

## Decentralization Toolkit

**Welcome to the toolkit that assesses the degree of decentralization within a country as well as intergovernmental fiscal, political and administrative relations and its potential impact on macroeconomic stability.**

The purpose of the decentralization toolkit is to characterize the degree of decentralization within a country and assess how well it is designed and implemented. Characterizing the degree of decentralization is useful for monitoring how the roles and responsibilities of different levels of government change over time within a particular country and to a lesser extent, for cross country comparisons. Assessing the design and implementation of decentralization is important for learning if the current arrangements are likely to lead to (a) fiscal imbalance and macroeconomic instability and (b) efficient and equitable service delivery. (Service delivery is also affected by many other institutional issues and thus, is addressed in a separate toolkit.) The toolkit is structured into two major sets of questions to help the analyst in a particular country: (1) characterize decentralization (i.e. how much/what kind of decentralization exists in the country), and (2) assess the design of decentralization (i.e. are there particular design or institutional arrangements which are likely to lead to a “soft budget constraint” and become problematic?)

Contributors to the toolkit include:

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# Introduction

## Background and Rationale

Decentralization involves the shifting of fiscal, political and administrative responsibilities from higher to lower levels of government. Throughout the world, countries have been enthusiastically embracing different aspects of decentralization, particularly during the past decade. Because the motivation and design of decentralization differ in each country, it is extremely difficult to compare a single notion of "decentralization" across countries.

This toolkit tries to characterize the decentralization taking place in a given country at a point in time so that the roles and responsibilities of different levels of government can be compared across countries, and most importantly, so that those decentralization policies that have significant impacts can be monitored over time within a country.

Four points should be stressed at the outset<sup>1</sup>:

1. There are several different forms of decentralization which can exist within a country (and indeed, sectors within a country can be characterized by different forms of decentralization). "Deconcentration" occurs when the central government disperses responsibilities for certain services to its regional branch offices. This is the mildest form of decentralization since it does not involve any transfer of authority to local governments. "Delegation" refers to a situation in which a central government transfers responsibilities for decision making and administration of public functions to local governments or semi-autonomous organizations that are not wholly controlled by the central government but are accountable to it (i.e. principal-agent relationship). Finally, "devolution" is a more extensive form of decentralization whereby the central government transfers authority for decision making, finance and management to local governments that have clear and legally recognized jurisdictions over which they exercise authority, within which they perform public functions, and to whose constituents they are accountable. This is usually considered *true* decentralization – it holds the most promise but also poses the greatest risk. Much of the literature on decentralization focuses on devolution; however, in many developing countries, discussions are focused on the milder forms of decentralization.

2. In general, decentralization is neither good nor bad. If designed well it can move decision making closer to people and improve governance, including the efficiency of service delivery. However, "design" is extremely complicated since it involves political, fiscal and administrative policies and institutions which individually and interactively affect outcomes. If decentralization is not designed well, or introduced in certain types of environments, it can have negative impacts. The key challenge is to balance responsibilities with accountability and resources.

3. In practice, there is often a big difference between formal arrangements for decentralization and what is actually happening in the country. Thus, any analyst of

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<sup>1</sup> For an elaboration of these issues see Rethinking Decentralization in Developing Countries, Litvack, Ahmad and Bird, PREM Sector Studies, 1998.

decentralization must start by looking at the formal arrangements (i.e. constitution, laws, regulations and policy discussions) but must also look at the actual practices.

