statute of Autonomy) introduced a bilateral mechanism to transfer resources from the central and local administrations towards emerging ACs. This mechanism consisted in bilateral negotiations between central government and pre-autonomous regions in the so-called Mixed Commissions of Transfers.[5] The Constitution provided for some regulations on regional financing (articles 156 and following) but they did not modify the role that bilateral bargaining had played in the previous period. In addition, the Catalan Statute of Autonomy established that the transfer of powers and authority would be carried out through bilateral bargaining in Mixed Commissions, a system that was subsequently copied in the other Statutes of Autonomy (Ramallo and Zornoza 1995: 12). According to these regulations the role of bilateral bargaining in Mixed Commissions was in principle only lasting for the transitory period.[6] However, in practice these bodies have played a crucial role in regulating administrative decentralization and intergovernmental fiscal arrangements. In sum, the State of Autonomies grew around bilateral bargaining in Mixed Commissions, where transfers of

---

[5] There are two different types of Mixed Commissions. On the one hand there are Mixed Commissions on the transfer of service provision (administrative decentralization) towards regional governments. Bilateral agreements in these Commissions are subsequently introduced in section 32 of the General Budgetary Act. The legal nature of these Commissions is based in the Statutes of Autonomy and the 147.2 article of the Spanish Constitution so that there is no Act from the central administration that can regulate an area within the competences of Mixed Commissions. Bilateral negotiation in these commissions is binding on the central administration, which must respect the terms and contents of the agreements (Ramallo y Zornoza 1995: 30). On the other hand, there are Mixed Commissions on regional financing, whose agreements take the form of a proposal (not binding) on central government, which approves it as a decree-law.

[6] In practice the transitory period was fixed according to the Catalonian Statute of Autonomy, which established a transitory period of 6 years (after the Statute of Autonomy was approved).

policy responsibilities and their corresponding financing were negotiated between regional and central government representatives.

There was an attempt to curtail the role of bilateralism in intergovernmental relations in 1980, when the LOFCA created a multilateral bargaining body, the Finance and Tax Policy Council (FTPC), aimed at coordinating issues on regional financing. However, despite the fact that the FTPC has had a prominent role in regulating the evolution of regional financing, multilateral agreements are subject to subsequent ratification in Mixed Commissions. This allows regions to use a sort of *"opting out"* clause so that the terms of the financing agreement are only applicable to regions once they are ratified in bilateral negotiations. Otherwise, ACs continue to be financed through the former system.[7]

In chapter five the empirical analysis revealed that bargaining power in bilateral negotiations varied across regions according to their political characteristics (party affiliation; swing vs. core support nature). I showed that the central administration was not capable of ignoring the political features of ACs when designing fiscal intergovernmental arrangements. I defined this as a *commitment problem*, since politicians were unable to stick to their promises and accordingly design intergovernmental transfers based on technical criteria.

In the next section I explain how the commitment problem together with *cumbersome* bilateral negotiations have caused the ongoing renegotiation of fiscal intergovernmental arrangements. I use an extensive-form game to illustrate the dynamic of bilateral bargaining. The outcome of the game is determined by the

---

[7] As was already mentioned in previous chapters of the dissertation, Extremadura, Galicia and Castilla-León did not ratify the FTPC Agreement in 1993. From 1995 onwards, only Extremadura was excluded from the regional financing system approved in 1993. In 1996 Andalusia, Castilla la Mancha and Extremadura did not ratify the FTPC Agreement and, as a result, they remained financed through the former model until the reform of 2001.

incompetence of central government to build a reputation as a "strong" player. The central administration cannot make credible the threat to oppose particular regional demands. When regional governments realize they face a weak central government, they adopt a bargaining strategy that maximizes their preferences. This strategy consists in renegotiating fiscal intergovernmental arrangements to introduce into the allocation formula those variables that grant them greater resources, which brings about ongoing reforms of the regional financing system.

7.2.1.1. The representation of bilateral commissions of regional financing through the Chain Store Model

Reputation is a belief about the *type* of player in a game. Or, in other words, it is *"the chance that you are the type that always carries out your promise or threat"* (Morrow 1994: 281). This belief is constructed through the accumulation of knowledge about a player's actions over time. I use game theory to formalize the importance of reputation in the bargaining processes. More specifically, I use the *Chain Store Paradox* (CSP) to formalize bilateral negotiations of the regional system of financing in Spain[8]. The Chain Store model is based on the following game: there is a monopolist M who owns a chain store and is faced with the possibility of entrants to its many, separate markets (Morrow 1994: 281). The entrant (player E) must decide whether to enter the market (strategy E) and compete with the monopolist or to stay out (strategy SO), allowing the monopolist to reap benefits in all

---

[8] The Chain Store Paradox originates in the work of Selten (1978). Other references to this game are found in Morrow (1994) and Ordeshook (1986: 451-462). The CSP has been used in a similar way as I do in this chapter to account for the failure of constitutional amendments in Canada (Meech Lake and Charlottetown Agreements) (see Patrick 1999). In addition, Alt, Calvert y Humes (1988) have applied the CSP model to describe the instability of an international regime based on a hegemonic leadership.

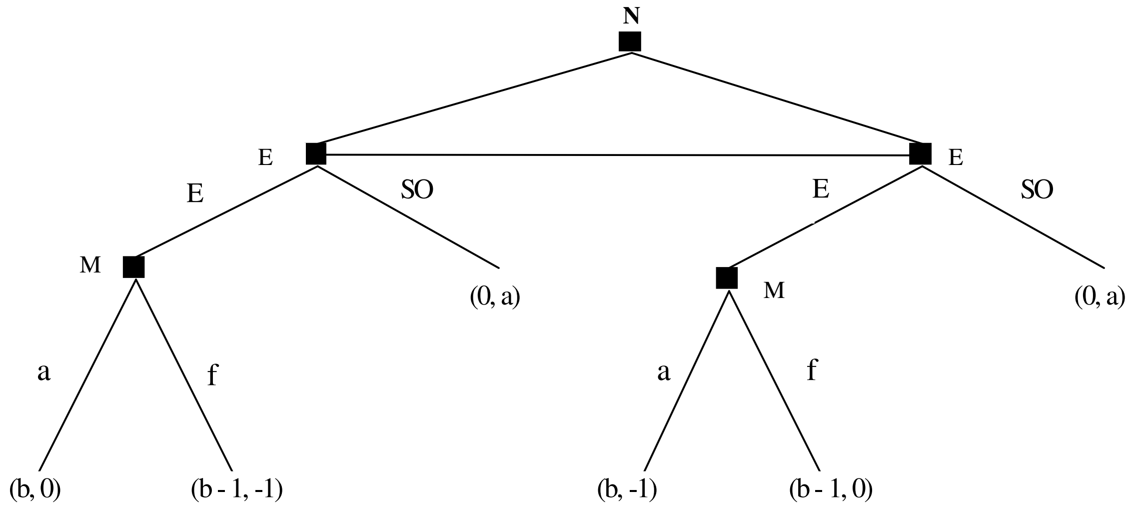
markets (see Figure 7.1). The best of worlds for the monopolist occurs when no entrant challenges his markets. If there is an entrant, then the monopolist must decide whether or not to fight the entrant through price competition (strategy "f" for "fight" or "a" for "accept"). The best of worlds for the entrant is to challenge the monopolist without having to bear the costs of price competition; whereas it prefers to stay out of the market rather than entering and having to incur costs (from price competition).

The CSP deals with the question of when threats are credible. As I stated above, ongoing renegotiation of fiscal arrangements in Spain is the result of central government being unable to make credible threats. I next represent fiscal intergovernmental bargaining between central government and ACs through the Chain Store model. With the extensive-form game I formalize bilateral bargaining between the central administration and regional governments (see Figure 7.2). Accordingly, the monopolist is central government ("CG" in Figure 7.2) and it competes with ACs (which represent potential "entrants") to control the design of fiscal intergovernmental arrangements.

Before the game starts I assume that the central administration has decided autonomously on a particular distribution of intergovernmental transfers across levels of government. This distribution follows the general principles of grant design (so it is aimed at compensating for vertical fiscal imbalances, to offset horizontal fiscal disparities or influence regional choices in the presence of positive/negative externalities across jurisdictions). The development of the game is determined by the ability of central government to deter regional representatives from modifying its financing proposal in bilateral negotiations. This will crucially depend on central government's ability to build a reputation of being a "strong" player.

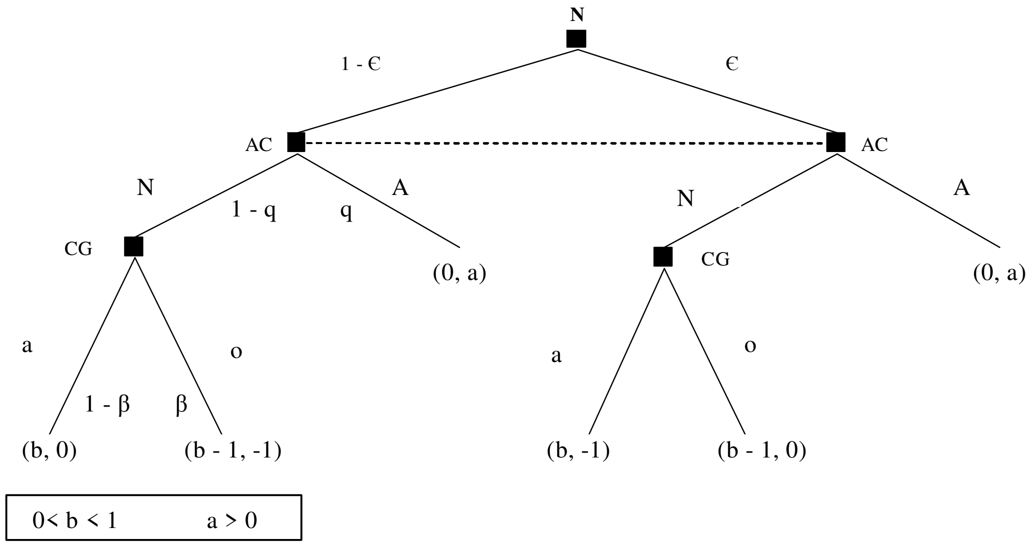
Bilateral bargaining between regional and central government representatives is represented in each stage of the game so it is a repeated game with 15 rounds (as there are 15 regions in the Common system of regional financing). In bilateral commissions ACs must decide whether to agree with the regional financing

Figure 7.1. The Chain Store Game with complete information



$0 < b < 1 \qquad a > 0$

Figure 7.2. The Chain Store Model applied to bilateral bargaining of the regional financing model in Spain



model that central government has designed autonomously (strategy "A" for "accept") or to negotiate the terms of the financing proposal (strategy "N"). Should they choose to bargain, then central government must decide whether to oppose regional attempts to modify the financing model (with the threat to exclude regional governments from the financing agreement; strategy "o" for "oppose") or to accept regional demands and introduce reforms in its proposal accordingly (strategy "a" for "accept").

The best of all possible worlds for central government occurs when: *a)* it decides autonomously (that is with no intervention from regional governments) about any aspect of fiscal intergovernmental arrangements; and *b)* regional governments fully ratify the agreement without any modification of central government's proposal. The best outcome for regional governments is to modify the financing agreement without opposition from central government. And agreeing with central government proposal is preferable to attempting a modification and being excluded from the financing agreement.

Potential outcomes of intergovernmental bargaining:

x = the regional government enters and central government accepts changes
y = the regional government agrees with the proposal
z = the regional government enters and central government opposes

Order of preferences for AC: $x > y > z$
Weak government's preferences: $y > x > z$
Strong government's preferences: $y > z > x$

they face in each negotiation round. Or, in other words, they ignore central government's payoffs – and therefore the probability that carrying out the threat will be costly for central government. Central government is a weak player with probability ϵ and it is a strong player with probability $1 - \epsilon$. Both a strong and weak central government prefer outcome *y*. However, if the regional government chooses to modify the agreement, a weak central government will be better off if it accepts regional demands; whereas for a strong central government opposing the modification of its financing proposal is preferable to accepting regional demands.

The set of beliefs and strategies exhibited in Table 7.1 represent the Perfect Bayesian equilibrium of the CSP adapted to intergovernmental bargaining of financing agreements (in the Appendix I describe how Kreps and Wilson (1982) arrive at this equilibrium). This equilibrium is similar to a Nash equilibrium that satisfies some requirements.[9] The most relevant feature of this model is that, when there is uncertainty about the game's payoffs (incomplete information[10]).

---

[9] ACs' beliefs, P_k, account for the central administration's reputation of being a "strong" player; P* is the belief that makes the region indifferent between strategy "A" and "N"; *k* is a round of the game; and *n* represents the overall number of rounds.

[10] On the contrary, in a *stage game* (a one-round game) with *complete* information the weak central government has a dominating strategy, which consists in accepting a modification of the financing proposal (strategy "a"). The Nash equilibrium is (N;a). If the game is repeated a finite number of times, in the last round the AC will anticipate that the central administration will choose strategy "a" and therefore the region will enter negotiation. But then, if central government cannot prevent regions from entering the last round of the game then there is no incentive for the central administration to oppose regional demands in the first-to-last round in order to deter regions from entering into negotiation. Therefore, the strategy "a" strongly dominates strategy "o" in the first--to-last region. Following backwards induction we arrive until the first round of the game where the equilibrium is that the AC enters negotiation (N) and the central administration accepts (a). In sum, there is only a Nash equilibrium when the stage game with complete information is finitely repeated: (N; a). The strategy of opposing regional demands as an investment in a "strong" reputation is not rational because the central administration cannot make threats credible. When there is

Table 7.1. The Bayesian Equilibrium

Central government's strategy
If central government is strong, it always opposes regional demands. If central government is weak, in round *n* it accepts a modification of its financing proposal. Before this round arrives, a weak central government chooses the strategy of opposing regional demands in round *k* if $P_k \geq b^{n-k}$. If this is not so (that is, if $P_k < b^{n-k}$) a weak central government opposes a modification of its proposal with probability $\beta = \frac{\left[(1-b^{n-k})P_k\right]}{\left[(1-P_k)b^{n-k}\right]}$
AC's strategy
If $P_k > b^{n-k+1} \equiv P^*$, AC accepts central government's financing proposal Si $P_k < b^{n-k+1} \equiv P^*$, AC negotiates the financing proposal Si $P_k = b^{n-k+1}$, AC accepts with a probability of 1/a.
Beliefs
When AC accepts then $P_k = \epsilon$. When AC enters negotiation and central government accepts its demands, then $P_k = 0$. When AC enters negotiation and central government opposes demands, then $P_k = \max(b^{n-m}, \epsilon)$, where *m* is the last round where central government opposed demands.

reputation becomes an instrument that a weak central government can exploit. That is, when ACs ignore whether opposing regional demands is a costly strategy for central government they cannot

---

complete information ACs are certain that the strategy of opposing regional demands is costly to central government.

anticipate central government's actions. Then central government may choose to build the reputation of being a "strong player" in the early rounds of the game aimed at deterring remaining ACs to enter negotiation in subsequent rounds. Accordingly, a weak central government may punish regional governments even when punishment is costly, as this action represents an "investment" in reputation.[11]

As negotiation rounds unfold, it becomes more difficult for a weak central government to invest in building the reputation of a "strong" player – that is, to oppose a modification of the financing proposal. This is so because payoffs are accumulated as rounds follow. The expected benefits of maintaining the reputation of being a "strong" player (that consists in deterring the remaining regions from entering into negotiation) gradually diminish, as the number of remaining rounds is increasingly lower. In the end, the costs of maintaining the reputation of being a strong player exceed

---

[11] For instance, let us assume that in the first round the value of *b* is high (0.9) and the probability that central government is a "strong" player is very low ($P_1 < P^*$). Then a weak central government will oppose regional demands with probability β. For central government to follow a mixed strategy *"oppose demands with a probability of 0.5 and accept with a probability of 1 – 0.5"* we only need a very small probability that it is a strong player ($P_1 = 0,1$). That is, even when the belief that central government is strong does not surpass the probability threshold above which a weak central government always opposes demands ($P_k < P^*$) and the payoff that a region obtains from following strategy "N" is very high (b = 0.9); it is enough to have a probability of 10% that central government is a "strong" player for it to follow a mixed strategy.

$$\beta = 0.5 = \frac{\left[(1-b^{n-k})P_k\right]}{\left[(1-P_k)b^{n-k}\right]} = \frac{\left[(1-b^{14})P_1\right]}{\left[(1-P_1)b^{14}\right]}$$

We find the value of $P_1 = 0.1$

the expected benefits of deterring regions from entering into negotiation about the financing proposal.[12]

The basic idea in understanding the development of the game is that central government's reputation has a *fragile* nature. Once central government accepts regional demands in one negotiation round, then reputation fades away until the end of the game, as the central administration reveals its true *weak* nature. When reputation is destroyed, ACs' belief in the type of central government are not subject to probabilities anymore, as they are certain that carrying out threats is costly for central government (or, in other words, the probability that central government is a strong player is equal to zero). At this time regional governments know the real extensive-form of the game, which becomes a game with complete information (that is, the game is only played on the left branch of figure 7.2). The best strategy of regions when there is a weak central government is to enter into negotiation about the financing agreement, since this strategy entails higher payoffs (b) than accepting the central administration's proposal (0). It is possible to determine the exact round in which central government's threats lose their power of deterrence and the

---

[12] In the first rounds of the game, central government succeeds in making threats credible even when the probability that it is a strong player is very low (this is so because in the first round the probability of being a strong player must be $P_k > b^{n-k+1}$, that is, $P_1 > b^{15}$, which results in a very small number since $0 < b < 1$). However, as rounds progress, k increases and therefore the belief that central government is a strong player must be higher in order to deter regions from entering into negotiation in the remaining rounds. Eventually the threshold increases until it exceeds the initial belief about central government reputation ($\epsilon < b^{n-k+1}$). When this occurs, the AC enters into negotiation and central government must choose whether to follow a mixed strategy and oppose demands with probability β, with the objective of making indifferent the next AC between entering negotiation (N) or accepting central government proposal (A). When the central administration *once* accepts regional demands in a particular round (round k), then the belief that it is a strong player becomes zero until the last round of the game (P_{k+1}, $P_{k+2}...P_n = 0$).

regional government enters into negotiation (I include an example of this in the Appendix).

