Fiscal Federalism and Political Selection: Evidence From Italy

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Motivation

- Theoretical support in favour of fiscal decentralization rather strong ➜ increase in accountability by local politicians (e.g., Lockwood, 2006)

- Empirical support, however, far less conclusive, with contrasting estimated effects in terms of growth, efficiency, quality of services, corruption, financial stability (e.g., Rodden, 2006)

- Why mismatch between theory and evidence?

Motivation

- The degree of Vertical Fiscal Imbalance matters
  - Fiscal decentralization works when VFI is low ➔ citizens pay for their services
  - Fiscal decentralization does not work well when VFI high ➔ transfers from the Centre continue to be large
    - Eyraud and Lusinyan (2011) for recent cross-country strong supportive evidence

- But why it is so?

Motivation

- We argue that a likely channel of causation is the *link between the "quality" of fiscal decentralization and the "quality" of local politicans* ➔ quality of local politicians endogenous to the quality of decentralization
    - Where VFI high, "better" politicians at the local level means politicians able to attract transfers from the Center (e.g., more politically connected)
    - Where VFI low, "better" politicians are better administrators (e.g., more skilled)

    - True for voters' behaviour, self-selection of candidates, selection by political parties

This paper

- We explore the relationship between VFI and the "quality" of local politicans using Italy as a testing ground

- Important reforms changed the working of Municipalities in the early '90s

  - Reform of the electoral system ➔ same impact for all Municipalities

  - Introduction of ICI ➔ change in VFI different in "rich" and "poor" Municipalities

  - Diff-in-Diff approach: "treatment" is reduction in VFI

This paper

- Consider Chief Provincial Towns (Capoluoghi di Provincia) in Ordinary Statute Regions from 1985 to 2010

- Focus on the role of Mayor only, because of the role assigned by the 1993 Reform

- Define ex-ante and ex-post measures of "quality" of local politicians, following (at least partly) the literature (Nannicini and Galasso, 2011; Nannicini and Gagliarducci, 2011)

- Test for differences in "quality" before and after the reforms, between "rich" and "poor" Municipalities

Theory

- Still to be done: self-selection by potential candidates for different levels of VFI

- Related literature
    - Brollo et al. (2011): in the Brazilian context, higher transfers lead to politicians of poorer quality, because they can extract higher rents
    - Besley (2006) ➔ different political institutions select different politicians

Empirical analysis: strategy

- We consider the following model

$$Y_i = \alpha + \beta_1 RICH_i + \beta_2 NEWELEC_i +$$

$$+\beta_3 RICHxNEWELEC_i + \gamma X_i + \xi_i$$

where

Y a measure of "quality" of politicians

RICH is a variable identifying the wealthier Municipalities

NEWELEC is a variable identifying new electoral rules (take up value 1 at time of first elections with the new rules)

- Our working hypothesis can be tested considering β_3

Empirical analysis: strategy

- How to define "quality" of politicians?

    - Ex-ante: level of education (college?), type of occupation (high-skilled jobs?), political experience (political career before becoming Mayor/working years)