7.2.1.1.1. Heterogeneity in the payoffs

So far I have assumed that payoffs are the same in every round of the game. This basically means two things. First, that the costs that central government incur when opposing regional demands are the same with any regional government. Second, that ACs get the same benefits (b) and costs (b – 1) from pursuing strategies "N" and "A".

But, how is the game modified if I introduce heterogeneity into the payoffs? On the one hand, it is reasonable to think that the central administration faces more costs when opposing some regions than others. If this is so, then the order in which each regional government enters the game is important in understanding how the game develops. Let us assume that in the early rounds central government bargains with *costly* regions (that is, regions whose demands are costly to oppose). As the costs of building a reputation are higher in the early rounds and payoffs are accumulated over rounds, costs of opposing regional demands soon surpass benefits of deterrence in the remaining rounds. In consequence, the round where central government accepts regional demands comes earlier, as compared to the game with homogeneous payoffs.

On the other hand, if regional payoffs vary across regions, the implications of the game are as follows. Assume there are some regional governments with strong preferences for a particular model of regional financing, which departs to a great extent from central government's proposal. This means that benefit (b) reaped of following strategy "N" (entering negotiation) is higher for those governments than for the rest. The result is the same as when considering heterogeneity in central government's payoffs: the round where regional government enters into negotiation moves forward *and* central government accepts regional demands.

For instance, according to the game's payoffs, a regional government receives *b* if it agrees on central government's proposal, where $0 < b < 1$. Assume we are in the twelfth round. This means the $n\text{-}k = 15 - 12 = 3$ bargaining rounds remain. Following the game equilibrium, an AC will enter into negotiation if $P_k < b^{n-k+1}$. Given region *A* with a payoff of b = 0.5, in the twelfth round (k= 12) the threshold is $b^{n-k+1} = b^4 = (0.5)^4 = 0.06$; whereas for region *B* with a higher payoff (b=0.7) in the same round (twelfth) the threshold is $b^{n-k+1} = b^4 = (0.7)^4 = 0.24$. This means that when, for instance, the chance that central government is a strong player (P_k) is low ($P_k = 0.2$); then in the twelfth round (k=12) the AC with highest payoffs (region B) will have incentives to enter negotiation and try to modify the central administration's financing proposal (since $P_k < b^{n-k+1}$; $P_{12} < 0.24$). On the contrary, the region with a weaker intensity of preferences (region A) will not have incentives to enter negotiation because $P_k > b^{n-k+1}$; $P_{12} > 0.06$).

Finally, taking into consideration the consequences of introducing heterogeneity into the game's payoffs, I can predict the situation in which central government is *less* capable of maintaining reputation: when in the early rounds of the game central government interacts with regions with strong preferences for negotiating the proposal *and* whose demands are very costly to oppose.

7.2.1.2. Back to reality: the evolution of fiscal intergovernmental arrangements in Spain

The first attempt to establish a stable model of regional financing took place in 1986, when multilateral bargaining in the FTPC gave birth to the 1/1986 Regional Financing Agreement. As was explained in chapter five, this model superseded the former system (based on the "effective cost" method) and was named as the "definitive system", indicating that it was aimed at initiating a new period characterized by a steady model of regional financing.

The negotiation of the 1986 Agreement can be represented as an incomplete information game. It is plausible to assume that when the 1986 Agreement was negotiated regional governments were not certain of the extent to which central government could be a "strong" player. That is, regional representatives ignored whether the central administration was willing to modify the terms of the multilateral agreement in the bilateral bargaining process of ratification. This is well illustrated in the words of Carlos Solchaga – Minister of Economy from 1985 to 1993. In comparing the context where the negotiations of the 1986 Agreement took place with the scenario in which the subsequent model (the second definitive regional financing system) was negotiated, he states:

> "In 1985-1986 it was the first time that (a new financing model) was negotiated...Nobody was ready to negotiate…and all (representatives) had their guard down...but in the next round (the negotiation process of the second definitive model of regional financing) all (representatives) were fully awake....(then) everybody knew what was at stake in the negotiation process (...) I knew what the demand was from La Rioja and La Rioja knew what the position of the Ministry was **…** not only regarding a particular issue, but about many other (issues)(...). In the second round everything went ahead without great surprises as everybody knew what was at stake."[13]

Central government showed itself to be a *weak* player in the negotiation process. This means that it was unable to oppose regional demands in the bilateral ratification of financing agreements. In consequence, political criteria have prevailed over technical concerns in the configuration of fiscal intergovernmental arrangements. *Why is the central administration a weak player?* The answer to this question has been given in the foregoing chapters of the dissertation. The two general hypotheses formulated in chapter two dealt with central government strategies

---

[13] Source: interview made by the author to Carlos Solchaga the 28th of July 2005.

in the allocation of intergovernmental transfers. Testing these hypotheses on the Spanish case provided empirical support to the idea that the design of fiscal intergovernmental arrangements responded to central government's electoral strategies. It is the *political* use of fiscal intergovernmental arrangements what makes central government a weak player.

In the extension-form game I assumed that central government's financing proposal was grounded in technical criteria (general principles of grant design) and aimed at being stable over time. However, central government cannot commit to these objectives because it incurs high costs. The central administration threatens to exclude from the financing model regions that attempt to modify the terms of its proposal. But these are not credible threats as they are too costly. If central government opposes bilateral negotiation of fiscal arrangements it incurs costs because it restrains itself from designing fiscal arrangements in a way that advances its electoral goals. More specifically, as I stated in chapter five, central government may transfer more financing resources towards regions whose political characteristics enhance electoral prospects. It cannot therefore make threats credible, as it is not capable of committing to disregard those political features when designing fiscal arrangements. The opportunity cost of doing so is represented by the potential electoral benefits it may obtain from designing fiscal arrangements in a strategic way.

The design of intergovernmental transfers in Spain clearly shows that fiscal arrangements have been the result of a process of bilateral negotiation where political criteria have prevailed. As was explained in chapter five, the 1986 Agreement introduced an allocation formula that distributed resources according to regional needs. This formula was intended to provide a regular and stable mechanism of regional financing. But the distribution formula ended up being the *outcome* (and not the origin) of a distribution of resources that had been previously negotiated in bilateral commissions (Ruiz-Huerta and Herrero 2005: 8; Pérez 2000: 108; Herrero 2005: 153; Castells, Sorribas and Vilalta 2005: 74). There is no a clear justification for the selection of some of the distribution formula parameters and weightings but the *rationale* of political negotiation.[14] For instance, the 1986 Agreement introduced three new parameters in the allocation formula that had not been provided for in the LOFCA dispositions: *administrative units* (the number of provinces in each AC), *area* and *insularity*. There exist other indicators that could have better measured regional financing needs (Monasterio and Suárez; 1993).[15] Additionally, in the 1992-1996 financing Agreement the allocation formula was modified. Changes affected the weighting of some formula parameters and a new variable – the population dispersion – was introduced, whereas the *administrative units* variable was incorporated into the allocation formula for slow-track regions. Following the argument presented above, these reforms reveal central government's weak nature, which results in the ongoing modification of regional financing mechanisms.

The credibility of a central government that commits to a stable model of financing virtually fades away when the model includes a provision for its periodical revision. The 1986 Agreement provided for an automatic update of regional financing, even though this measure was not foreseen in the

[14] Castells, Sorribas y Vilalta state that "nobody ever gave a rationale for the parameters and weightings used (in the allocation formula) nor for their modification over time" (2005: 74). In addition, Sevilla (2005: 41) argues that as regional indicators of need have been subject to bargaining – between the central and regional administrations - it is likely that those indicators have some limitations in capturing variation in the cost of service provision across regions.

[15] Additionally, the weighting of each parameter is subject to some modulation rules that modify the distribution of monies according to regional average of per capita financing. It seems, therefore, that the objective has been to make per capita financing equal across regions or at least shorten regional differences in per capita financing. However, some academics argue that the equalization objective was not part of the LOFCA provisions. Instead – they say – LOFCA regulations seem to point towards a distribution of resources according to financing needs (Moldes 1996: 139; Sevilla 2005: 38).

LOFCA regulations (Ramallo and Zornoza 1995: 20, 23; Moldes 1996: 139). This measure did not gel with the aim of having a long-lasting regional financing system. One could then argue that the origin of the instability of regional financing in Spain is simply the result of the automatic revision that takes place every five years. However, reforms in regional financing have not only taken place every five years but important modifications have been enacted in the middle of the implementation of a financing agreement. In addition, the automatic revision was removed in the last regional financing Agreement (passed in December 2001) - in an attempt to make it more stable. However, a reform of the 2001 Agreement is foreseen in the near future (in 2007). This indicates that the origin of instability is not related to central government's attempts to commit to a stable system of regional financing, but to the compatibility between rules and the existing structure of incentives.

7.2.1.2.1. Heterogeneity of payoffs in the real bargaining process

Finally, there are two remarkable features of the extensive-form game that have shown to be crucial in accounting for the evolution of fiscal intergovernmental arrangements in Spain. I refer to heterogeneity in regional preferences for a revision of regional financing and heterogeneity in the central administration's payoffs across negotiations rounds (or, in other words, a variation in the incurred costs of opposing regional demands).

The interview-based qualitative analysis presented in chapters four and five have shown that Catalonia has played a leading role in the evolution of fiscal intergovernmental arrangements. On the one hand, this region has been characterized by having an intense preference for a revision of the different models of regional financing.[16] As was mentioned above, the origin of this strong preference for change is the attempt of regional representatives from Catalonia to reduce differences between the *Foral* regime and the Common system of financing. On the other hand, the central administration has traditionally faced higher costs of opposing regional demands from Catalonia for several reasons. First, between 1993 and 2000 the central incumbent has depended on the ruling party in Catalonia to get a parliamentary majority.[17] Second, the Catalan party federation has concentrated a majority of the Socialist party's electoral support. Party members from the Catalan party federation have assumed relevant positions within

---

[16] For instance, when the 1992-1996 Agreement was adopted, regional representatives from Catalonia committed to create a study group that would analyze the possibility of increasing fiscal co-responsibility in future reforms of regional financing.

[17] Political factors have strongly impacted upon regional financing when a minority central government has needed parliamentary support from regionalist parties (Aja 1999: 226). When the Socialist Party lost their majority in the 1993 general elections, two regionalist parties - *Partido Nacionalista Vasco* (PNV) and *Convergencia i Unió* (CiU) – agreed to provide parliamentary support to the minority Socialist government in return for a modification of the regional system of financing. As a result, a new model of regional financing was approved in the FTPC that granted regional governments 15% of the personal income tax yield collected by the central administration within their territory (a reform that was part of the electoral pledges of the ruling party in Catalonia, CiU). In 1996 the Popular Party (PP) won a general election and forms a minority government. This obliged the PP to form an alliance with regionalist parties (CiU, PNV and *Coalición Canaria* (CC)), which provided parliamentary support to the central incumbent in exchange for the implementation of their demands. For instance, the Basque government was granted full powers over excise taxes. As for the Catalonian government's demands, they resulted in a modification of the *Common* model of regional financing whereby regions are endowed with powers to regulate some aspects of ceded taxes – mainly tax brackets, tax rates and some tax credits - and the personal income tax partially becomes a ceded tax (Gordo y Hernández de Cos, 2000).

the PSOE's organization. These features have endowed regional leaders (from the Catalan party federation) with great power in bilateral bargaining. Therefore, Catalonia combines strong preferences for renegotiating the model with high costs for central government of opposing its demands. According to the extensive-form game presented in the foregoing section, when the central administration interacts in an early round with this type of region it is unable to maintain a reputation as a strong player. As a result, it accepts the modification of fiscal arrangements, uncovers its true weak nature and the game unfolds with the renegotiation of fiscal decentralization in the subsequent rounds. In sum, the fact that fiscal intergovernmental bargaining in Spain has been fundamentally driven by early negotiations with Catalonia is a crucial factor in understanding the unstable nature of fiscal arrangements.

However, accepting regional demands may also be a costly strategy for the central administration, which qualifies the arguments presented in the former paragraph. The argument would go as follows. If a particular AC (or group of regions) succeeded in negotiating the terms of financing agreements (that is, if central government accepted its demands) it was common knowledge among regional representatives.[18] This usually caused grievances among regions and a spiral of increasing regional financing claims, as none of the remaining ACs wanted to be the laggard in maximizing revenues through bilateral bargaining. The central administration coped with these demands by granting ACs compensatory financing revenues (basically through higher conditional grants such as investment funds).[19] As a result, intergovernmental fiscal arrangements became a positive-sum game, since central government was stifling the spur of regional

---

[18] As is assumed in the extensive-form game, regions know how bargaining unfolds in the previous rounds.

[19] There is supportive empirical evidence on this strategy in the interview-based analysis of chapter 6.

demands by increasing the overall flow of resources towards sub-national level.

This argument is well supported by qualitative data. For instance, Carlos Solchaga described the system of regional financing in the mid-1980s as hyper-redistributive. He characterized the distribution of per capita financing as favourable to poor regions. This situation filled some ACs with a sense of grievance, which hampered the negotiation of a new model of regional financing in 1986. The way central government sorted this problem out is well summarized in his following statement:[20]

> "How do you cope with the problem (of having a hyper-redistributive financing system)? Well, we turned a (distribution) game that by nature is similar to a zero-sum game into a positive-sum game. What does it mean? It means that any reform you introduce in the system of regional financing (…) results in a more expensive system. (This is so because) Regions (only) accept the new system if they get more monies."

In sum, these considerations reveal that central government incurs some costs when accepting regional financing demands. Then comes the question of whether these costs are high enough to modify the game's payoffs. Recall that central government has a weak nature because the strategy of opposing demands is more costly than accepting them. Therefore, if accepting demands involve some costs: will costs turn strategy "o" (oppose) into a more preferred option than strategy "a" (accept)? They will probably not and, therefore, the development of the game will remain the same. The explanation lies in central government's preferences. As I assumed in chapter one (section 2.5) , central government will only be willing to cede some control over resources on behalf of its electoral concerns. As was stated above, central government bears the costs of opposing regional demands because it restrains itself from designing fiscal arrangements in a way that advances its electoral goals. On the other hand, adopting

[20] A similar statement was made by Juan Manuel Eguiagaray.

the strategy of "accepting" demands entails a loss of resources for the central administration. Following central government's preferences, the costs of opposing regional financing demands will therefore remain higher than the costs of accepting them.

Finally, an additional argument further supports this line of reasoning. It has to do with the *time* when costs become effective. It is reasonable to think that the costs that stem from opposing demands are more immediate than those related to a gradual emptying of the central administration's coffers. The former have to do with short-term electoral concerns; whereas the latter are the result of a cumulative process whose effects may become clear in the long-term. Future costs might be discounted, which further corroborates the idea that for the central administration it is still preferable to accept regional financing demands than to oppose them.

7.2.2. Asymmetries in administrative and fiscal decentralization

As was explained in chapters three and five, two different types of asymmetries characterize decentralization in Spain: one is related to expenditure decentralization whereas the second affects fiscal powers. On the one hand, the Spanish Constitution established two different procedural mechanisms for Autonomous Communities to be formed. The first mechanism offered some ACs greater and faster autonomy whereas the second entailed more limited autonomy and established a slower devolution of spending responsibilities. On the other hand, the Constitution introduced two differentiated models of regional financing: the *Foral* regime applicable to the Basque Country (*Concierto*) and Navarre (*Convenio*); and the Common regime, which is applicable to the other ACs. The main difference between them lies in their taxing authority: the Basque Country and Navarre fully administer major taxes whereas regions under the Common system have had very limited (but increasing) taxation powers, which have made them more dependent upon transfers from central administration.

First, the homogeneization of expenditure powers across regions was initiated with the so-called *Autonomous Pacts*, which were signed by the incumbent party at the center (PSOE) and the main party in opposition (*Partido Popular*). These Pacts established the procedure to provide slow-track regions with greater authority and expenditure powers.[21] The Organic Law 9/1992, 23rd of December, made those agreements legally effective. Regional Statutes of Autonomy were reformed to enlarge the catalogue of regional competences with new granted powers (the Statutory reform was uniformly established through Organic Laws in 1994). Regions were subsequently transferred powers through Real decree-laws (the chronology of transfers is exhibited in Tables 10 and 11 in chapter three). The balance of expenditure powers across regions culminated with the transfer of health care services towards slow-track ACs in January 2002.

The initial decree-laws that transferred powers towards fast-track regions were approved in the early 1980s and until the early 1990s a constant downward transfer of competences took place. In 1992 the implementation of Autonomous Pacts extended the period during which there was a continuous flow of resources and authority from the central administration to ACs. Each new transfer of services involved an increase in the regional financing needs and, consequently, a modification of regional revenues. This bestowed the regional financing model with an *incomplete* or *unfinished* nature. In addition, as the model of financing was permanently under revision it fostered regional governments' expectation that their particular demands could be eventually introduced in future modifications of the model. Accordingly, when an AC was granted new powers, this was regarded as a new opportunity to negotiate bilaterally a more favourable allocation of regional financing. To summarize, the process of balancing initial

---

[21] The enlargement of competences to slow-track regions was grounded in Constitutional provisions. The Spanish Constitution (article 148.2) established the fact that ACs could extend their powers by reforming the Statutes of Autonomy five years after its approval.

asymmetries across regions left the model of intergovernmental distribution of power excessively opened, which fostered renegotiation of financing arrangements.

Second, asymmetries between the *Foral* and Common model of regional financing also account for the instability of regional financing. The Basque Country and Navarre have been granted full autonomy over taxes, which have prompted rich regions to claim reforms oriented towards an increase of tax decentralization within the Common financing system. In addition, *Foral* regions do not contribute with their revenues to the pool of resources that are used to finance regional expenditures (this is known as *Fondo de Garantía,* which covers the difference between each region's financing needs and regional revenues from ceded taxes). This has filled some regions with a sense of grievance, above all those that are net contributors to the common pool of resources, which also happen to be those with above-average per capita income. In sum, asymmetries between the *Foral* and Common model of regional financing have given grounds for complaints among the richest regions, which are willing to bring tax decentralization in the Common system closer to the *Foral* level. This has given rise to heterogeneity across regions regarding preferences for a modification of the Common system of financing. Or in other words, regional grievances that originate in asymmetric fiscal powers between the *Foral* and the Common financing systems have fostered preferences for a revision of the model among the richest regions in the Common system. Following the extensive-form game of Section 7.2.1, this could be represented with higher payoffs of adopting strategy "N". As a result, the strategy of opposing regional demands becomes more costly for central government. As was shown in the development of the game, the existence of regions with strong preferences for a modification of the central administration's financing proposal entails more difficulties for central government to oppose regional demands.

7.2.3. Vertical imbalances

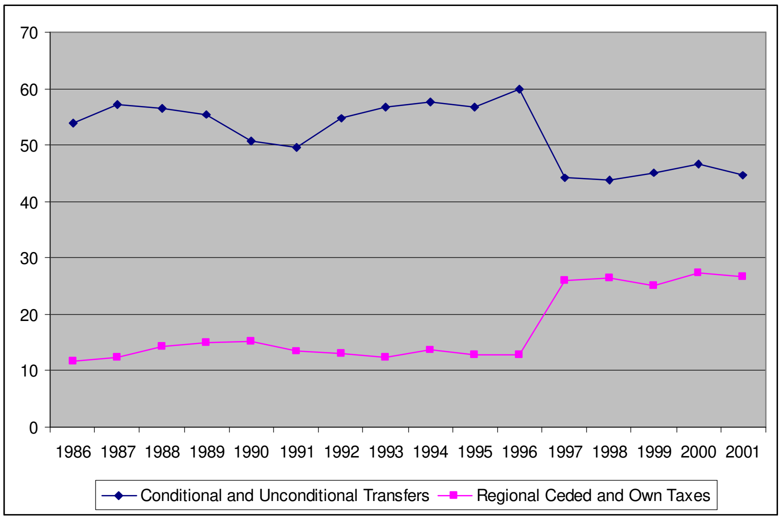
Vertical fiscal imbalances occur when expenditure decentralization does not match tax decentralization. Or, put in a different way, vertical imbalances exist when services that have been transferred to sub-national governments cannot be exclusively financed through local taxes. The fiscal gap is covered through grants from central administration. In Spain, expenditure decentralization has not matched tax decentralization. Regional governments were granted powers over the provision and management of public services that involve high expenditures (such as Education or Health Care). However, expenditure decentralization did not come along together with further autonomy over taxes. As a result, until the mid 1990s regional financing was overwhelmingly composed of unconditional and conditional transfers, whereas autonomy over taxes was very low (Ruiz 2003).

Figure 7.3 displays vertical fiscal imbalances in Spain for regions within the Common system of financing. In this figure I compare the percentage of total regional revenues that come from conditional and unconditional transfers with the percentage of total regional revenues that originate in regional ceded and own taxes. As is shown in these figures, transfers from the central administration represent on average 52% of regional financing revenues throughout the period (1986-2001); whereas regional own and ceded taxes only represent 17% of total regional revenues.[22]

---

[22] The percentage of ceded taxes, own taxes and transfers from central government over ACs' total resources do not make one hundred since there are other regional revenue sources that I have not calculated, namely: loan operations, surcharges over national taxes; service fees, subsidies to families and corporations that are managed by regional governments (and come from the European Union or the central administration), investment agreements and program-contracts between the central administration and regional governments and, finally, local grants (transferred from the central administration towards municipalities

Figure 7.3. Vertical fiscal imbalance. Conditional and Unconditional transfers vs. Regional Taxes as a percentage of regional resources (Common Regime Regions) 1986-2001



Source: Instituto de Estudios Fiscales (Institute of Fiscal Studies). Badespe Database

Two related effects have resulted from vertical fiscal imbalances. On the one hand, an overly transfer-biased system of regional financing has created perverse incentives in regional governments' fiscal behavior. It has encouraged regional overspending and deficits. This result corresponds with existing empirical evidence in other countries where sub-national revenues are mainly composed of transfers from a higher level of government.[23] On the other hand, vertical imbalances have created

and provinces through the regional administration, which manages them).

[23] The combination of a centralized tax system with decentralized service provision violates the "fiscal equivalence" principle (Oates 1977). Put simply, this principle states that each jurisdiction should cover

incentives for regional governments to base their expectations on future increases of revenues on higher transfers from the central administration.[24] Both effects are the result of a rationale based on costs and benefits. ACs have basically three different mechanisms to finance their expenditures: to raise ceded taxes (or create new taxes); to incur debt or to demand higher transfers from the central administration.

As far as the first revenue source is concerned, regions have no incentives to increase tax pressure on their jurisdiction's population. First, because tax decentralization and normative powers over ceded taxes have traditionally been very limited (until the reform of regional financing was passed in 2001). Therefore, the capacity to generate extra revenue through ceded taxes has been low[25] (Moreno 1998). Second, because the use of taxes may incur important electoral costs for the regional executive, as an increase in the tax burden is an unpopular measure that may hamper the electoral performance of the implementing administration.[26] As a result, incurring debt or demanding more

---

its own expenditure predominantly from its own taxable income. When sub-national jurisdictions' expenditures are mostly financed through "common pool" resources (for instance, through revenue-sharing), then sub-national governments face greater incentives to overspend. This is so because sub-national leaders do not integrate into their expenditure the decision costs of collecting taxes (Rodden 2001; Jones, Sanguinetti and Tommasi 2000).

[24] A Report on the Reform of Regional Financing states that the "instability (of regional financing) creates incentives for ACs to adopt decision strategies based on the expectation that the central administration, sooner or later, will bail them out." (Lasarte et al. 2002: 102)

[25] Even though the LOFCA establishes that ACs can create new taxes, service fees and special contributions (subject to some limits) and set up surcharges over national taxes; in practice these sources of revenues represent a very small percentage of regional financing.

[26] Survey data shows that in Spain citizens have become more sensitive to an increase in the tax burden. For instance, the percentage of individuals that disagree with the sentence *"in order to have more and*

transfers from central administration are ACs' preferred sources of raising extra revenue (Corona *et al.* 1998). This is so because regional governments can generate greater revenue through these mechanisms than through ceded taxes without bearing political costs.

As far as the second generating-revenue option is concerned (sub-national debt), in Spain regional levels of indebtedness increased, above all in the late 1980s and early 1990s (Suárez Pandiello 1996). Some limits to regional borrowing were implemented, particularly through the Budgetary Stability Act in 2001. In consequence, the third type of revenue source– demanding higher transfers from the central administration – remained as the only feasible mechanism through which regions could obtain extra revenues.

A rise in regional revenues through intergovernmental grants may occur if there is a general increase in the overall amount of monies that flow from central government to regions. Alternatively, it may be the result of a different allocation of monies among ACs (caused by a modification of the distribution formula, for instance). Both factors involve a modification of the system of regional financing. But how costly is the modification of fiscal intergovernmental arrangements for regional governments? Transaction costs related to a revision of regional financing are low. On the one hand, legal proceedings to modify the financing model are relatively simple, as Agreements made in the FTPC have no legal status.[27] These Agreements are presented to the central executive as a recommendation and therefore are not legally binding. On the other hand, regional representatives know that the financing system that is agreed in the FTPC is only

---

better public services and social benefits it is necessary to increase taxes" has steadily risen from 42% in 1985 to 70% in 1999 (see Public Opinion and Fiscal Policy series, *Centro de Investigaciones Sociológicas*, series from 1985 to 1999 (except for 1987, when there is no data available)).

[27] Except the last financing agreement, which was approved as the Act 21/2001 27th of December.

applicable in their region if there is ratification in the corresponding Mixed Commission. Or, in other words, the bilateral ratification process reduces transaction costs, as regional governments have only to bargain with one actor (central government representatives) and not with representatives from the remaining fourteen ACs. In sum, the most efficient way for regions to obtain extra revenues consists in demanding an increase in grants from central administration. Regions succeeded in adopting this strategy, as financing Agreements (except the 2001 Agreement) included revenue guarantees whereby each region was receiving under a new financing system at least as much as under the former model. This contrasts with the mild use of normative powers over ceded taxes, which have basically consisted in the introduction of tax exemptions.[28]

7.3. Conclusions

The main purpose of this chapter has been to account for the instability of regional financing in Spain. My explanation is grounded in the theoretical approach I presented in chapter one, that is, in the combination of actors' preferences and the incentives that stem from the institutional structure where they make decisions. More specifically, I focus on three characteristics of the context where central and regional representatives interact: the strong role of bilateralism in negotiations over regional financing, the open-ended and asymmetric nature of fiscal and administrative decentralization, and the existence of high vertical fiscal imbalances. My argument is that these features – that characterize the specific design of fiscal and administrative decentralization in Spain - have given rise to incentives that are not compatible with maintaining a stable system of regional financing.

---

[28] See Ruiz Almendral (2002) for a description and discussion of the regional use of tax powers.

The core argument to explain the ongoing renegotiation of fiscal arrangements revolves around the formalization of intergovernmental bilateral bargaining through an extensive-form game. I use the Chain Store Paradox to illustrate why central government is unable to design a long-lasting system of regional financing based on technical criteria. With this model I connect empirical findings from the foregoing chapters of the dissertation with the causal mechanisms of regional financing instability. Both quantitative and interview-based analysis in chapters four and five showed that intergovernmental financing agreements in Spain have been driven by political negotiation. Empirical evidence corroborated the *commitment problem* whereby central government cannot restrain itself from a strategic use of intergovernmental fiscal arrangements. It is precisely the existence of this commitment problem that makes central government a weak player in bilateral bargaining, which results in a failure to prevent regions from renegotiating the terms of financing agreements. As for regional governments, the extensive-form game assumes that their preferred option is to attempt to modify the terms of fiscal intergovernmental arrangements. The *rationale* of those preferences is grounded, on the one hand, in the set of incentives generated by the asymmetric nature of fiscal and administrative decentralization. The process of balancing initial asymmetries in competences across regions prompted the ongoing revision of the distribution of powers across levels of government, and in turn a permanent modification of regional revenues. This fostered the perception among regions that regional financing was highly *malleable* and increased the expectation that particular demands would be eventually introduced in future modifications of the system. In addition, asymmetric fiscal powers between the *Foral* and the Common financing systems caused regional grievances between the richest regions and spurred demands to reform the system by bringing tax decentralization closer to the *Foral* level. On the other hand, the existence of high vertical imbalances left the strategy of demanding higher transfers from central government (that is, a repeated interaction with the central administration to demand more monies) as the only feasible mechanism for regions to increase revenues. This strategy grants them greater revenues than alternative sources of financing - such as debt or imposing taxes – without having to bear the political costs of increasing tax burden in their jurisdictions.

To summarize, the main objective of this chapter was to uncover a puzzling scenario whereby the central and regional administrations were unable to establish a stable system of regional financing. My explanation is that instability is a rational outcome: no matter how strongly central government commits to stable fiscal arrangements that instability is likely to last as long as the current structure of incentives remains.

CHAPTER 8. SUMMARY AND CONTRIBUTIONS

8.1. A summary of the theoretical framework and empirical findings

In this thesis I began to analyze fiscal decentralization by establishing a definition that could be clearly distinguished from other forms of decentralization (namely, political and administrative). I characterized fiscal decentralization as the set of policies designed to increase the revenues or fiscal autonomy of subnational governments. It is a process that involves a downward reallocation of revenue sources for subnational governments, which may consist in transfers from central government, new subnational taxes or tax-sharing. I therefore exclude from this definition expenditure decentralization, which in other studies falls within the fiscal decentralization category. Expenditure decentralization is related to the transfer of responsibilities over the administration and delivery of public policies such as education, health care or social services, which I classify within the administrative decentralization type. Among the different revenue sources that fiscal decentralization arrangements may involve, I decided to focus my research question on the analysis of a particular component of fiscal intergovernmental arrangements: intergovernmental transfers. In addition, I limited the analysis to a *devolved* context, that is, a setting characterized by the existence of subnational, democratically elected governments that have been transferred responsibility or authority. By restricting the analysis to a devolved context I was controlling for one of the two types of decentralization (political decentralization).[1]

I grounded my theoretical model in the assumption that politicians' actions result from the combination of politicians' preferences and the incentives that stem from the institutional framework where they make decisions. Accordingly, and assuming that preferences are stable over time, the variation in fiscal intergovernmental arrangements will be the result of politicians' facing a different structure of incentives.

As far as politicians' preferences is concerned, I departed from the fiscal federalism approach where politicians were characterized as benevolent planners that pursue the maximization of economic efficiency. I employ a more realistic characterization where national politicians' preferences are to control resources and policies and secure re-election. And subnational politicians prefer more power to less but, as they also want to stay in power, they do not press for resources if it threatens their political survival. Accordingly, a modification of revenue sources across levels of government is not due to the implementation of technical solutions but is the result of a political compromise that is brought about by bargaining between different strategic political elites. My argument is that the institutional context where political elites negotiate will crucially determine their negotiation strategies and

---

[1] This restriction excludes cases such as a transfer of certain administrative responsibilities to lower units within the public sector hierarchy that are accountable to higher levels (*deconcentration*). Also, the transfer of managerial and administrative responsibilities to organizations and agencies that have a flexible link with the structure of the public administration – and where the central administration's control is exercised indirectly (delegation) would not be part of my object of study. Neither would the transfer of a set of functions from the public sector to a private one (for instance, the *contracting-out* of public services to private for-profit or non-for-profit organizations) (See Mills 1994).

therefore will account for the design of fiscal intergovernmental arrangements.

An important premise is that there may exist electoral benefits from the use of expenditure transfers. Electoral benefits might result from the increase in welfare that public expenditures generate amongst voters. Intergovernmental transfers finance those public expenditures and therefore, citizens' welfare may increase the greater the monies that flow from the central administration to a subnational jurisdiction. This is the way transfers might assist politicians in advancing their electoral goals. Therefore one question is: in a devolved context, which level of government benefits more from the use of transfers? I argue that some particular features of the institutional setting determine the distribution of electoral benefits across levels of government. A second question is: why is it important to know which level of government gets the lion's share of intergovernmental transfers' benefits? I argue it is because a) the allocation of electoral benefits impacts upon the strategies politicians bring to the negotiation of fiscal arrangements and b) strategies result in a particular design of intergovernmental transfers. In fact, this is what the two general hypotheses of this thesis are about: they establish a causal relation between a particular institutional setting and the design of intergovernmental transfers.

8.1.1. Coming to the two general hypotheses

In order to come to the two general hypotheses I developed two ideal types of institutional contexts: a centralized and a decentralized institutional context where only two types of actors (the central administration and subnational governments) interact. What makes these two scenarios different is the degree of subnational governments' authority over tax and expenditure powers. In addition, variation in decentralization levels brings variance in other features, as well, namely: citizens' ability to ascribe responsibilities across levels of government; electoral externalities between copartisans at different levels of government and the structure of the party system. I characterized each institutional setting according to these features. I therefore assume that in a centralized setting: first, citizens ascribe low salience to subnational institutions and still regard central government as the main level of government responsible for both the financing and provision of goods and services (despite the fact that expenditure powers are formally decentralized). Second, that there are high electoral externalities across levels of government. This means that the chances of (re)election of subnational politicians are highly determined by the value of their national party labels. Or, in other words, the electoral fates of national politicians are correlated with those of their local and regional counterparts. And third, the internal organization of parties is centralized, that is, the party's political agenda is in the hands of the party national leadership.

Given these assumptions, electoral benefits from public expenditures financed through transfers are accrued in full at central level. This is so because, on the one hand, citizens make central administration fully responsible for public expenditures (and, in turn, for welfare) that are financed through intergovernmental transfers. On the other hand, subnational politicians have no incentives to attempt to reap some of the electoral benefits from intergovernmental transfers. High electoral externalities and a centralized party system prevent subnational elites from adopting a strategy of intergovernmental "bickering" with the central administration. This is particularly so for party affiliated jurisdictions. Confrontation with their national copartisans would negatively affect the electoral prospects of the party in national electoral contests (as a consequence of party disunity), and eventually have a negative impact upon subnational electoral performance (due to the existence of high electoral externalities). Also, subnational leaders incur within-party costs associated to national party leaders' retaliation measures.

My assumptions for a decentralized context are of the opposite sign. This means that: first, citizens are more capable of ascribing responsibilities across levels of government. They are aware that the subnational administration is the most responsible level of government over the provision of services and public goods in their jurisdictions and ascribe electoral rewards for expenditure transfers accordingly. Second, there are weak electoral externalities. When regional governments are endowed with a high level of authority and expenditure powers, subnational elections are increasingly held on local issues, which fosters the formation of differentiated constituencies for the local and regional counterparts of national politicians. This means that citizens are more likely to vote differently in national and local elections. As a result, subnational leaders' electoral fate becomes gradually independent to that of their copartisans at the center (weaker electoral externalities). Third, when subnational governments are endowed with a high level of powers and authority, this introduces some centrifugal pressures within the structure of national parties that make national and subnational counterparts more independent from each other and the latter more powerful. This means that subnational leaders have more influence within the party organization to select the candidates that run for national and subnational elections or to set the political agenda.