    - Ex-post (still to be done): Legambiente environmental quality index

Empirical analysis: strategy

- How to define RICH?
    - Rank cities according to average 1995-2010 (1995-2000) GDP per capita
    - Identify a threshold of the per capita income distribution
    - Dummy RICH=1 for those above the threshold
        - Four different thresholds according to income quartiles
        - Most important ones: MEDIAN (3rd and 4th q.) and MEDIAN2 (only 3rd q.)
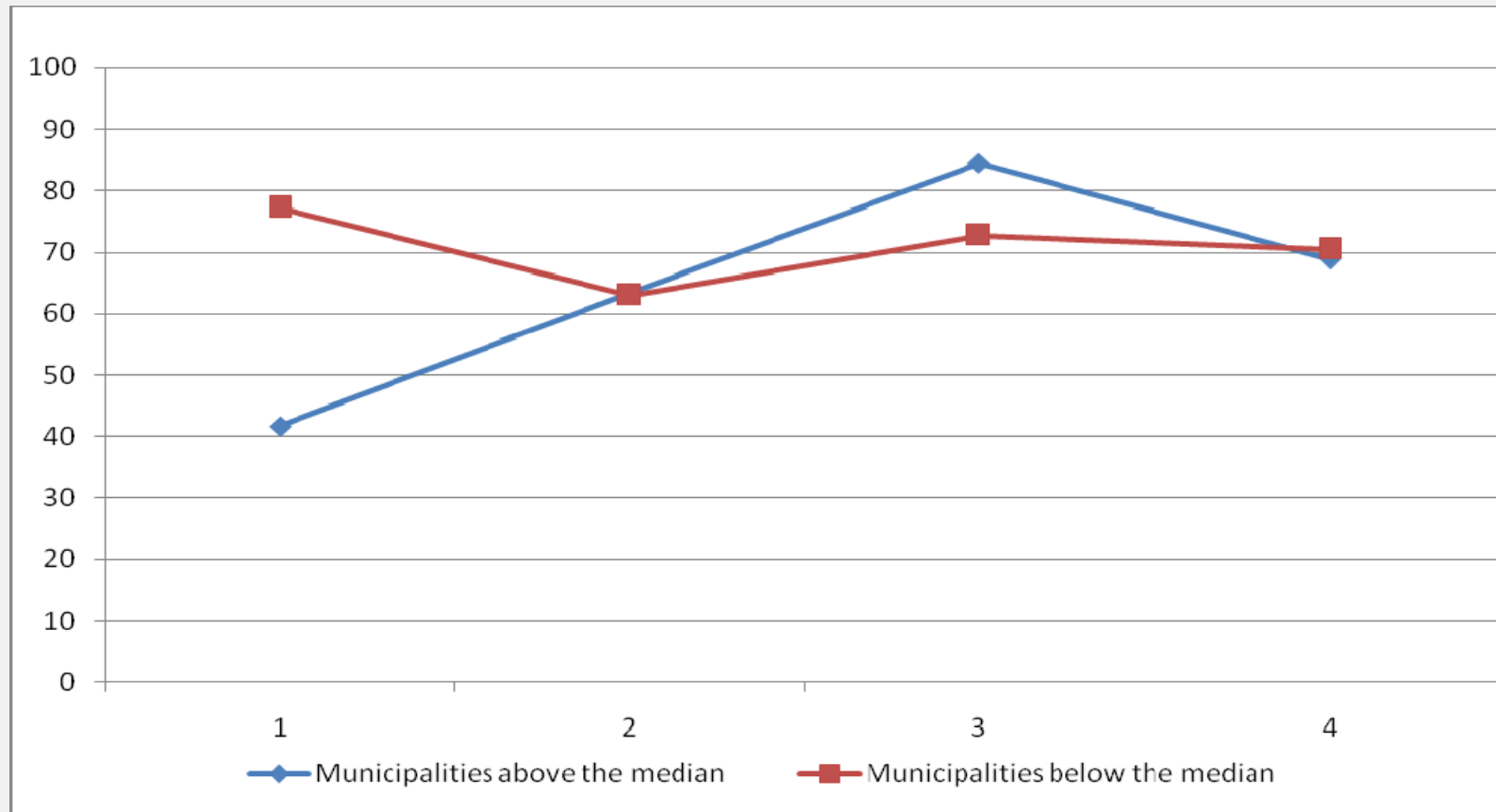
Empirical analysis: strategy

- Other controls
    - Individual characteristics: gender, age, not first time Mayor
    - Characteristics of the Municipality:
        - Political: political alignment (ALIGNED), ideological constraint (%_VOTE_CENTRE-LEFT), set of dummies for political parties
        - Social: population, population in need, number of enterprises out of total population (%_ENTERPRISES)