Given these assumptions, in a decentralized context subnational governments are more capable of reaping a greater amount of electoral benefits from the use of intergovernmental transfers. On the one hand, they have greater expenditure powers and authority and subnational competences are more visible to voters (as citizens' are more capable of distinguishing the distribution of responsibilities across levels of government). In addition, the existence of regional-based parties increases the potential "bickering" strategies from subnational leaders that the central administration has to face across the territory. And among party affiliated subnational leaders, weaker electoral externalities diminish the costs that otherwise would have prevented them from claiming credit – rather than the central incumbent - for welfare generated through public expenditure. On the other hand, higher levels of political decentralization make national politicians more vulnerable to subnational demands. In a decentralized context, subnational leaders are more capable of mobilizing their own constituencies, and they may use their powers against national representatives, even when they are copartisans. As a result, the central incumbent may have problems to ask for subnational leaders' electoral support in national elections. Central government may not be fully able to count on subnational copartisans' support to be reelected and the latter may make support conditional on a higher transfer of resources. Additionally, national party representatives are less able to exert pressures towards affiliated subnational representatives through the internal organization of the party. This is so because, when subnational governments are endowed with a high level of powers and authority, power within the party apparatus of state-wide parties flows towards subnational copartisans.

After characterizing the two ideal institutional contexts I introduce a model to represent central government's decision on the design of intergovernmental transfers. In this model individuals take into account two criteria when they vote: ideology and the amount of welfare received from the incumbent. Voters' welfare depends on the level of public expenditures in their jurisdiction, which I assume is equivalent to the amount of grants spent in a particular state. An individual evaluates the incumbent at the center on the basis of the amount of welfare provided in office, as compared to a threshold or cut-off point. He re-elects the incumbent when the level of welfare is above this threshold point. An individual with ideology close to the central incumbent will have a lower threshold value, as compared to voters who do not identify themselves with the ideology of central government. States might be classified according to their swing or loyal nature. A loyal state is one where there is a higher proportion of individuals with low re-election threshold values than with high ones. Or, in other words, the density function of thresholds values has a downward slope because the density is higher at low cut-off points than at high threshold points. On the contrary, in a "swing" state the density function has a positive slope, which means that there is a higher proportion of voters with high cut-off points.

The decision of central government regarding the distribution of intergovernmental transfers varies across institutional settings. In a centralized context central government has more incentives to transfer more resources towards swing states because the percentage of votes they gain per each additional unit of transfers is higher than in a loyal state. As the electoral benefits from expenditure transfers are fully accrued at central level, it may adopt an allocation strategy that maximizes votes per unit of transfer. The first hypothesis, therefore, is that in a centralized context central government will skew more resources towards swing regions (where it reaps more electoral benefits from each unit of transfers) regardless of their partisan affiliation.

On the other hand, in a decentralized context the central administration must take into account that – given the assumptions made in this context – that some of the electoral benefits from public expenditures are reaped by the subnational level of government. In addition, unlike in the centralized context, in this scenario the affiliated or non-affiliated nature of the state is important for the allocation strategy. In an affiliated region, central government may accrue some benefits out of those received by the subnational incumbent. This would be a sort of positive spillover effect of affiliated subnational government's electoral support for the central incumbent. On the other hand, central government cannot expect that electoral benefits in a non-affiliated state would have any positive spillover effect on its electoral prospects. As a result, in this context transferring resources towards swing states would become a risky strategy. Additionally, among affiliated regions, there is variation with respect to how much electoral support moves towards central government. It will depend on the willingness of partisan affiliated incumbents to mobilize their constituencies and administrative resources in support of the central incumbent. For instance, if electoral support of the central incumbent is concentrated in a particular region, the central administration's representatives will be more vulnerable to its demands. We know from given assumptions in a decentralized context that affiliated subnational leaders may have incentives to use their powers against national copartisans' electoral interests (due to weak electoral externalities). As a result, the extent to which national leaders benefit from subnational copartisans' electoral support depends on the latter's eagerness to mobilize resources in favour of national copartisans. In sum, the second hypothesis states that in a decentralized context central government will have incentives to skew more resources towards partisan affiliated regions and, among them, towards the ones whose political support and resources are crucial to winning national elections. Or, in other words, transfers will go to party affiliated regions upon which the central incumbent is more dependent to gain votes.

In summary, my theoretical framework tells a story about politicians who pursue the maximization of their electoral results and about how they use different strategies to attain these goals. Variation in the design of intergovernmental transfers is the result of politicians adopting different strategies in distinct institutional contexts where subnational politicians' responsibility and authority over public expenditures differ.

8.2. Empirical findings

Spain represents an excellent case to test the two general hypotheses. There exists a devolved territorial organization of the State - *Estado de las Autonomías* (State of Autonomies) that has experienced increasing fiscal and administrative decentralization. One can distinguish two different institutional contexts: from the early eighties until the early nineties the institutional setting corresponds to a centralized scenario. It is characterized by a highly disciplined and centralized party system and a powerful central government (as slow-track regions had limited powers over expenditures and fast-track Autonomous Communities were still involved in the process of negotiating some transfers of expenditure responsibilities). In addition, at that time the level of entrenchment of regional institutions was low and citizens were generally not familiar with the regional administration. The second period lasts from the mid-nineties until the early years of the XXIst century and is equivalent to a decentralized institutional setting. In these years the implementation of Autonomous Pacts (1992) put slow-track regions on a level with fast-track Communities in terms of competences.

Results reveal that the design of the regional financing system in Spain is the product of different political strategies, which correspond to the two general hypotheses. Accordingly, in the early years of the State of Autonomies the model of regional financing favored swing Autonomous Communities; whereas fiscal intergovernmental arrangements that were approved in the second period were beneficial to affiliated regions and, among them, to those that represented electoral strongholds for the central incumbent.

The assumptions made when describing each institutional setting have also been subject to empirical-testing. On the one hand, results have corroborated the causal relation between variation in decentralization levels and citizens' capabilities to allocate responsibilities across levels of government. Spain was an excellent case to test that hypothesis, as there exists variation in fiscal and expenditure powers across regions and over time (as regions have been granted increasing powers and authority). This allowed me to explore whether differences across regions and over time have had an impact on citizens' ability to assign responsibilities between the central, regional and local administrations.

On the other hand, I explored whether there is a causal relationship between decentralization and the impact of national electoral results upon subnational elections (electoral externalities). Results revealed that national electoral spillovers across party co-partisans diminished as regional leaders accrued powers and authority. Qualitative data corroborated that decentralization has a centrifugal impact on the structure of state-wide parties. As subnational representatives are granted higher authority and expenditure responsibilities they gradually gain more influence within the state-wide party. Empowered subnational governments create centrifugal forces within the party structure, as they gain more influence in selecting candidates and drawing up the party's policy agenda. Additionally, interview-based qualitative analysis showed that as decentralization increases, so does heterogeneity between subnational politicians' policy agendas. They pursue differentiation strategies, that is, they adopt policy agendas that depart from the headquarters' guidelines – particularly when copartisans at the center face an electoral downturn.

8.3. Contributions

The contribution of this thesis can be evaluated as follows. In the first place, this study takes us further in the understanding of fiscal decentralization from a political economy perspective. By bringing politics to the study of fiscal intergovernmental arrangements I depart from theories that provide an economic rationale of fiscal decentralization. An economic justification relies largely on the allocative and productive efficiency gains of fiscal decentralization. Politicians have been accordingly characterized as benevolent planners that pursue economic efficiency. In my approach I abandon the normative terrain of fiscal federalism to adopt a positive approach that aims at explaining how politicians *do* in fact design fiscal intergovernmental arrangements - rather than how they *should* do. I characterize politicians as actors whose first and foremost objective is winning elections. Fiscal intergovernmental regulations are conceived of as a contract that is self-enforcing as long as incentives remain unchanged. Additionally, efficiency concerns play no role in the perpetuation of fiscal arrangements. In fact, actors' choices may give rise to outcomes that are collectively sub-optimal. This has been well illustrated in chapter six, where I analyzed how intergovernmental bargaining gives rise to a regional financing system that is unstable and has gradually depleted the central administration's resources. This study has shown that politicians are not credible when promising to improve these outcomes if they do not have incentives to do so. Having incentives means knowing that their actions link the means with their goals in the most efficient way. In sum, this thesis makes a contribution to a better understanding of the self-enforcing mechanisms that underlie any regulatory framework and make it enduring.

One of the advantages of my approach is that it encompasses the three related research questions that have traditionally been posed about fiscal decentralization (why, when, how?). In my perspective explanations revolve around politicians' motivations and actions. Their actions result from the combination between preferences and the structure of incentives that stems from the institutional context in which they make decisions. As a result, the design of fiscal intergovernmental arrangements (that is how revenue sources are eventually distributed across levels of government) is the result of what drives politicians' actions. In consequence, by exploring the *why* (variables that impact upon politicians' actions) I account for the *how* (pattern). In addition, what drives politicians' actions (incentives) represents the self-enforcing mechanism of fiscal intergovernmental rules. Fiscal arrangements are enduring as long as they assist politicians in pursuing their goals. My approach, therefore, also provides an explanation for durability of fiscal arrangements and by so doing it contributes to a better understanding of the *dynamics* of fiscal decentralization (*when* fiscal arrangements change).

This thesis also builds bridges between the study of the causes and consequences of decentralization. My research question deals with the explanatory factors of fiscal decentralization. I addressed it by creating a theoretical framework with two idealized institutional contexts that vary with respect to the degree of powers and authority that have been granted to subnational governments. The set of assumptions made in each scenario establishes a causal relationship between variation in decentralization and incentives generated by three factors: citizens' ability to distinguishing responsibilities across levels of government; electoral externalities and the structure of the party system. These assumptions, therefore, deal with the *consequences* of having variation in decentralization. The two general hypotheses on the design of fiscal intergovernmental arrangements are grounded on suppositions about the *effects* of having different decentralization levels on three particular features of the institutional context. In fact, one of the conclusive arguments of this thesis is that two devolved systems may give rise to totally different fiscal intergovernmental arrangements if they differ in levels of decentralization. Variation in decentralization involves variance in actors' bargaining power and strategies, which in turn gives rise to different fiscal agreements. This is an argument that directly addresses the effects or consequences of decentralization.

Bringing politics to the study of fiscal decentralization is not new. In chapter one I discussed some studies on decentralization that have recently incorporated a political interpretation of the decentralization processes. A political rationale relies on variables such as the structure of the party system or electoral competition. I elsewhere characterized these variables as within-party and between-party factors. The former refers to the distribution of power within political parties, that is, on the internal structure of political parties. The latter is related to variables that characterize electoral competition between parties. With a few exceptions, arguments have navigated one of the two sets of variables. One of the contributions of my theoretical framework is that it integrates both types of factors in the explanation. Politicians' actions are primarily driven by electoral goals and, in pursuing this objective, they use the most efficient strategy. Strategies entail different costs depending on within-party features such as electoral externalities across copartisans at different levels of government or subnational leaders' leverage within the party organization. In sum, in my model electoral competition dynamics set up politicians' preferences whereas within-party variables enter benefit/cost calculations in maximizing preferences.

Also, the arguments I elaborate in this thesis make some contribution to the study of the electoral politics of intergovernmental transfers. Different explanations exist on the distribution of intergovernmental transfers grounded in the political characteristics of subnational units (swing, core support, overrepresented, etc). But none of them have explained whether these variables have changed over time. This dissertation takes up that task and provides an argument to understand why some political features may become more relevant than others in explaining the design of intergovernmental grants.

Another important contribution of this thesis has to do with its implications on the irreversibility of decentralization processes. Let us assume a devolved country with a centralized institutional setting. Imagine that politicians decide to undertake political and fiscal decentralization. As decentralization unfolds, my theory predicts some changes in the strength of electoral externalities among copartisans, in the strategies of subnational political elites as well as in citizens' ability to distinguishing responsibilities across levels of government. As subnational leaders are endowed with greater powers, the institutional context gradually transforms. As a result, the central administration becomes more vulnerable to subnational demands and authority within political parties spins centrifugally towards subnational leaders. There exists, though unspecified, a sort of threshold decentralization level beyond which the process becomes virtually irreversible. This means the central administration incurs increasing costs of attempting to put an end to further decentralization or to backtracking powers. Crossing the threshold level beyond which decentralization starts to become irreversible depends on the interaction between time and the extent to which subnational governments are endowed with power and authority. These findings send a warning to myopic politicians who undertake decentralization with the belief that they will always be able to stop it. The same applies to those politicians who decide to decentralize with the hope that they will be able to backtrack powers in the future. In sum, at a certain point in time, politicians may be willing to surrender power if this assists them in furthering their electoral goals. But calculations to decentralize should take into account two caveats. First, that decentralization is a practically unstoppable process because it modifies the structure of incentives after the first decision to decentralize is made. Second, that decentralization effects may make future recentralization virtually impossible.

Finally, this thesis offers an exploration of the Spanish case. There is scant theoretical and empirical analysis of the Spanish regional financing system from a political economy perspective. As I stated in the introductory chapter, research on administrative and fiscal decentralization in Spain has traditionally been carried out from the disciplines of Law and Economics. Although this literature has made an important contribution in terms of enhancing knowledge about the legal provisions and models of regional financing, none of them have adequately addressed how the set of rules and proceedings that so far have regulated fiscal intergovernmental relations in Spain respond to political factors. This gave rise to a mismatch between the frequent portrayals of regional financing as a highly politicized process and the scant theoretical and empirical analysis devoted to further elaborate and back up this statement. By using Spain as a case study I covered this gap and set it within a theoretical framework that might be tested in other cases. In sum, this thesis introduces a political economy perspective in studying the Spanish system of regional financing.

8.4. So what comes next?

I hope to have provided in this thesis a coherent theoretical framework that could be tested in future comparative work. One the one hand, the two general hypotheses have to be tested with other cases. That can be done in different ways. Firstly, by comparing intergovernmental fiscal arrangements in the same country over time. This would require the country to have experienced increasing decentralization (or centralization) so that it is possible to distinguish different institutional contexts. Secondly, by comparing the design of fiscal decentralization arrangements in devolved countries with different levels of decentralization. Finally, as I have argued above, there might exist a threshold decentralization level beyond which it becomes virtually an irreversible process. Future research could tackle the task of disentangling when the accumulation of powers in the hands of subnational governments gives decentralization an irreversible nature, and if there are particular policy areas that, when transferred to subnational jurisdictions, accelerate irreversibility.

APPENDIX

Table A.1. List of Interviewees in alphabetical order

Name of Interviewee	Position	Date of Interview	Place of Interview
Joaquin Almunia Amann	Minister of Public Administration (1986-1989) General Secretary of the Socialist Party (1997-2000)	30th September 2005	European Commission (Brussels)
Abel Caballero Álvarez	Secretary of Institutional Policy of the Socialist Party (1988-1993)	14th July 2005 20th July 2005	El Escorial (Madrid) *Fundación Pablo Iglesias* (Madrid)
Juan Manuel Eguiagaray Ucelay	Minister of Public Administration (1991-1993) Member of the Federal Executive Committee of the PSOE (1991-2000)	19th July 2005	*Fundación Alternativas* (Madrid)

Francisco Fernández Marugán	Secretary of Economic Affairs of the Socialist Party	27th July 2005	Socialist Parliamentary Group (Madrid)
Miguel A. Fernández Ordóñez	State Secretary for Economy (1982-1986) State Secretary for Finance (2004 - ?)	20th July 2005	Ministry of Finance (Madrid)
Félix Pons Irazazábal	Minister of Territorial Administration[1] (1985-1986)	5th October 2005	Office (Palma de Mallorca)
Tomás de la Quadra-Salcedo Fernández del Castillo	Minister of Territorial Administration (1982-1985)	18th July 2005	Carlos III University (Madrid)
Carlos Solchaga Catalán	Minister of Economy and Finance (1986-1993)	28th July 2005 12th September 2005	Office (Madrid) Office (Madrid)

[1] The Ministry of Territorial Administration became the Ministry of Public Administration in 1986.

*Table A.2. Chronology of expenditure transfers for fast-track and slow track regions**

Regions	**80**	**81**	**82**	**83**	**84**	**85**	**86**	**87**	**90**	**94**	**95**	**96**	**97**	**98**	**99**	**00**	**01**	**02**	**03**
Andalusia			e				E												M
Aragon												E,S		e			H	M	
Asturias											E,S			e			H,M		
Balears												E,S	e				H,M		
Canary Islands				e		S	E			H					M				
Cantabria												E,S		e			H,M		
Castilla y León											E,S				e		H,M		
Castilla la Mancha											S	E		e			H	M	
Catalonia	e	H,S					E						M						
Extremadura											E,S			e			H,M		
C.Val				e		E,S		H						M					
Galicia		e				S		E	H				M						
Madrid											E,S				e	M	H		
Murcia											E,S				e		H		M
Navarre									H,e,S						M				
Basque Country	e					E		H,S											
La Rioja												E		S	e		H,M		

*No significant expenditure transfers were granted to ACs between 1991 and 1993// e= primary and secondary education; E = University education; H = health care services; S = social services; U = unemployment (occupational training)

Table A.3. Chronology of tax decentralization

SYSTEM of financing	REGION	TAX										
		Income	Corporate	VAT	W	I	S	GM	Excise	Vehicles	Electricity	Gas
	Andalusia	 01 (33)		01 (35)	84	84	84	84	01(40)	01	01	01
	Aragon	96 (30) 01 (33)		01 (35)	84	84	88	86	01(40)	01	01	01
	Asturias	96 (30) 01 (33)		01 (35)	86	86	88	86	01(40)	01	01	01
	Balearic I.	96 (30) 01 (33)		01 (35)	86	86	88	99	01(40)	01	01	01
	Canary I.	96 (30) 01 (33)		01 (35)	84	84	88	84	01(40)	01	01	01
Common Regime	Cantabria	96 (30) 01 (33)		01 (35)	86	86	88		01(40)	01	01	01
	C.Leon	96 (30) 01 (33)		01 (35)	85	85	88	85	01(40)	01	01	01
	C.Mancha			01 (35)	85	85	88	85	01(40)	01	01	01
	Catalonia	96 (30) 01 (33)		01 (35)	82	82	88	82	01(40)	01	01	01
	C.Valenciana	96 (30) 01 (33)		01 (35)	84	84	88	84	01(40)	01	01	01
	Extremadura	 01 (33)		01 (35)	84	84	88	84	01(40)	01	01	01
	Galicia	96 (30) 01 (33)		01 (35)	84	84	88	84	01(40)	01	01	01

Table A.3. Chronology of tax decentralization (Cont.)

SYSTEM of financing	REGION	TAX										
		Income	Corporate	VAT	W	I	S	GM	Excise	Vehicles	Electricity	Gas
	Madrid	96 (30) 01 (33)		01 (35)		90	97		01(40)	01	01	01
Common System	Murcia	96 (30) 01 (33)		01 (35)		86	88	86	01(40)	01	01	01
	Rioja	96 (30) 01 (33)		01 (35)	86	86	86	86	01(40)	01	01	01
Foral Regime	Navarra[1]	86	86		86	86	86	86	86 A 98 G/T	93	98	
	Basque C.	86	86			86	86	86	86 A 97 G/T	97	97	

W = wealth tax; I = inheritance tax; S = stamp-duty tax; GM = gambling tax; A = alcohol tax; G/T = gas and tobacco tax

First two digits in each cell account for year of transfer. Tax-sharing percentages are in parenthesis. If not, it is assumed that regions accrue 100% of the tax.

[1]In 1986 Navarra and the Basque country were transferred a tax on alcohol and a tax on intermediary products.

In addition, since 1997 (Basque Country) and 1998 (Navarra) these regions have levied a tax on premiums.

Table A.4. The "regionalist bias" in Group 2 regions

Policy Area: Unemployment (exclusive central)			
	Autonomous Communities		
Level of Government	Group 1	Group 2	Group 3
Central	53.14	59.43	72.39
Regional	41.8	35.32	23.32
Local	5.06	5.25	4.29
Total	100	100	100

Table A.5. The "centralist bias" in Group 3 regions

Policy Area: Housing (exclusive regional)			
	Autonomous Communities		
Level of Government	Group 1	Group 2	Group 3
Central	21.14	30.76	42.65
Regional	58.73	47.09	34.47
Local	20.13	22.15	22.88
Total	100	100	100

Table A.6. The "centralist bias" in Group 3 regions

Policy Area: Industry and Trade (exclusive regional)			
	Autonomous Communities		
Level of Government	Group 1	Group 2	Group 3
Central	38.03	40.14	54.09
Regional	55.81	52.03	39.01
Local	5.36	7.83	6.91
Total	100	100	100

Table A.12. Summary Statistics Model 1 in Chapter 5

Variables	Obs	Mean	Std. Dev.	Min	Max
ΔRV	89	-1.063034	6.683154	-14.5	12.95
ΔNV	103	.6208738	7.255015	-10.38	26.62
ΔU	90	-.7118889	5.458356	-9.65	10.08
ΔPCI	90	.9133333	.8213376	-1.09	4.13
ΔIPC	90	13.23244	6.078019	-25.87	45.81
Incumbent PP	104	.3461538	.4780468	0	1
PCF	87	1119.734	777.2238	108.1	3372.9

Table A.13. Summary Statistics Model 2 in Chapter 5

Variables	Obs	Mean	Std. Dev.	Min	Max
Difference	107	5.123178	3.760945	.04	16.97
ΔREGP	87	.3773564	6.791771	-17.52	26.94
ΔFRAGMENTATION	104	-.3557692	2.057042	-4	3
Months	106	21.20755	12.63308	0	43
PCF	87	1119.734	777.2238	108.1	3372.9
Incumbent	89	.9325843	.9510491	0	2
PP	104	.3461538	.4780468	0	1
Intensity	121	3.545455	1.408309	1	5

Table A.13. Pairs of general and regional elections by Autonomous Communities

PAIR	REGION	NATIONAL ELECTION	REGIONAL ELECTION
1	Andalusia	1982	1982
2	Andalusia	1986	1986
3	Andalusia	1989	1990
4	Andalusia	1993	1994
5	Andalusia	1996	1996
6	Andalusia	2000	2000
7	Andalusia	2004	2004
1	Aragon	1982	1983
2	Aragon	1986	1987
3	Aragon	1989	1991
4	Aragon	1993	1995
5	Aragon	1996	1999
6	Aragon	2000	2003
1	Asturias	1982	1983
2	Asturias	1986	1987
3	Asturias	1989	1991
4	Asturias	1993	1995
5	Asturias	1996	1999
6	Asturias	2000	2003
1	Balearic I.	1982	1983
2	Balearic I.	1986	1987

3	Balearic I.	1989	1991
4	Balearic I.	1993	1995
5	Balearic I.	1996	1999
6	Balearic I.	2000	2003
1	Canary I.	1982	1983
2	Canary I.	1986	1987
3	Canary I.	1989	1991
4	Canary I.	1993	1995
5	Canary I.	1996	1999
6	Canary I.	2000	2003
1	Cantabria	1982	1983
2	Cantabria	1986	1987
3	Cantabria	1989	1991
4	Cantabria	1993	1995
5	Cantabria	1996	1999
6	Cantabria	2000	2003
1	Castilla-León	1982	1983
2	Castilla-León	1986	1987
3	Castilla-León	1989	1991
4	Castilla-León	1993	1995
5	Castilla-León	1996	1999
6	Castilla-León	2000	2003
1	Castilla la Mancha	1982	1983

2	Castilla la Mancha	1986	1987
3	Castilla la Mancha	1989	1991
4	Castilla la Mancha	1993	1995
5	Castilla la Mancha	1996	1999
6	Castilla la Mancha	2000	2003
1	Catalonia	1982	1984
2	Catalonia	1986	1988
3	Catalonia	1989	1992
4	Catalonia	1993	1995
5	Catalonia	1996	1999
6	Catalonia	2000	2003
1	Comunidad Valenciana	1982	1983
2	Comunidad Valenciana	1986	1987
3	Comunidad Valenciana	1989	1991
4	Comunidad Valenciana	1993	1995
5	Comunidad Valenciana	1996	1999
6	Comunidad Valenciana	2000	2003
1	Extremadura	1982	1983
2	Extremadura	1986	1987
3	Extremadura	1989	1991

4	Extremadura	1993	1995
5	Extremadura	1996	1999
6	Extremadura	2000	2003
1	Galicia	1982	1985
2	Galicia	1989	1989
3	Galicia	1993	1993
4	Galicia	1996	1997
5	Galicia	2000	2001
6	Galicia	2004	2005
1	Madrid	1982	1983
2	Madrid	1986	1987
3	Madrid	1989	1991
4	Madrid	1993	1995
5	Madrid	1996	1999
6	Madrid	2000	2003
1	Murcia	1982	1983
2	Murcia	1986	1987
3	Murcia	1989	1991
4	Murcia	1993	1995
5	Murcia	1996	1999
6	Murcia	2000	2003
1	La Rioja	1982	1983
2	La Rioja	1986	1987

3	La Rioja	1989	1991
4	La Rioja	1993	1995
5	La Rioja	1996	1999
6	La Rioja	2000	2003
1	Navarre	1982	1983
2	Navarre	1986	1987
3	Navarre	1989	1991
4	Navarre	1993	1995
5	Navarre	1996	1999
6	Navarre	2000	2003
1	Basque Country	1982	1984
2	Basque Country	1986	1986
3	Basque Country	1989	1990
4	Basque Country	1993	1994
5	Basque Country	1996	1998
6	Basque Country	2000	2001
7	Basque Country	2004	2005

Table A.13. Electoral support of regionalist parties across Autonomous Communities

	Region	Regional Election Year	Regionalist Parties (%)	Regionalist parties' support by parties
1	Andalusia			
1		1982	5.36	*PSA – Partido Socialista de Andalusia (luego PA)*
1		1986	5.78	*PA – Partido Andalucista*
1		1990	10.71	*PA – Partido Andalucista*
1		1994	5.76	*PA – Partido Andalucista*
1		1996	6.62	*PA – Partido Andalucista*
1		2000	7.39	*PA – Partido Andalucista*
1		2004	6.12	*PA – Partido Andalucista*
2	Aragon			
2		1983	20.21	*PAR – Partido Aragonés*
2		1987	27.81	*PAR – Partido Aragonés*
2		1991	24.51	*PAR – Partido Aragonés*
2		1995	20.31	*PAR – Partido Aragonés*
2		1999	13.17	*PAR – Partido Aragonés*
2		2003	24.73	*PAR - 11.10* *CHA – Chunta Aragonesista – 13.63*
3	Asturias			
3		1983	0	
3		1987	0	
3		1991	2.71	*Coalición Asturiana (CA)*
3		1995	3.15	*Partiú Asturianista (PA)*
3		1999	7.1	*Unión Renovadora Asturiana (URA)*
3		2003	0[2]	

[2] *IU- Bloque por Asturias (Coalition)* gets 10.93% of votes.

4	Balearic I.			
4		1983	22.51	*UM (Unión Mallorquina) – 14.95* *CIM (Candidatura Independent Menorca) – 1.83* *PSM (Partit Socialista de Mallorca) – 6.53*
4		1987	15.03	*UM (Unión Mallorquina) – 8.91* *PSM-EN (Partit Socialista de Mallorca-Entesa Nacionalista) (nuevo nombre de PSM desde 1989) – 4.83* *EEM – Esquerra de la Entesa de Menorca – 1.29*
4		1991	10.45[3]	*PSM-NM (Partit Socialista de Mallorca – Nacionalistas de Mallorca)(adoptado en 1990) – 6.59* *EEM – 1.39* *UIM-IM (Unió Independent de Mallorca – Independents de Mallorca) – 2.47*
4		1995	17.25	*PSM-NM – 10.91* *PSM-NI – 1.06 (Partit Socialista de Menorca – Nacionalistas de les Illes)* *UM – 5.28*
4		1999	23.29	*PACTE[4] – 4.40* *PSM-EN – 11.63* *UM – 7.26*
4		2003	23.77	*PACTE[5] – 3.61* *PSM-EN[6] - 7.90* *UM – 7.41* *EUIB-EVM-EM[7] – 4.85*

[3] I have not included UM+PP, which in 1991 gained a 47.04 percentage of votes.

[4] PACTE: Electoral coalition formed by representatives from PSIB-PSOE, EUIB, ERC i Els Verds, in Ibiza island, together with the *Entesa Nacionalista i Ecologista* and independent representatives.

[5] Electoral coalition formed by representatives from PSIB-PSOE, EUIB, ERC i Els Verds, in Ibiza, together with the *Entesa Nacionalista i Ecologista* and independent representatives.

5	Canary Islands			
5		1983	1.51	*AIC – Agrupaciones Independientes de Canary I.*
5		1987	26.82	*AIC – 19.79* *AC-INC (Asamblea Canaria – Izquierda Nacionalista Canaria) – 6.82* *AHÍ – Agrupación Herreña Independiente – 0.21*
5		1991	32.68	*AIC – 18.54* *ICAN – Iniciativa Canaria (Izquierda de Canary I. Unida y Asamblea Canaria Nacionalista) – 12.17* *AIC – PIL – Agrupaciones independientes de Canary I. – Partido Independiente de Lanzarote – 1.97*
5		1995	35.43	*CC – Coalición Canaria*[8] *- 32.46* *PCN – Plataforma Canaria Nacionalista – 2.97*
5		1999	36.87	*AHI – 0.33* *CC – 36.54*
5		2003	37,52	*CC- 32.72* *FNC – 4.80*
6	Cantabria			
6		1983	6.62	*PRC – Partido Regionalista Cántabro*
6		1987	12.61	*PRC – Partido Regionalista Cántabro*

6 The percentage accounts for the number of votes in Mallorca and Menorca islands. Votes that were obtained in an electoral coalition (in Ibiza island and Formentera) are calculated separately.

7 The percentage accounts for the number of votes that EUIB obtained in an electoral coalition made with *Els Verds de Mallorca* and *Esquerra de Menorca*. Votes that were obtained in an electoral coalition (in Ibiza island and Formentera) are calculated separately.

8 *Coalición Canaria* is the result of AIC, ICAN, AM (*Asamblea Majorera*), CCI (*Centro Canario Independiente*) y PNC (*Partido Nacionalista Canario*). All define as nationalist parties.

6		1991	39.55	*UPCA – Unión Para el Progreso de Cantabria – 33.25* *PRC – 6.3*
6		1995	30.93	*UPCA – 16.49* *PRC – 14.44*
6		1999	13.41	*PRC*
6		2003	10.08	*PRC*
7	Castilla-León			
7		1983	0	
7		1987	0	
7		1991	0	
7		1995	2.53	*UPL – Unión Pueblo Leonés*
7		1999	5.05	*UPL – 3.67* *TC-PNC Tierra Comunera – Partido Nacionalista Castellano – 1.38*
7		2003	3.81	*UPL*
8	Castilla la Mancha			
8		1983		
8		1987	0	
8		1991	0	
8		1995	0	
8		1999	0	
8		2003	0	
9	Catalonia			
		1980	36.55	*CIU – Convergència I Unió – 27.68* *ERC – Esquerra Republicana de Catalonia – 8.87*
9		1984	50.95	*CIU – 46.56* *ERC - 4.39*
9		1988	49.61	*CIU – 45.49* *ERC – 4.12*
9		1992	53.94	*CIU – 46* *ERC – 7.94*
9		1995	50.29	*CIU – 40.83* *ERC – 9.46*
9		1999	46.25	*CIU – 37.6* *ERC – 8.65*

9		2003	47,3	*CIU – 30.90* *ERC – 16.40*
10	Comunidad Valenciana			
10		1983	0[9]	
10		1987	16.9	*UV – Unió Valenciana – 9.04* *EUPV – UPV (coalición Esquerra Unida del País Valencià – Unitat del Poble Valencià) – 7.86*
10		1991	17.8	*UV – 10.31* *EUPV – 7.49*
10		1995	18.44	*EUPV – EV (Esquerra Unida del País Valencià – Els Verds) – 11.47* *UV – IC (coalición de UV con Independientes Centristas) – 6.97*
10		1999	6.02	*EUPV*
10		2003	0	
11	Extremadura			
11		1983	8.4	*EU - Extremadura Unida*
11		1987	5.75	*EU - Extremadura Unida*
11		1991	0	
11		1995	14.27	*IU-LV-CPEX Coalición Izquierda Unida - Los Verdes - Compromiso Por Extremadura – 10.47* *CE – Coalición Extremeña – 3.8*
11		1999	6.02	*IU-CPEX*
11		2003	0	
12	Galicia[10]			
12		1981	9.48	*BNPG – PSG (Bloque Nacional Popular Galego – Partido Socialista Galego) – 6.15* *EG – Esquerda Galega – 3.33*

[9] In 1983 regional elections Unió Valenciana forms an electoral coalition with AP, Partit Demócrata Popular and Unión Liberal.

[10] About Galicia see Heras (1997: 333).

12		1985	22.54	*CG – Coalición Galega – 12.79* *PSG – EG (Partido Socialista Galego – Esquerda Galega) – 5.60* *BNG – Bloque Nacionalista Galego – 4.15*
12		1989	15.26	*BNG – 7.91* *PSG-EG – 3.74* *CG – 3.61*
12		1993	18.29	*BNG – 18.29*
12		1997	24.66	*BNG*
12		2001	22.43	*BNG*
12		2005	18.7	*BNG*
13	Madrid			
13		1983	0	
13		1987	0	
13		1991	0	
13		1995	0	
13		1999	0	
13		2003	0	
14	Murcia			
14				
14		1983	0	
14		1987	0	
14		1991	0	
14		1995	0	
14		1999	0	
14		2003	0	
15	La Rioja			
15		1983	7.34	*PRP – Partido La Riojano Progresista*
15		1987	6.3	*PRP*
15		1991	5.34	*PR – Partido La Riojano (in 1990 the PRP becomes PR)*
15		1995	6.65	*PR*
15		1999	5.73	*PR*

15		2003	6.75	*PR*
16	Navarre[11]			
16		1983	17.18	*HB – Herri Batasuna (10.43)* *PNV – Partido Nacionalista Vasco (6.75)*
16		1987	23.59	*HB – 13.31* *EE – Euskadiko Ezquerra – 3.36* *EA – Eusko Alkartasuna – 6.92*
16		1991	15.14	*HB – 11.11* *EA – 4.03*
16		1995	32.09	*CDN – Convergencia de Demócratas de Navarre – 18.41* *HB – 9.15* *EA – 4.53*
16		1999	27.66	*EH (antiguo HB) – Euskal Herritarrok – 15.45* *CDN – 6.81* *EA – 5.4*
16		2003	21,35	*CDN 7.16* *Aralar 7.24* *EA-EAJ/PNV – 6.95*
17	Basque Country			
17		1980	63.58	*PNV – 37.58* *HB – 16.32* *EE – 9.68*
17		1984	63.96	*PNV – 41.57* *HB – 14.5* *EE – 7.89*
17		1986	67.2	*PNV – 23.46* *HB – 17.3* *EA – 15.68* *EE – 10.76*
17		1990	66.56	*PNV – 23.46* *HB – 18.11* *EA – 11.24* *EE – 7.68* *UA – Unión Alavesa – 1.39*
17		1994	57.78	*PNV – 29.14* *HB – 15.91* *EA – 10.07* *UA – 2.66*

[11] I do not code UPN (*Unión Pueblo Navarro*) as a regionalist party.