Preliminary evidence
College-graduated Mayors (MEDIAN)
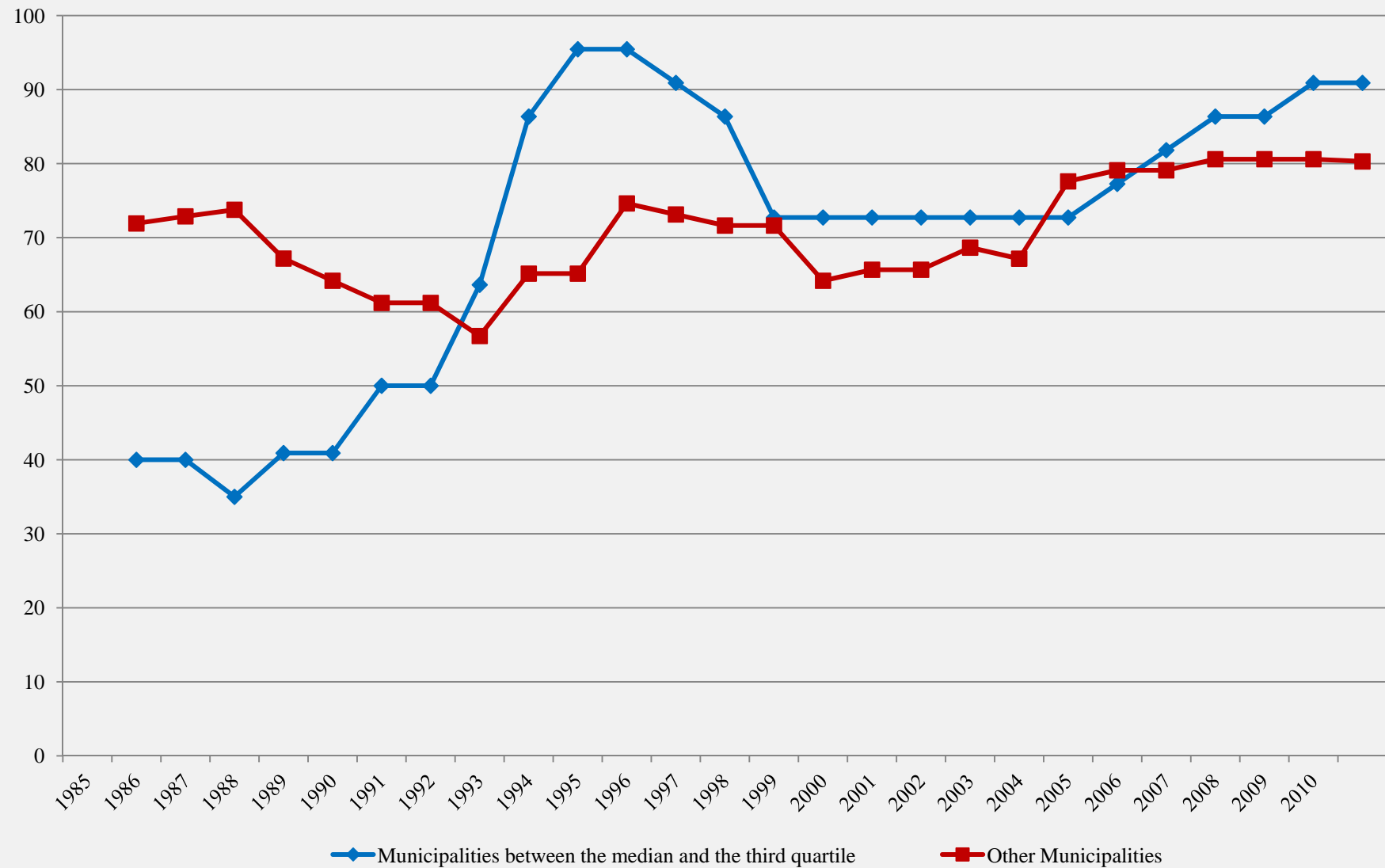
Legend:
- ◆ Municipalities above the median