17	1998	54.8	*PNV – 27.48* *EH – 17.57* *EA – 8.52* *UA – 1.23*
17	2001	52,19	*PNV – 42.19* *EH - 10*
17	2005	53,21	*PNV – 38.26* *EHAK – 12.31* *ARALAR – 2.30* *UA – 0.34*

Development of Bayesian equilibrium with incomplete information (Kreps and Wilson 1982)

The game begins with Nature and a random probabilistic distribution. There is a probability Є that central government is a strong player whereas there is a probability 1- Є that it is weak. There are 16 players: central government and 15 ACs. The difference in the game with complete information is that the ACs are not certain about central government's payoffs. They ignore the type of central government they face. Each round of the game represents bilateral negotiation in a Mixed Commission. ACs know about the rounds that follow, that is, they observe the game in previous rounds (this is reflected in P_k = probability that central government is a weak player according to how game unfolded until round *k*). In round *k* AC updates its beliefs on the type of central government it faces.

In order to find the game equilibrium, the concept of subgame perfect equilibrium is not appropriate in an incomplete information game, since it does not take into account players' beliefs. A new type of equilibrium is needed, namely the *Perfect Bayesian Equilibrium*. To find this type of equilibrium when in a repeated name it is easier to generalize results when the game only consists of two rounds.

An AC has two strategies: to accept central government's financing proposal or to enter negotiation and attempt to modify it. In the first round AC_1 will choose one of the foregoing strategies if its belief in central government being a strong player exceeds a threshold (that is, if P_k exceeds a particular threshold). The initial belief is P_1= Є. In principle, AC_1 will be indifferent to following strategy "A" and "N" when their corresponding expected utilities are the same that is, when $P_1(b - 1) + (1 - P_1)b = 0$. Finding the value of P_1 we have: $P_1 = b = P^*$. Therefore, when $P_1 < b$ or $P_1 < P^*$ then AC_1 enters negotiation on the financing proposal.

In the second round of the game AC_2 would have observed central government's strategy in the previous round. If there is a weak central government it will follow that the strategy of opposing in the first round with the objective of deterring CA_2 from entering negotiation. However, a weak central government will not oppose regional demands in the first round if the payoff it obtains from deterring CA_2 is smaller than one, that is if $a < 1$. On the other hand, if central government is strong it will always oppose regional demands. As CA_1 is not certain about the type of central government it faces, it will choose a strategy depending on whether its belief that central government is a strong player exceeds a particular threshold:

- **If $P_1 < P^*$**: then CA_1 enters negotiation; the weak central government (WG) accepts and a strong central government (SG) opposes. It is therefore a separating equilibrium: each type of central government chooses a different strategy. In consequence, CA_2 observes central government's action in $k = 1$, and updates its beliefs accordingly (P_2). For instance, if it observed that in $k = 1$ CG has opposed regional demands, following Bayes' rule we have:

$$P_2(SG \mid o) = \frac{p(SG)\ p(o \mid SG)}{p(SG)p(o \mid SG) + p(WG)p(o \mid WG)} = \frac{P_1 \cdot 1}{P_1 \cdot 1 + (1 - P_1)0} = 1$$

Note: "o" stands for "strategy of opposing demands"

As $P_2 = 1$ then CA_2 accepts.

- **If $P_1 > P^*$**: then CA_1 accepts central government's proposal. Beliefs cannot be updated and therefore $P_1 = P_2$. In the next round CA_2 accepts, as well.

If $a > 1$ a weak central government may decide to build a reputation of a strong player by choosing strategy "o" in $k = 1$ in order to deter CA_2 in $k = 2$. We know that:

- If $P_1 > P^*$ then AC_1 accepts the financing proposal and then – as was shown above - CA_2 does not update beliefs and $P_2 = P_1$. In consequence, CA_2 also accepts the proposal.

On the other hand,

- If P_1 < P* and a > 1 then there is a semi-separating equilibrium: a weak central government sometimes opposes regional demands in *k = 1* and sometimes it accepts them. That is, a weak central government mixes strategies in *k = 1* to make CA_2 indifferent between following strategy "N" and "A" in the next round. For CA_2 to be indifferent between strategy "N" and "A" it is necessary that $P_2 = P^* = b$. We find this equation through Bayes' rule:

$$P_2(SG \mid o) = \frac{p(SG)p(o \mid SG)}{p(SG)p(o \mid SG) + p(WG)p(o \mid WG)} = \frac{P_1 \cdot 1}{P_1 \cdot 1 + (1 - P_1)\beta}$$

$$\frac{P_1 \cdot 1}{P_1 \cdot 1 + (1 - P_1)\beta} = b$$

Note: "o" stands for "strategy of opposing demands"

Then:

We find the value of β to know the probability that a weak central government will oppose regional demands to make indifferent CA_2 between entering negotiation ("N") and accepting the proposal ("A"):

$$\beta = \frac{P_1(1 - b)}{b(1 - P_1)}$$

In consequence, central government's mixed strategy will be *"opposing regional demands with probability β, accepting with probability 1 - β"* so that it makes indifferent CA_2 in the next round. This allows CA_2 to play a mixed strategy to make indifferent central government between accepting regional demands ("a") and opposing them ("o") *in the first round*. This will happen when the utility of following strategy "a" is equal to the utility of adopting strategy "o", namely:

$U_{WG}(\text{accept}) = U_{WG}(\text{oppose})$

U_{WG} (accept) = 0 + 0
U_{WG} (oppose)= -1 + [q(a) + (1-q)0]
Therefore, U_{WG} (accept) = U_{WG}(oppose):
0 = -1 + qa; and we find the value of *q* so that: q = 1/a

CA_2 has a mixed strategy: *"enter negotiation with probability 1 - q, and accept central government's proposal with probability q"*, which makes central government indifferent in the first round.

Finally, we have to calculate CA_1's belief (when $P_1 < P^*$) that makes it indifferent between accepting and negotiating the financing proposal. The probability that in *k=1* central government opposes regional demands is the following:

$$P_1 \cdot 1 + (1 - P_1)\frac{P_1(1-b)}{b(1-P_1)} = P_1 + \frac{P_1(1-b)}{b} = \frac{P_1}{b}$$

P_1: probability that central government is a strong player (SG)

1: probability that a strong central government opposes regional demands

(1- P_1): probability that central government is a weak player (WG)

P_1 (1-b)/[b(1- P_1)]: probability that a weak central government opposes regional demands

Therefore, the probability that a weak central government accepts demands is the opposite, namely:

$$1 - \frac{P_1}{b} = \frac{b - P_1}{b}$$

Then, CA_1 will be indifferent when:

$U_{CA1}(N)=U_{CA1}(A)$

$$U_{CA1}(N) = \frac{P_1}{b}(b-1) + \frac{b-P_1}{b}b$$
$$U_{CA1}(C) = 0$$

$P_1 = b^2$

$$\frac{P_1}{b}(b-1) + \frac{b-P_1}{b}b = 0$$

To summarize, when $P_1 > b^2$ a weak central government opposes regional demands in the first round and CA_1 accepts. CA_2 accepts with probability $q=1/a$. If $P_1 < b^2$, CA_1 enters negotiation and the weak central government opposes demands with probability β. CA_2 accepts with probability $q=1/a$.

Finally, the following combination of strategies and beliefs is a Bayesian perfect equilibrium:

Central government's strategy

If CG = SG, always opposes regional demands
If CG = WG and $a < 1$, WG never opposes demands
If CG = WG, $a > 1$ and $P_1 > P^*$, WG opposes demands in the first round
If CG = WG, $a > 1$, $P_1 < P^*$ and $P_1 > b^2$, WG opposes demands in the first round
If CG = WG, $a > 1$, $P_1 < P^*$ and $P_1 < b^2$, WG opposes demands in the first round
with probability β.

AC's strategy

If $k=(1,2)$
If $P_k > b^{2-K+1}$, CA_k accepts the financing proposal
If $P_k < b^{2-K+1}$, CA_k enters negotiation
If $P_k = b^{2-K+1}$, CA_k enters negotiation with probability 1/a.

Beliefs

When CA_1 accepts, P_2= Є

When CA_1 enters negotiation and central government accepts: P_2=0

When CA_1 enters negotiation and central government opposes: P_2= max (b, Є)

To find the equilibrium when the game is repeated *n* times we can generalize the results of the two-rounds game.

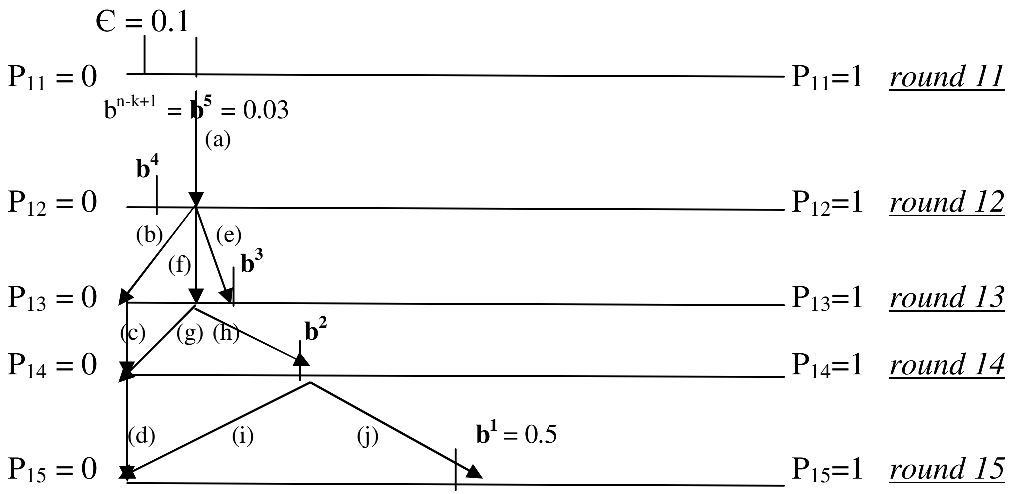
An example on how central government's reputation is destroyed after "n" bargaining rounds[12]

Next I calculate the round of the game when central government's threat to oppose regional demands is not credible anymore. Let us assume that there are 15 bargaining rounds (*n*=15); with Є = 0.1 and b = 0.5) (See Figure A.1).

Before reaching round 12, a weak central government chooses strategy "o" because $P_k \geq b^{n-k}$. However, in the 12th round $P_{12} < b^{n-k}$, that is, $0.1 < b^3 = 0.12$ and, therefore, following the Bayesian perfect equilibrium, central government chooses a mixed strategy where it opposes regional demands with probability β and accepts them with probability 1- β in order to make indifferent CA_{13} between strategy "A" and "N". If central governments accepted regional demands, then automatically $P_{13}= P_{14}= P_{15}= 0$ since the remaining ACs would anticipate that they face a weak central government (arrows (b), (c) and (d)). If central government opposes demands with probability β, it makes CA_{13} indifferent towards entering negotiation and accepting the financing proposal so that $P_{13} = b^3$ (arrow (e)) and CA_{13} accepts with probability 1/a. However, in round 12 $P_{12} > b^{n-k+1}$. That is, CA_{12}'s belief that central government is a strong player is still high enough to deter

[12] This example draws on Kreps and Wilson (1982: 261).

Figure A.1. Strategies in "n" bargaining rounds



it from entering negotiation. In consequence, the game unfolds according to arrow (f). In the next round there is no updating of beliefs $P_{13}= \epsilon$. In this round CA_{13} does have incentives to attempt to modify the financing proposal since there is a low probability that central government is strong ($P_{13} < b^{n-k+1}$). If central government accepts demands, its reputation is destroyed and $P_{14}=$ 0 (and the game unfolds according to arrows (g) and (c)). If it adopts a mixed strategy it opposes demands with probability β and the game develops following arrow (h) and $P_{14}= b^2$. With this belief, CA_{14} is indifferent between entering negotiation and accepting the financing proposal and adopts a mixed strategy (where it accepts the proposal with probability 1/a). If it chooses to enter into negotiation, central government adopts a mixed strategy between accepting (arrow (i)) and opposing regional demands (arrow (j)). If CA_{14} accepts the financing proposal, the game follows arrow (j) until round 15 where $P_{15} = b^1$. Then CA_{15} surely adopts the strategy of negotiating the financing proposal.

BIBLIOGRAPHY

Afonso, J. R. R., and L. de Mello. November 2000. Brazil: An Evolving Federation. *Conference on Fiscal Decentralization IMF*.

Agranoff, R. 1996. Federal Evolution in Spain. *International Political Science Review* 17(4): 385-401.

Ahmad, J. K. 1998. South Africa: An Intergovernmental Fiscal System in Transition. In *Fiscal Decentralization in Developing Countries*, eds. R. M. Bird, and F. Vaillancourt. Cambridge University Press.

Aja, E. 1999. *El Estado Autonómico. Federalismo Y Hechos Diferenciales*. Madrid: Alianza Editorial.

Aja, E. 2003. *El Estado Autonómico. Federalismo Y Hechos Diferenciales*. Second Edition ed. Madrid: Alianza Editorial.

Alesina, A., and E. Spolaore. November 1997. On the Number and Size of Nations. *The Quarterly Journal of Economics*: 1027-56.

Alt, J. E., R. L. Calvert, and B. D. Humes. 1988. Reputation and Hegemonic Stability: A Game-Theoretic Analysis. *American Political Science Review* 82: 445 - 466.

Ames, B. 1987. *Political Survival. Politicians and Public Policy in Latin America*. Berkeley, Calif.: University of California Press.

Anderson, J. E., and H. Van-den-Berg. May 1998. Fiscal Decentralization and Government Size: An International Test for Leviathan Accounting for Unmeasured Economic Activity. *International Tax and Public Finance* 5(2): 171-86.

Ansolabehere, S., and J. Snyder. *Party Control of State Government and the Distribution of Public Expenditures* [http://web.mit.edu/polisci/research/representation/parties & distrib.pdf], n.d.

Arzaghi, M., and V. Henderson. 2002. "Why Countries Are Fiscally Decentralizing?" Brown University manuscript.

Atkeson, L. R., and R. W. Partin. March 1995. Economic and Referendum Voting: A Comparison of Gubernatorial and Senatorial Elections. *American Political Science Review* 89(1): 99 - 107.

Bahl, R. 1995. Worldwide Trends in Fiscal Decentralization. In. Georgia State University: Policy Research Center Working Paper.

Bakvis, H. 1981. *Federalism and The Organization of Political Life: Canada in Comparative Perspective*. Kingston, Ontario, Canada: Institute of Intergovernmental Relations.

Bednar, J., and J. Ferejohn. 1999. "A Political Theory of Federalism." Standford University manuscript.

Beramendi, P., and R. Máiz. 2004. Spain. Unfulfilled Federalism (1978-1996). In *Federalism and Territorial Cleavages*. The Johns Hopkins University Press.

Besley, T., and S. Coate. n.d. Centralized Versus Decentralized Provision of Local Public Goods: A Political Economy Analysis. *NBER Working Paper 7094.*

Bingham Powell, G., and G. D. Whitten. May 1993. A Cross-National Analysis of Economic Voting: Taking Account of the Political Context. *American Journal of Political Science* 37(2): 391 - 414.

Bird, R. M. 2001. Can Fiscal Federalism Reconcile Diversity and Cohesion in Fragmented States? *Environment and Planning C: Government and Policy* 19: 159-61.

Bird, R. M., J. K. Ahmad, and J. Litvack. 1998. *Rethinking Decentralization in Developing Countries*. Sector Studies Series / World Bank. Washingtong DC: World Bank.

Bird, R. M., and F. Vaillancourt. 2000. *Fiscal Decentralization in Developing Countries*. Cambridge, UK: Cambridge University Press.

Bird, R. M. June 1993. Threading the Fiscal Labyrinth: Some Issues in Fiscal Decentralization. *National Tax Journal* 46(2): 207-27.

Bird, R. M. 1994. A Comparative Perspective on Federal Finance. In *The Future of Fiscal Federalism*, eds. K. G. Banting, D. M. Brown, and T. J. Courchene. Kingston, Ont: School of Policy Studies - Queen's University.

Bird, R. M., R. D. Ebel, and C. I. Wallich. 1995. Fiscal Decentralization: From Command to Market. In *Decentralization of the Socialist State*, eds. R. M. Bird, R. D. Ebel, and C. I. Wallich. Washington, D.C.: World Bank.

Blom-Hansen, J. 1999. Avoiding the Joint-Decision Trap: Lessons From Intergovernmental Relations in Scandinavia. *European Journal of Political Research* 35(1): 35 - 67.

Blom-Hansen, J., and T. Pallesen. 2001. The Fiscal Manipulation of a Decentralized Public Sector: Macroeconomic Policy in Denmark. *Environment and Planning C: Government and Policy* 19: 607-23.

Boex, J., and M. Jorge. March 2005. "The Determinants of the Incidence of Intergovernmental Grants: A Survey of the International Experience." Georgia State University. International Studies Program -Working Paper 05-09.

Bolton, P., and G. Roland. November 1997. The Breakup of Nations: A Political Economy Analysis. *The Quarterly Journal of Economics*: 1057-90.

Boone, C. May 2003. Decentralization As Political Strategy in West Africa. *Comparative Political Studies* 36(4): 355-80.

Bosch Roca, Núria and Javier Suárez Pandiello. *Hacienda Local Y Elección Pública: El Caso De Los Municipios Españoles*. Bilbao: Fundación BBV, 1994.

Brancati, D. 2005. The Origins of Regionalist Parties. *British Journal of Political Science (Forthcoming)*.

Braun, D. 2003a. Federal Fiscal Constitution and Intergovernmental Relationships. In *Fiscal Policies in Federal States*.Ashgate.

Braun, D. 2003b. *Fiscal Policies in Federal States*. Ashgate.

Brodjonegoro, B., and S. Asanuma. December 2000. Regional Autonomy and Fiscal Decentralization in Democratic Indonesia. *Hitotsubashi Journal of Economics* 41(2): 111-22.

Bryson, P. J., and G. C. Cornia. May2000. Fiscal Decentralization in Economic Transformation: The Czech And Slovak Cases. *Europe-Asia Studies* 52(3): 16p.

Buchanan, J. 1995. Federalism As an Ideal Political Order and an Objective for Constitutional Reform. *Publius* 25(2).