- ■ Municipalities below the median
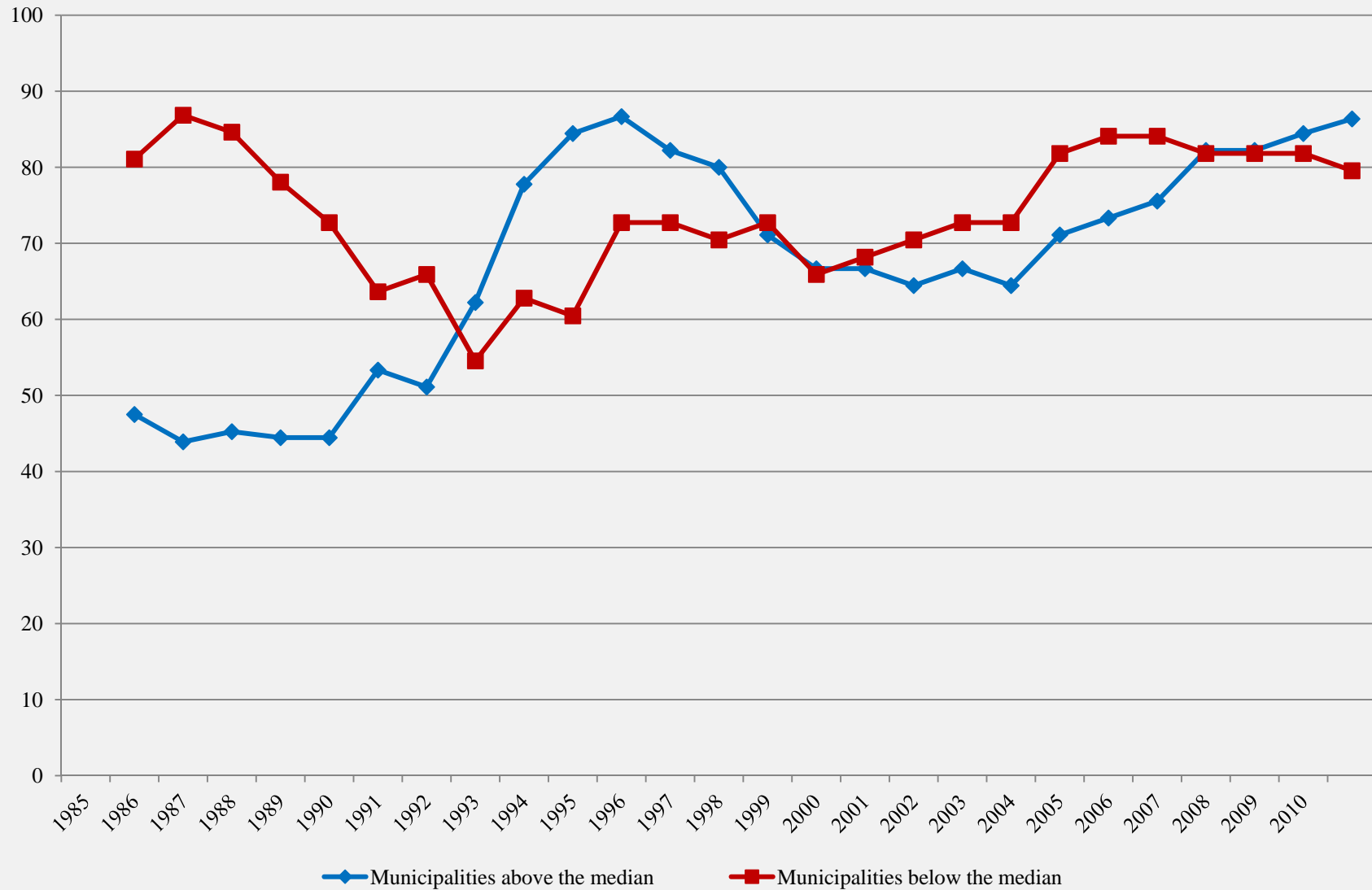
Preliminary evidence
College-graduated Mayors (MEDIAN)