Bukowski, J. Winter 1997. Decentralization in Spain: A Re-Evaluation of Causal Factors. *South European Society and Politics* 2(3): 80-102.

Burki, J., G. Perry, and W. Dillinger. 1999. *Beyond the Center: Decentralizing the State*. Latin American Studies. Washington, DC: World Bank, 1999.

Campbell, S. 1994. *Parties and Federalism in Australia and Canada*. Canberra: Federalism Research Centre, the Australian University.

Carsey, T. M., and G. C. Wright. July 1998. State and National Factors in Gubernatorial and Senatorial Elections. *American Journal of Political Science* 42(3): 994 - 1002.

Case, A. 2001. Election Goals and Income Redistribution: Recent Evidence From Albania. *European Economic Review* 45: 405 - 423.

Castells, A. 1988. *Hacienda Autonómica: Una Perspectiva De Federalismo Fiscal*. Barcelona: Ariel.

Castells, A., P. Sorribas, and M. Vilalta. 2005. *Las Subvenciones De Nivelación En La Financiación De Las Comunidades Autónomas. Análisis De La Situación Actual Y Propuestas De Reforma.* Barcelona: Universitat de Barcelona.

Chandler, W. M. 1987. Federalism and Political Parties. In *Federalism and the Role of the State*, eds. H. Bakvis, and W. M. Chandler. Toronto: University of Toronto Press.

Cheibub, J. A., and A. Przeworski. 1999. Democracy, Elections and Accountability for Economic Outcomes. In *Democracy, Accountability and Representation*. Cambridge: Cambridge University Press.

Chhibber, P., and K. Kollman. 2004. "The Formation of National Party Systems: Federalism and Party Competition in Britain, Canada, India, and the United States." Princeton University Press.

Chubb, J. E. n.d. Institutions, The Economy and the Dynamics of State Elections.

Corona, J. F., L. M. Alonso, and P. Puy. 1998. *Hacia Un Federalismo Competitivo. Propuesta Para Reformar ElSistemade Financiación Autonómica*. Madrid: Círculo de Empresarios.

Cox, G. W., and M. D. McCubbins. May 1986. Electoral Politics As a Redistributive Game. *The Journal of Politics* 48(2): 370 - 389.

Cremer, J., and T. Palfrey. 1996. Political Confederation. *American Political Science Review* 93(1): 69 - 82.

Dahlberg, M., and E. Johansson. March 2002. On the Vote-Purchasing Behavior of Incumbent Governments. *American Political Science Review* 96(1): 27 - 40.

Dasgupta, S., A. Dhillon, and B. Dutta. April 2001. "Electoral Goals and Centre-State Transfers: A Theoretical Model and Empirical Evidence From India."

Davoodi, H., and Z. Heng-fu. 1998. Fiscal Decentralization and Economic Growth: A Cross-Country Study. *Journal of Urban Economics* 43: 244-57.

de-Mello, L. December 1999. Fiscal Federalism and Government Size in Transition Economies:The Case of Moldova. *International Monetary Fund Working Paper* WP/99/176(WP/99/176).

Dente, B. 1998. Los Gobiernos Subnacionales En La Larga Transición Italiana. In *Federalismo Y Subsidiariedad En Italia*. Barcelona: Fundació Carles Pi i Sunyer d´Estudis Autonòmics i Locals.

Dente, B., and F. Kjellberg. 1988. *The Dynamics of Institutional Change*. London: Sage Publications.

Dillinger, W. 1994. Decentralization and Its Implications for Urban Service Delivery.

Dixit, A., and J. Londregan. December 1995. Redistributive Politics and Economic Efficiency. *The American Political Science Review* 89(4): 856 - 866.

Dixit, A., and J. Londregan. November 1996. The Determinants of Success of Special Interests in Redistributive Politics. *The Journal of Politics* 58(4): 1132 - 1155.

Dixit, A., and J. Londregan. May 1998. Ideology, Tactics, and Efficiency in Redistributive Politics (The Quarterly Journal of Economics). 113(2): 497 - 529.

Donahue, J. D. 1997a. Tiebout? Or Not Tiebout? The Market Metaphor and America's Devolution Debate. *The Journal of Economic Perspectives* 11(4): 73 - 81.

Donahue, J. D. 1997b. Tiebout? Or Not Tiebout? The Market Metaphor and America's Devolution Debate. *The Journal of Economic Perspectives* 11(4): 73 - 81.

Dougherty, K. 1999. Public Goods and Private Interests: An Explanation for State Compliance with Federal Requisitions, 1775-1789. In *Public Choice Interpretations of American Economic History*, ed. J. e. a. Heckelman. Dordrecht, The Netherlands: Kluwer Academic Publishing.

Eaton, K. 2001. Political Obstacles to Decentralization: Evidence From Argentina and the Philippines. *Development and Change* 32: 101-27.

Eaton, K. 2004. The Link Between Political and Fiscal Decentralization in South America. In *Decentralization and Democracy in Latin America*, eds. A. P. Montero, and D. J. Samuels. Notre Dame, IN: University of Notre Dame Press.

Ebel, R., and S. Yilmaz. 2001. *Fiscal Decentralization: Is It Happening? How Do We Know?* Atlanta, Georgia: International Studies Program - Georgia State University.

Elazar, D. J. 1994. *Federal Systems of the World. A Handbook of Federal, Confederal and Autonomy Arrangements*. Essex, U.K: Longman Group Limited.

Emiliani, N., S. Lugaresi, and E. Ruggiero. 1997. Italy. In *Fiscal Federalism in Theory and Practice*, ed. T. Ter-Minassian. Washington, US: International Monetary Fund.

Engel, C., and J. Van Ginderachter. 1993. *Trends in Regional and Local Government in the European Community*. Leuven/ Amersfoort: acco.

Epple, D., and T. Romer. 1991. Mobility and Redistribution. *The Journal of Political Economy* 99(4).

Epstein, D., and S. O'Halloran. 1999. *Delegating Powers. A Transaction Cost Politics Approach to Policy Making under Separate Powers*. Political Economy of Institutions and Decisions. Cambridge, MA: Cambridge University Press.

Escobar-Lemmon. 2001. Fiscal Decentralization in Latin America. *Publius: The Journal of Federalism* 31(4): 23-64.

Falleti, T. G. August 2005. A Sequential Theory of Decentralization: Latin American Cases in Comparative Perspective. *American Political Science Review* 99(3): 327 - 346.

Fearon, J. D., and P. van Houten. May 2002. "The Politicization of Cultural and Economic Difference." Laboratory in Comparative Ethnic Processes (LiCEP).

Filippov, M., P. C. Ordeshook, and O. Shvetsova. 2004. *Designing Federalism: A Theory of Self-Sustainable Federal Institutions*. Cambridge (MA): Cambridge University Press.

Ford, J. 1999. Rationale for Decentralization. In *Decentralization Briefing Notes*, eds. J. Litvack, and J. Seddon.World Bank Institute - WBI Working Paper.

Forsyth, M. 1989. *Federalism and Nationalism*. New York: St. Martin's Press.

Fossati, A., and G. Panella. 1999. *Fiscal Federalism in the European Union*. London: Routledge.

García Milà, T., and T. J. McGuire. 2001. Do Interregional Transfers Improve the Economic Performance of Poor Regions? The Case of Spain. *International Tax and Public Finance* 8: 281-95.

Garcia-Mila, T. forthcoming 2004. Fiscal Decentralization in Spain: An Asymmetric Transition to Democracy. In *Subsidiarity and Solidarity: The Role of Intergovernmental Fiscal Relations in Maintaining an Effective State in Diverse Countries*, eds. R. M. Bird, and R. D. Ebel. Cheltenham, UK: Edward Elgar.

Garret, G., and J. Rodden. *Globalization and Fiscal Decentralization* [http://web.mit.edu/jrodden], July 2001.

Gibson, E. L., E. F. Calvo, and T. G. Falleti. n.d. *Reallocative Federalism: Legislative Overrepresentation and Public Spending in the Western Hemisphere*. Working Paper, Northwestern University.

Gillespie, R. 1992. Factionalism in the Spanish Socialist Party. *Institut De Ciències Polítiques I Socials - Working Paper 59*.

Giron Reguera, E. 1998. Los Modelos De Financiación Autonómica. *I Congreso De Ciencia Regional De Andalucía: Andalucía En El Umbral Del Siglo XXI*.

Gordo, L., and P. Hernández de Cos. n.d. *El Sistema De Financiación Autonómica Vigente Para El Período 1997-2001*. Banco De España - Servicio De Estudios, vol. 0003.

Gourevitch, P. 1986. *Politics in Hard Times*. Ithaca, NY: Cornell University Press.

Govinda Rao, M., and N. Singh. September 2001. The Political Economy of Center-State Fiscal Transfers in India. *Center for Research on Economic Development and Policy Reform. Working Paper No.107*.

Grau, M. 2000. Spain: Incomplete Federalism. In *Federalism and Political Performance*, ed. Ute Wachendorfer-Schmidt. London: Routledge.

Grossman, P. J. July 1989. Fiscal Decentralization and Government Size: An Extension. *Public Choice* 62(1): 63-9.

Grossman, P. J. 1994. A Political Theory of Intergovernmental Grants. *Public Choice* 78: 295 - 303.

Haggard, S., and R. Kaufman. 1992. *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts, and the State*. Princeton: Princeton University Press.

Häkkinen, U., and J. Lehto. n.d. "Health Care Reforms of the 1990s in Finland." A paper to be presented a LSE, 21-22 February 2002.

Hamlin, A. P. September 1991. Decentralization, Competition and the Efficiency of Federalism. *The Economic Record*: 193-204.

Hayek, F. 1948. The Economic Conditions of Interstate Federalism. In *Individualism and Economic Order*.University of Chicago.

Heras, R. 1997. *Enciclopedia Política Y Atlas Electoral*. Madrid: Temas de Hoy.

Herrero Alcalde, A. 2005. *Aplicación De Un Fondo De Nivelación En El Marco De Un Sistema De Financiación Autonómica Estable*. Madrid: Instituto de Estudios Fiscales.

Hettich, W., and S. Winer. 1997. The political economy of taxation. In *Perspectives On Public Choice: A Handbook*, ed. D. Mueller, 481-505. Cambridge: Cambridge University Press.

Hine, D. 1996. Regionalism in the Italian Republic: Centre and Periphery Under Strain. In *Italian Regionalism. History, Identity and Politics.* Oxford: Berg.

Holcombe, R. G. 1999. Tax Policy From a Public Choice Perspective. In *Tax Policy in the Real World*, ed. Joel Slemrod, 397-409. Cambridge; New York: Cambridge University Press.

Hommes, R. 1995. Conflicts and Dilemmas of Decentralization. In *Annual World Bank Conference on Development Economics*, eds. M. Bruno, and B. Pleskovic. Washington, D.C.: World Bank.

Iglesias, M. A. 2003. *La Memoria Recuperada: Lo Que Nunca Han Contado Felipe González Y Los Dirigentes Socialistas De Sus Años De Gobierno*. Madrid: Aguilar.

Inman, R. P., and D. L. Rubinfeld. 1997. The Political Economy of Federalism. In *Perspectives on Public Choice*, ed. D. C. Mueller.Cambridge University Press.

Inman, R., and D. Rubinfeld. 1992. Fiscal Federalism in Europe: Lessons From the United States Experience. *European Economic Review* 36: 654 - 660.

James, P. 1999. The Chain Store Paradox and Constitutional Politics in Canada. *Journal of Theoretical Politics* 11(1): 5-36.

Jeffery, C. Winter 2003. The Politics of Territorial Finance. *Regional and Federal Studies* 13(4): 183-96.

Jennings, K. M. 1998. Political Trust and the Roots of Devolution. In *Trust and Governance*. New York: Russell Sage Foundation.

Jones, M. P., P. Sanguinetti, and M. Tommasi. 2000. Politics, Institutions, and Fiscal Performance in a Federal System: An Analysis of the Argentine Provinces. *Journal of Development Economics* 61: 305 - 333.

Jordana, J. n.d. Relaciones Intergubernamentales y Descentralización en América Latina: Una Perspectiva Institucional. *Banco Interamericano de Desarrollo (BID)*: 2001.

Joulfaian, D., and M. L. Marlow. April 1990. Government Size and Decentralization: Evidence From Disaggregated Data. *Southern Economic Journal* 56(4): 1094-102.

Keating, M., and T. C. Salmon. 2001. *The Dynamics of Decentralization: Canadian Federalism and British Devolution*. McGill - Queen's University Press.

Khemani, S. 2002. *Partisan Politics and Subnational Fiscal Deficits in India: What Does Imply for the National Budget Constraint?* Washington, D.C.: World Bank, Development Research Group.

Khemani, S. April 2003. Partisan Politics and Intergovernmental Transfers in India. *World Bank Policy Research Working Paper 3016*.

King, J. D. May 2001. Incumbent Popularity and Vote Choice in Gubernatorial Elections. *The Journal of Politics* 63(2): 585 - 597.

Kreps, D. M., and R. Wilson. 1982. Reputation and Imperfect Information. *Journal of Economic Theory* 27: 253-79.

Lago Peñas, I., and S. Lago Peñas. 2001a. La Influencia De Los Resultados Económicos Sobre El Apoyo Electoral De Los Gobiernos Autonómicos, 1980-1997. *Revista De Investigaciones Sociológicas* 93: 165-79.

Lane, J., and S. Ersson. n.d. Is Federalism Superior? In *Political Institutions and Public Policy*, eds. B. Steunenberg, and F. van Vught, 85-113.

Lasarte, J. D. 2002. *Informe Sobre La Reforma Del Sistema De Financiación Autonómica*. Madrid: Instituto de Estudios Fiscales.

Lavrov, A., J. M. Litwack, and D. Sutherland. November 2000. Fiscal Federalist Relations in Russia: A Case for Subnational Autonomy. In.

Levitt, S. D., and J. M. Snyder. November 1995. Political Parties and the Distribution of Federal Outlays. *American Journal of Political Science* 39(4): 958-80.

Leyden, K. M., and S. A. Borrelli. June 1995. The Effect of State Economic Conditions on Gubernatorial Elections: Does Unified Government Make a Difference? *Political Research Quarterly* 48(2): 275-90.

Lijphart, A. June 1996. The Puzzle of Indian Democracy: A Consociational Interpretation. *American Political Science Review* 90(2): 258-68.

Linz, J., and A. Stepan. August 2000. Inequality Inducing and Inequality Reducing Federalism. *Paper Prepared for the XVIII World Congress of the International Political Science Association.*

Livingstone, I., and R. Charlton. 2001. Financing Decentralized Development in a Low-Income Country: Raising Revenue for Local Government in Uganda. *Development and Change* 32: 77-100.

López Casasnovas, G. 2004. El Déficit Fiscal De Una Comunidad Autónoma Con La AdministraciónCentral: ¿De Qué Estamos Hablando? *Papeles De Economía Española* 99.

López Laborda, J. Anuario 2002. La Reforma De La Financiación Autonómica De La Sanidad (El Médico). *El Médico* 32.

Lowry, R., J. Alt, and Ferree. n.d. Fiscal Policy Outcomes and Electoral Accountability in the AmericanStates. *American Political Science Review* 92(4): 759 - 74.

Lowry, R., J. Alt, and K. E. Ferree. 1998. Fiscal Policy Outcomes and Electoral Accountability in the American States. *American Political Science Review* 92(4): 759 - 74.

Lupia, A., and M. McCubbins. 1998. *The Democratic Dilemma: Can Citizens Learn What They Need to Know*. New York: Cambridge University Press.

Mahler, V. January 2002. Exploring the Subnational Dimension of Income Inequality. *Luxembourg Income Study Working Paper No.292*.

Manor, J. 1999. *The Political Economy of Democratic Decentralization*. Washington, D.C.: World Bank.

March, J. G., and J. P. Olsen. 1989. *Rediscovering Institutions*. New York : Collier Macmillan.

Mark Hansen, J. September 1998. Individuals, Institutions and Public Preferences Over Public Finance. *American Political Science Review* 92(3): 513-31.

Mc Lure, C. E. 1995. Comment on "Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects" by Vito Tanzi. In *Annual World Bank Conference on Development Economics*, eds. M. Bruno, and B. Pleskovic. Washington, D.C.: World Bank.

Mc Lure, C., and J. Martinez-Vazquez. 2000. "The Assignment of Revenues and Expenditures in Intergovernmental Fiscal Relations." World Bank Institute. Paper prepared for the core course on Intergovernmental Relations and Local Financial Management.

Méndez Lago, M. 2000. *La Estrategia Organizativa Del PSOE (1975-1996)*. Madrid: CIS.

Mény, Y., and V. Wright. 1985. *Centre-Periphery Relations in Western Europe*. London: Allen & Uwin.

Mills, A., P. J. Vaughan, D. L. Smith, I. Tabibzadeh, and (eds.). 1990. "Health System Decentralization. Concepts, Issues andCountryexperience." World Health Organization.

Mitchell, J. Winter 2003. Spectators and Audiences: The Politics of UK Regional Finance. *Regional and Federal Studies* 13(4).

Moe, T. M. November 1984. The New Economics of Organization. *American Journal of Political Science* 28(4): 739-77.

Moldes Teo, E. 1996. La Participación En Los Ingresos Del Estado. In *La Financiación De Las Comunidades Autónomas*, eds. E. Moldes Teo, and P. Puy Fraga.

Monasterio, C., and J. Suárez. 1993. *Financiación Autonómica Y Corresponsabilidad Fiscal En España*. Bilbao: Fundación BBV.

Montero, A. 2001. After Decentralization: Patterns of Intergovernmental Conflict in Argentina, Brazil, Spain, and Mexico. *Publius: The Journal of Federalism* 31(4).

Montero, A. October 2005. The Politics of Decentralization in a Centralized Party System: The Case of Democratic Spain. *Comparative Politics* 38(1).