Preliminary evidence
College-graduated Mayors (MEDIAN2)

Municipalities between the median and the third quartile — Other Municipalities
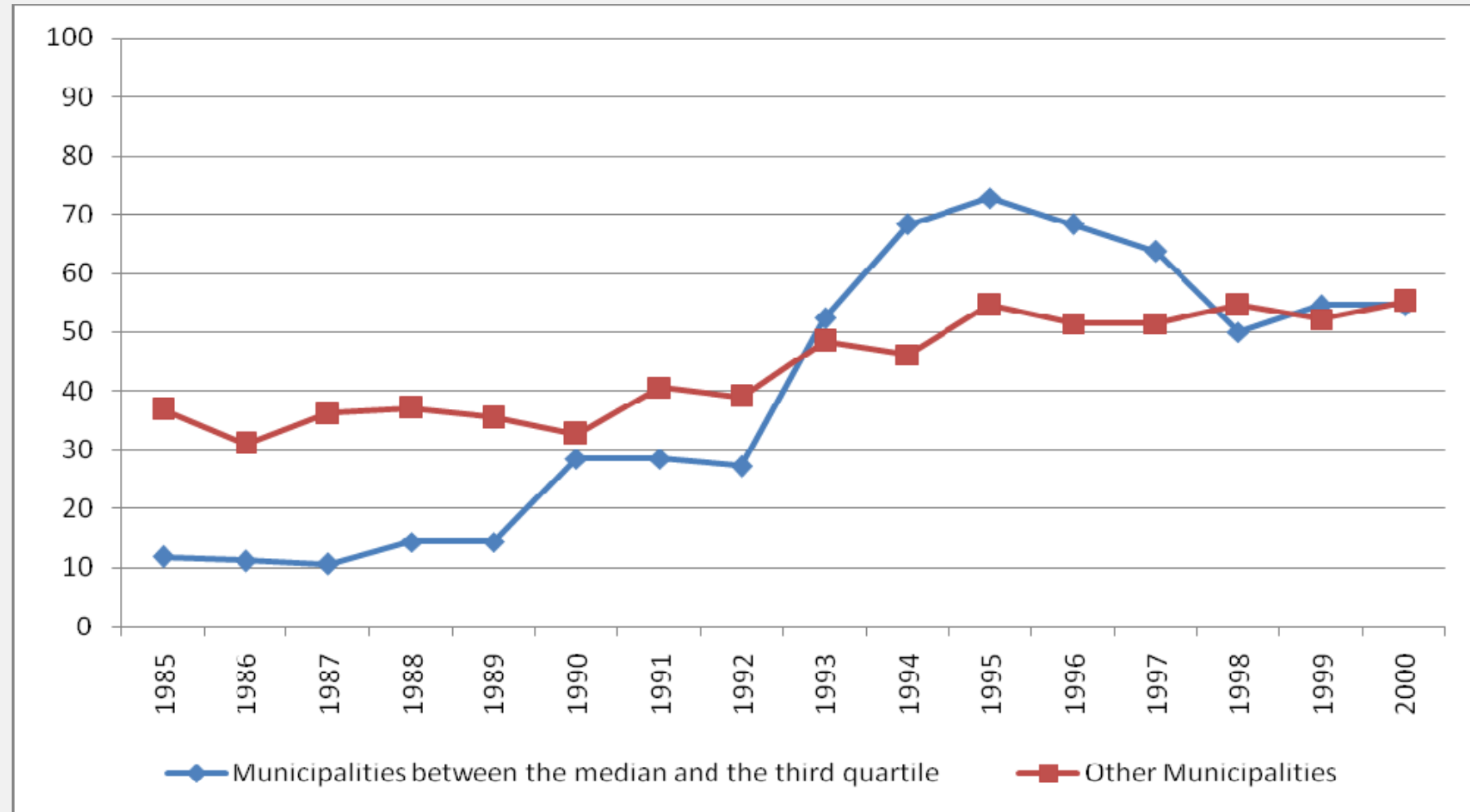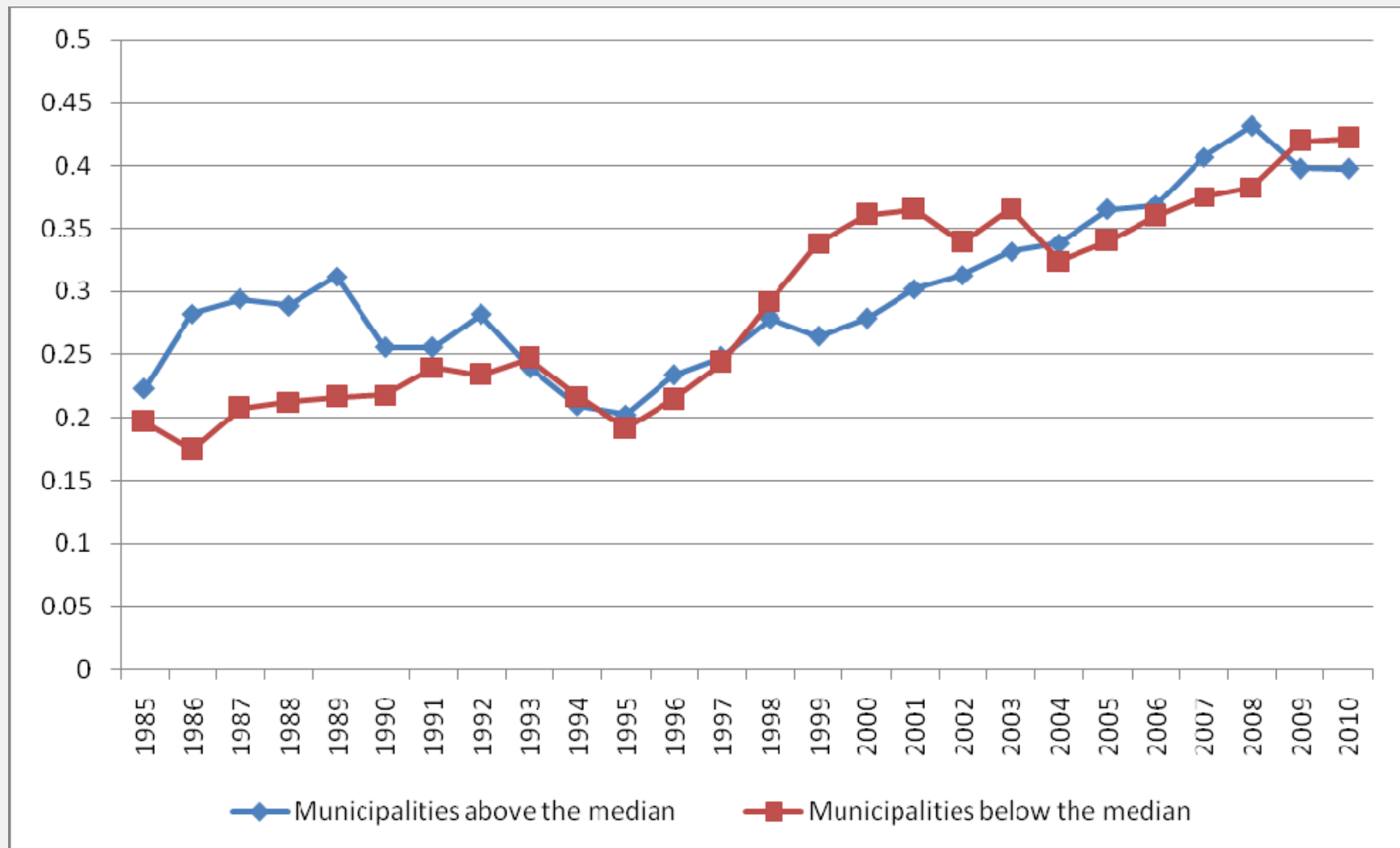
Preliminary evidence
High-skilled jobs (MEDIAN)
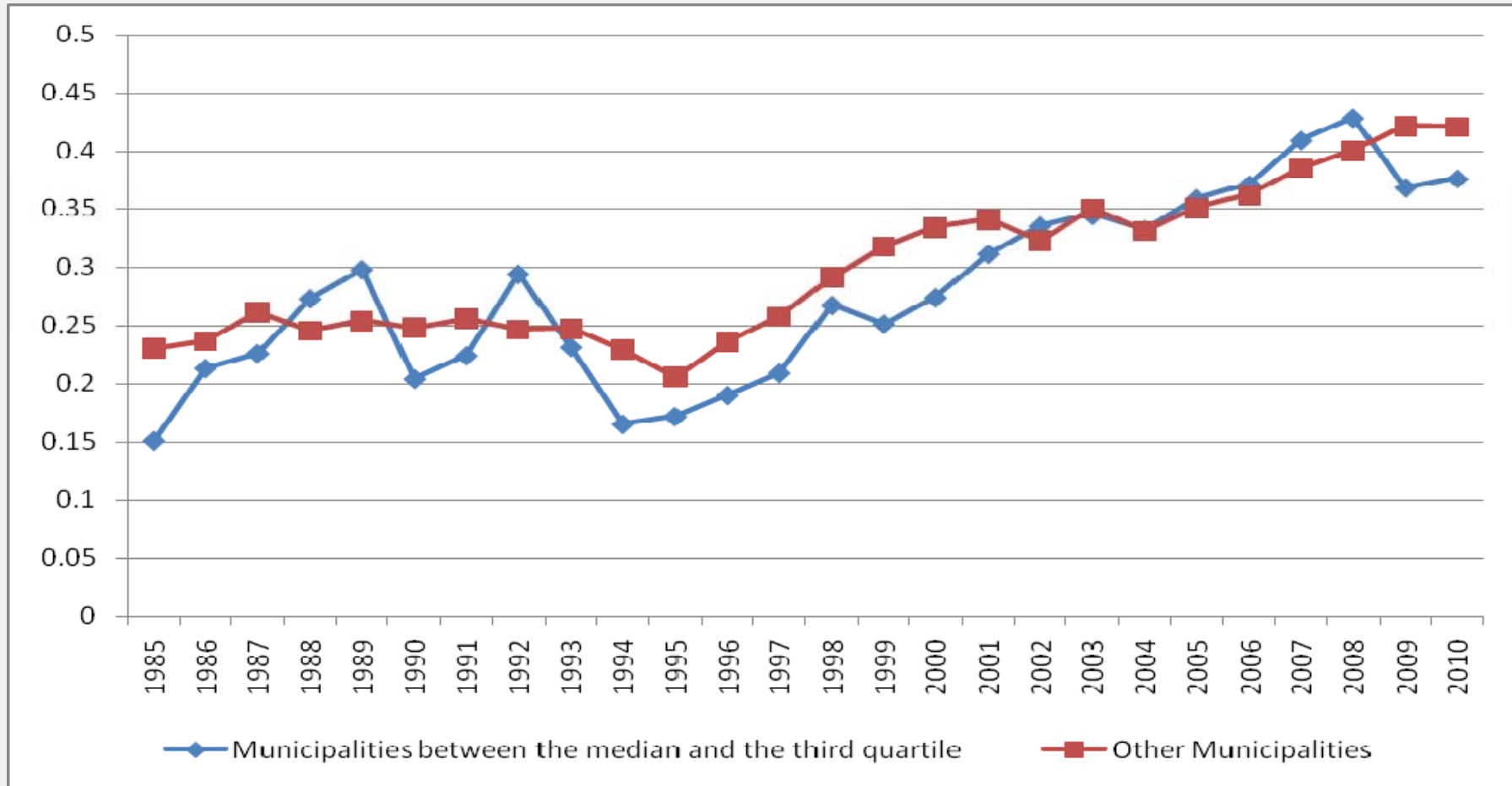
Preliminary evidence
High-skilled jobs (MEDIAN2)