Montero, A., and D. Samuels. 2004. The Political Determinants of Decentralization in Latin America: Causes and Consequences. In *Decentralization and Democracy in Latin America*, eds. A. Montero, and D. Samuels. Notre Dame: University of Notre Dame Press.

Morrow, J. D. 1994. *Game Theory for Political Scientists*. Princeton, NJ: Princeton University Press.

Mueller, D. e. 1997. *Perspectives on Public Choice: A Handbook*. Cambridge: Cambridge University Press.

Musgrave, R. A. 1959. *The Theory of Public Finance*. New York: Mc Graw-Hill.

Myrdal, G. 1957. *Economic Theory and Under-Developed Regions*. London: Duckworth.

Oates, W. E. 1972. *Fiscal Federalism*. New York: Harcourt, Brace, Jovanovich.

Oates, W. E. 1991. *Studies in Fiscal Federalism*. Aldershot, Hants, England; Brookfield, Vt., USA: E. Elgar,: Edward Elgar Publishing Limited.

Oates, W. E. September 1999. An Essay on Fiscal Federalism. *Journal of Economic Literature* 37: 1120-49.

O'Neill, K. 2001a. "Decentralization As an Electoral Strategy."

O'Neill, K. 2001b. "Return to Center?. Fiscal Decentralization and Recentralization in Comparative Perspective." Prepared for Delivery at the 2001 Meeting of the APSA.

O'Neill, K. M. 2004. Decentralization in Bolivia: Electoral Incentives and Outcomes. In *Decentralization and Democracy in Latin America*, eds. A. P. Montero, and D. J. Samuels. Notre Dame, IN: University of Notre Dame.

Ordeshook, P. C. 1986. *Game Theory and Political Theory: An Introduction*. Cambridge and London: Cambridge University Press.

Ordeshook, P. C., and O. Shvetsova. 1997. Federalism and Constitutional Design. *Journal of Democracy* 8(1): 27 - 42.

Pallarés, F. 1994. Las Elecciones Autonómicas En España: 1980-1992. In *Comportamiento Político Y Electoral*, ed. Pilar del Castillo. Madrid: CIS.

Panizza, U. 1999. On the Determinants of Fiscal Centralization. *Journal of Public Economics* 74: 97-139.

Parker, A. 1995. Decentralization: The Way Forward for Rural Development? (Policy Research Working Paper 1475. World Bank).

Peltzman, S. May 1987. Economic Conditions and Gubernatorial Elections. *The American Economic Review* 77(2): 293 - 297.

Penfold-Becerra, M. 2004. Electoral Dynamics and Decentralization in Venezuela. In *Decentralization and Democracy in Latin America*, ed. Montero and Samuels. Notre Dame, IN: Notre Dame University Press.

Pereira, P. T. C. 1996. A Politico-Economic Approach to Intergovernmental Lump-Sum Grants. *Public Choice 88*: 185-201.

Pérez, F. 1991. La Inestabilidad Del Sistema De Financiación Autonómica. *Herri-Ekonomiaz/D Economía Pública* 12(3): 161-84.

Persson, T., G. Roland, and G. Tabellini. 1997. Separation of Powers and Political Accountability. *Quarterly Journal of Economics* 112: 1163-202.

Persson, T., and G. Tabellini. 1996. Federal Fiscal Constitutions: Risk Sharing and Redistribution. *Journal of Political Economy* 104(5).

Perulles, J. M. 1991. La Financiación De Las Comunidades Autónomas. In *El Futuro De Las Autonomías Territoriales. Comunidades Autónomas. Balance Y Perspectivas*, 229-53. Santander: Universidad de Cantabria.

Piereson, J. E. November 1975. Presidential Popularity and Midterm Voting At Different Electoral Levels. *American Journal of Political Science* 19(4): 683-94.

Pierson, P. October 1995. Fragmented Welfare States: Federal Institutions and the Developmentof Social Policy. *Governance: An International Journal of Policy and Administration* 8(4): 449-78.

Pierson, P. 2000. Increasing Returns, Path Dependence, and the Study of Politics. *American Political Science Review* 94(2): 251-67.

Pola, G. 1999. A Comparative View of Local Finances in EU Member Countries: Are There Any Lessons to Be Drawn? In *Fiscal Federalism in the European Union*, eds. A. Fossati, and G. Panella. London: Routledge.

Porto, A., and P. Sanguinetti. November 2001. Political Determinants of Intergovernmental Grants: Evidence From Argentina. *Economics and Politics* 13: 237-56.

Poterba, J. M. 1999. Public Finance and Public Choice. In *Tax Policy in the Real World*. Cambridge; New York: Cambridge University Press.

Prud'homme, R. 1995. Comment on "Conflicts and Dilemmas of Decentralization" by RudolfHommes. In *Annual World Bank Conference on Development Economics*, eds. M. Bruno, and B. Pleskovic. Washington, D.C.: World Bank.

Qian, Y., and B. Weingast. 1997. Federalism As a Commitment to Preserving Market Incentives. *Journal of Economic Perspectives* 11(4): 83-92.

Ramallo Massanet, J., and J. Zornoza Pérez. 1995. Sistema Y Modelos De Financiación Autonómica. *Papeles De Economía Española* 51.

Ramallo Massanet, J., and J. Zornoza Pérez. 2000. El Consejo De Política Fiscal Y Financiera Y La Financiación De LasComunidades Autónomas. *Papeles De Economía Española* 83.

Rao, M., R. T. S. Govinda, and K. P. Kalirajan. March 27, April 2 1999. Convergence of Incomes Across Indian States: A Divergent View. *Economic and Political Weekly (India)*.

Remmer, K. L., and F. Gélineau. September 2003. Subnational Electoral Choice. Economic and Referendum Voting in Argentina, 1983 - 1999. *Comparative Political Studies* 36(7): 801 - 821.

Rey, M. 1991. Towards a Revision of The Theory of Fiscal Federalism. In *Local Government: An International Perspective*, eds. J. Owens, and G. Panella. Amsterdam: North-Holland.

Richard Scott, W. 1995. *Institutions and Organizations*. California: Thousand Oaks.

Rico Gómez, A. 1998. Descentralización Y Reforma Sanitaria En España (1976-1996).Intensidad De Preferencias Y Autonomía Política Como Condiciones Para ElbuenGobierno.Centro de Estudios Avanzados en Ciencias Sociales.

Riker, W. 1980. Implications From the Disequilibrium of Majority Rule for the Study of Institutions. *American Political Science Review* 74: 432-58.

Riker, W. H. 1964. *Federalism: Origin, Operation and Significance.* Boston: Little Brown.

Rodden, J. 2001. "Creating a More Perfect Union: Electoral Incentives and the Reform of Federal Systems."

Rodden, J. *Reviving Leviathan: Fiscal Federalism and the Growth of Government* [http://web.mit.edu/jrodden], May 2001.

Rodden, J. 2002. The Dilemma of Fiscal Federalism: Grants and Fiscal Performance Around the World. *American Journal of Political Science* 46(3): 670 - 687.

Rodden, J. 2004. "Comparative Federalism and Decentralization: On Meaning and Measurement." Comparative Politics (forthcoming).

Rodden, J., and S. Rose-Ackerman. 1997. Does Federalism Preserve Markets? *Virginia Law Review* 83(7): 1521-72.

Rodden, J., and E. Wibbels. July 2002. Beyond the Fiction of Federalism. *World Politics* 54: 494-531.

Rogowski, R. January 1978. Rationalist Theories of Politics: A Midterm Report. *World Politics* 30(2).

Rondinelli, D. A. 1981. Government Decentralization in Comparative Perspective: Theory and Practice in Developing Countries. *International Review of Administrative Sciences* 47(2).

Rondinelli, D. A. 1990. Decentralization, Territorial Power and the State: A Critical Response. *Development and Change* 21: 491-500.

Rondinelli, D. A., J. S. McCullough, and R. W. Johnson. 1989. Analysing Decentralization Policies in Developing Countries: A Political Economy Framework. *Development and Change* 20: 57-87.

Rose-Ackerman, S. 2000. The Economics and Politics of Federalism: Tensions and Complementarities. *APSA-CP* 11(1): 17-9.

Royed, T. J., K. M. Leyden, and S. A. Borrelli. 2000. Is "Clarity of Responsibility" Important for Economic Voting? Revisiting Powell and Whitten's Hypothesis. *British Journal of Political Science* 30: 669 - 698.

Ruiz Almendral, V. November 2002. The Assignment of Taxation Powers to the Autonomous Communities. *European Taxation* 42(11): 467-75.

Ruiz Almendral, V. Winter 2003. The Asymmetric Distribution of Taxation Powers in the Spanish State of Autonomies: The Common System and the Foral Tax Regimes. *Regional and Federal Studies* 13(4): 41-66.

Ruiz-Huerta Carbonell, J., and J. López Laborda. 1994. Hacia Un Nuevo Modelo De Financiación Autonómica (Comentarios Al Libro Blanco Sobre Financiación De Las Comunidades Autónomas). In *Informe Comunidades Autónomas*, 621-37.

Ruiz-Huerta Carbonell, J., and J. López Laborda. 1998. La Financiación Autonómica. Problemas Del Modelo Y Articulación Institucional. In *Informe Comunidades Autónomas*, 477-98.

Ruiz-Huerta Carbonell, J. 1993. Situación Actual Y Perspectivas De La Financiación De Las CCAA En Régimen Común. In *Informe Sobre Comunidades Autónomas*. Barcelona: Instituto de Derecho Público.

Ruiz-Huerta Carbonell, J., and A. Herrero Alcalde. n.d. "La Financiación De Las Comunidades Autónomas Españolas: Evolución,Situación Actual Y Perspectivas De Futuro".

Samoff, J. 1990. Decentralization: The Politics of Interventionism. *Development and Change* 21: 513-30.

Schady, N. R. June 2000. The Political Economy of Expenditures by the Peruvian Social Fund (FONCODES), 1991-1995. *The American Political Science Review* 94(2): 289-304.

Scharpf, F. 1991. Games Real Actors Could Play: The Challenge of Complexity. *Journal of Theoretical Politics* 3(3): 277 - 304.

Scott Long, J. 1997. *Regression Models for Categorical and Limited Dependent Variables. Advanced Quantitative Techniques in the Social Sciences*. Thousand Oaks, CA: Sage.

Seabright, P. 1996. Accountability and Decentralisation in Government: AnIncompletecontracts Model. *European Economic Review* 40: 61-89.

Selten, R. 1978. The Chain Store Paradox. *Theory and Decision* 9: 127 - 159.

Sevilla Segura, J. V. 2005. *Financiación Autonómica. Problemas Y Propuestas.* Madrid: Exlibris y Fundación Alternativas.

Sharpe, L. J. 1993. *The Rise of Meso Government in Europe.* London: SAGE Publications.

Simon, D. M. May 1989. Presidents, Governors and Electoral Accountability. *The Journal of Politics* 51(2): 286-304.

Simon, D. M., C. W. Ostrom, and R. G. Marra. December 1991. The President, Referendum Voting and Subnational Elections inTheUnites States. *American Political Science Review* 85(4): 1177 - 1192.

Slater, D. 1990. Debating Decentralization - A Reply to Rondinelli. *Development and Change* 21: 501 - 512.

Squire, P., and C. Fastnow. September 1994. Comparing Gubernatorial and Senatorial Elections. *Political Research Quarterly* 47(3): 705 - 720.

Stein, E. November 1999. Fiscal Decentralization and Government Size in Latin America. *Journal of Applied Economics* 2(2): 357-91.

Stein, R. M. February 1990. Economic Voting for Governor and U.S. Senator: The Electoral Consequences of Federalism. *The Journal of Politics* 52(1): 29 - 53.

Steinmo, S. 1993. *Taxation and Democracy : Swedish, British, and American Approaches to Financing the Modern State.* New Haven: Yale University Press.

Stepan, A. October 1999. Federalism and Democracy: Beyond the U.S. Model. *Journal of Democracy* 10(4): 19 - 33.

Stepan, A. 2001. Toward a New Comparative Politics of Federalism, (Multi)Nationalism and Democracy: Beyond Rikerian Federalism. In *Arguing Comparative Politics*, ed. A. Stepan. Oxford; New York: Oxford University Press.

Suárez Pandiello, J. 1996. Las Comunidades Autónomas Y Su Endeudamiento. Un Test Sobre Sus causas. In *La Financiación De Las Comunidades Autónomas*, eds. P. Puy, and E. Moldes.

Suárez, J., and C. Monasterio. Julio 1993. *El Endeudamiento Autonómico. Teoría Y Evidencia Empírica*. Bilbao: Fundación Banco Bilbao Vizcaya.

Subirats, Joan. *Federalismo Y Subsidiariedad En Italia. Reformas Políticas Y Administrativas Para La Renovación Democrática*. Barcelona: Fundació Pi i Sunyer d´Estudis Autonòmics i Locals, 1998.

Svoboda, C. J. March 1995. Retrospective Voting in Gubernatorial Elections: 1982 and 1986. *Political Research Quarterly* 48(1): 135 - 150.

Tanzi, V. 1995. Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects. In *Annual World Bank Conference on Development Economics*, eds. M. Bruno, and B. Pleskovic. Washington, D.C.: World Bank.

Tanzi, V. September 1997. The Changing Role of the State in the Economy: A HistoricalPerspective. *IMF Working Paper*.

Ter-Minassian, T. 1997. Intergovernmental Fiscal Relations in a Macroeconomic Perspective: An Overview. In *Fiscal Federalism in Theory and Practice*, ed. T. Ter-Minassian. Washington, US: International Monetary Fund.

Tiebout, C. M. 1956. A Pure Theory of Local Expenditures. *The Journal of Political Economy* 64(5): 416 - 424.

Treisman, D. April 1999. Political Decentralization and Economic Reform: A Game-Theoretic Analysis. *American Journal of Political Science* 43(2).

Treisman, D. 2000. *Decentralization and the Quality of Government*. Preliminary draft.

Treisman, D. December 2000. Decentralization and Inflation: Commitment, Collective Action, or Continuity? *American Political Science Review* 94(4).

Utrilla, A. 2002. Los Efectos Del Nuevo Sistema De Financiación Autonómico Sobre La Suficiencia Y La Equidad. *Instituto De Estudios Fiscales*.

van Houten, P. *The Politics of Fiscal Autonomy Demands. Regional Assertiveness and Intergovernmental Financial Relations in Belgium and Germany* [Department of Political Science. University of Chicago], September 1999.

Verdonck, M., and K. Deschouwer. Winter 2003. Patterns and Principles of Fiscal Federalism in Belgium. *Regional and Federal Studies* 13(4).

Vinuela, J. November 2000. Fiscal Decentralization in Spain.

von Braun, J., and U. Grote. n.d. Does Decentralization Serve the Poor? *IMF - Conference on Fiscal Decentralization. 20-21 November 2000*.

De Vries, M. S. 2000. The Rise and Fall of Recentralization: A Comparative Analysis of Arguments and Practices in European Countries. *European Journal of Political Research* 38: 193-224.

Wallis, J. J., and W. E. Oates. 1988. Decentralization in the Public Sector: An Empirical Study of State and Local Government. In *Fiscal Federalism: Quantitative Studies*, ed. H. S. Rosen. Chicago and London: The University of Chicago Press.

Watts, R. 1993. Representation in North American Federations: A Comparative Perspective. In *Representation and Policy Formation in Federal Systems*, eds. D. Olson, and C. E. S. Franks, 291-321. Berkeley: Institute of Governmental Studies.

Watts, R. Winter 2003. Introduction: Comparative Research and Fiscal Federalism. *Regional and Federal Studies* 13(4): 1-6.

Watts, R. L. 1994. Comment: The Value of Comparative Perspectives. In *The Future of Fiscal Federalism*, eds. K. G. Banting, D. M. Brown, and T. J. Courchene. Kingston, Ont: School of Policy Studies - Queen's University.

Watts, R. L. 1999. *Comparing Federal Systems*. Kingston, Ontario, Canada: Montreal McGill-Queen's University Press.

Weingast, B. R. 1995. The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development. *Journal of Law, Economics and Organization* 11(1): 1-31.

Wert, J. I. n.d. Elecciones Autonómicas En España, 1980-1996: Una Visión De Conjunto. In *Las Elecciones Autonómicas En España, 1980-1997*, eds. M. Alcántara, and A. Martínez. CIS ed. Madrid: CIS.

West, L. A., and C. P. W. Wong. Winter 1995. Fiscal Decentralization and Growing Regional Disparities in Rural China: Some Evidence in the Provision of Social Services. *Oxford Review of Economic Policy* 11(4): 70-84.

Wibbels, E. October 2000. Federalism and the Politics of Macroeconomic Policy and Performance. *American Journal of Political Science* 44(4): 687-702.

Wildasin, D. 1995. Comment on "Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects" by Vito Tanzi. In *Annual World Bank Conference on Development Economics*, eds. M. Bruno, and B. Pleskovic. Washington, D.C.: World Bank.

Williamson, J. July 1965. Regional Inequality and Process of National Development: A Description of the Patterns. *Economic Development Adn Cultural Change* XIII(4, Part II): 2-84.

Willis, E., C. Garman, and S. Haggard. 1999. The Politics of Decentralization in Latin America. *Latin American Research Review* 34(1): 7-56.

Willis, E., C. Garman, and S. Haggard. January 2001. Fiscal Decentralization. A Political Theory with Latin American Cases. *World Politics* 53: 205-36.

Wooldridge, J. M. 1999. *Introductory Econometrics*. Thomson Learning.

World Bank. 2000. Decentralization: Rethinking Government. In *World Development Report 1999/2000*. Washington, D.C.: World Bank.

Wright, V. 1984. Regions and Regionalisation in France, Italy and Spain -Some Concluding Remarks. In *Regionalisation in France, Italy and Spain*, eds. M. Hebbert, and H. Machin.ICERD.