Preliminary evidence
Past political experience (MEDIAN)

Preliminary evidence
Past political experience (MEDIAN2)

DiD estimates: college-graduated Mayors

Table 1 - Graduated Mayors, period 1985-2010

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.6582492***	0.0370105	0.148813	0.3828155
NEWELECT	0.0752034	0.0550557	-0.0538144	0.0912851
MEDIAN2	-0.1582492*	0.0870532	-0.0788307	0.1014264
MEDIAN2xNEWELECT	**0.2429784****	**0.0995204**	**0.1969871***	**0.1018346**

Table 2 - Graduated Mayors, period 1985-2000

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.6582492***	0.0370262	-0.5520374	0.4468104
NEWELECT	0.0366283*	0.064375	-0.0583876	0.0976135
MEDIAN2	-0.1582492	0.0870901	-0.0825631	0.1016093
MEDIAN2xNEWELECT	**0.301034****	**0.1039676**	**0.2241533****	**0.1090371**

DiD estimates: college-graduated Mayors

Table 3 - Graduated Mayors, legislatures 1-4

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.6458647***	0.0390949	-0.0037234	0.5315803
NEWELECT	0.0630906	0.0647055	-0.1383485	0.1527189
MEDIAN2	-0.1339599	0.0886719	-0.0429343	0.108194
MEDIAN2xNEWELECT	**0.2659138****	**0.104056**	**0.183454**	**0.1126028**

DiD estimates: high-skilled jobs

Table 4 - Mayors from high-skilled occupations, period 1985-2010

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.4297521***	0.0612088	0.9609885**	0.4592074
NEWELECT	0.1535813**	0.0677467	0.1730766*	0.1004655
MEDIAN	-0.1970155**	0.0759679	-0.1259388	0.0993715
MEDIANxNEWELECT	**0.2009837****	**0.0938224**	**0.2167355****	**0.0955376**

Table 6 - Mayors from high-skilled occupations, period 1985-2000

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.4297521***	0.0612358	1.00868**	0.5590376
NEWELECT	0.0668233	0.0825013	0.0514934	0.1130898
MEDIAN	-0.1970155**	0.0760014	-0.1754715*	0.091148
MEDIANxNEWELECT	**0.3356193*****	**0.1106472**	**0.4106539*****	**0.1103344**

DiD estimates: high-skilled jobs

Table 8 - Mayors from high-skilled occupations, legislatures 1-4

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.4310078***	0.0606725	1.704888***	0.6124325
NEWELECT	0.0747394	0.0851347	0.0647587	0.1983653
MEDIAN	-0.209227***	0.0752044	-0.2040436**	0.0955097
MEDIANxNEWELECT	**0.3368137***	**0.1119914**	**0.4462691***	**0.1190169**

DiD estimates: high-skilled jobs

Table 5 - Mayors from high-skilled occupations, period 1985-2010

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.3664921***	0.0464841	0.621223	0.4222647
NEWELECT	0.2223768***	0.057657	0.2426218***	0.0884329
MEDIAN2	-0.1620723**	0.078448	-0.1085524	0.0746173
MEDIAN2xNEWELECT	**0.1480696**	**0.0973019**	**0.1582295***	**0.0902172**

Table 7 - Mayors from high-skilled occupations, period 1985-2000

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.3664921***	0.0465046	0.3523363	0.5257235
NEWELECT	0.1750809**	0.0700901	0.1670888*	0.0998721
MEDIAN2	-0.1620723**	0.0784826	-0.1262189*	0.0718845
MEDIAN2xNEWELECT	**0.2633564**	**0.1096285**	**0.318661***	**0.1046681**

DiD estimates: high-skilled jobs

Table 9 - Mayors from high-skilled occupations, legislatures 1-4

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.3642677***	0.0465037	0.847663	0.5681706
NEWELECT	0.1846045**	0.0716815	0.1866045	0.1782349
MEDIAN2	-0.1618867**	0.0786887	-0.1136918	0.0768843
MEDIAN2xNEWELECT	**0.2493782****	**0.1086132**	**0.297523****	**0.1083864**

DiD estimates: past political exp.

Table 10 - % of years of political experience (past political experience ratio)

	a)		b)	
	Coefficient	Std. Error	Coefficient	Std. Error
Constant	0.2227314***	0.017724	-0.2497189	0.159626
NEWELECT	0.1026905***	0.0230694	0.0256711	0.0451262
MEDIAN	0.0549319**	0.0246374	0.0292857	0.0479271
MEDIANxNEWELECT	**-0.0677699****	**0.0337085**	**-0.0657554***	**0.0377184**

DiD estimates: other covariates

- ## Not a clear pattern, but …

  - NOT_FIRST_TIME_MAYOR ➔ negative coefficient: experience matters

  - %_VOTE_CENTRE-LEFT ➔ negative coefficient: ideological constraint matters, and reduce competition

  - %_ENTERPRISES ➔ negative coefficient: opportunity cost higher, quality of local politicians lower

  - Dummies political parties Second Republic ➔ positive coefficient: better at selecting candidates?

Main results so far

- Reduction of VFI had a different impact on "rich" and "poor" Municipalities in terms of quality of local politicians

    1. an increase in the share of Mayors with a university-level education
    2. an increase in the share of Mayors from high-skilled occupations;
    3. a decrease in the level of the political experience of the Mayors

- Need to show if this had an impact also on policies (the ex-post quality)