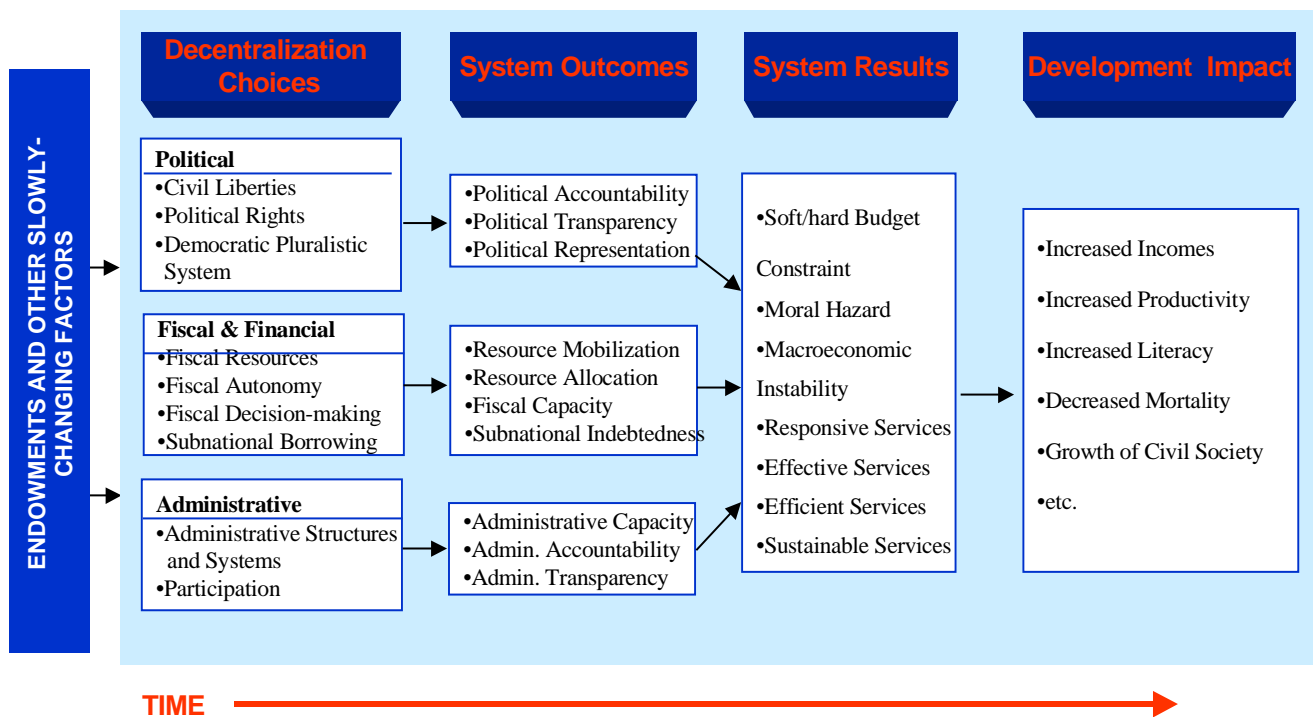
4. An absolutely essential element of decentralization is the need for a clear division of responsibilities and a clear system of accountability. There is no “perfect” set of intergovernmental arrangements which will remain in tact indefinitely – central and local officials must be accountable to their constituents to ensure effective governance.

Although we know that decentralization is usually driven by politics, we also know it can have profound effects on economic outcomes such as macroeconomic stability, efficiency and equity. Whether or not a “hard budget constraint” exists between levels of government is critical for determining the likely impact on macroeconomic stability and often on service delivery (addressed in a separate toolkit). The toolkit proposes a series of questions about policies and institutions which can help an analyst determine the likely impact of decentralization on macroeconomic stability.

## Part A: Characterizing Decentralization

To characterize decentralization, one must consider political, fiscal, and administrative issues. All these components must complement each other to produce more responsive local governments that will deliver effective, efficient and sustainable services and maintain fiscal discipline. This has been referred to as a Souffle Theory (see diagram below).

### Indicators of Decentralization **The Soufflé Theory**



**Source:** Adapted from Parker, Andrew N. 1995, *Decentralization: The Way Forward for Rural Development?* Policy Research Working Paper 1475. The World Bank, Washington, D.C.

Fiscal, political and administrative policies and institutions in a particular country will affect political accountability, fiscal soundness, and administrative capacity at both the national and subnational levels. This in turn affects service delivery as well as the prevalence of moral hazard, a soft (or hard) budget constraint between levels of government, potential for macroeconomic instability and ultimately this affects development impact. The rest of the toolkit focuses on the fiscal/financial, political and administrative arrangements which influence the hard budget constraint.

## Indicators for Assessing Decentralization

### Characterizing Decentralization

#### Political (answer each question for each level of government)

*Regularly held elections when ballots are cast secretly are important for the decentralization (devolution) to enable local leaders to be accountable to their constituents and reflect their needs and preferences. Political parties often improve accountability since they restrain individual leaders from acting too opportunistically and an opposition party can more effectively keep a check on the current government than could an independent opposition candidate.*

	National	Intermediate (State /provincial)	Local 1	Local 2 (If relevant)
1. Are governments elected ?				
	Yes			
	No			
2. Are there multi-party elections?				
	Yes			
	No			
3. Are ballots cast secretly in government elections?				
	Yes			
	No			
	Controversial			
4. Are elections held at regular intervals?				
	Yes			
	No			

5. Are elections free and fair?

Yes				
No				
Controversial				

6. Does the center have the authority to override results of local decisions?

Yes				
No				

7. Is the head of local government elected directly, indirectly or appointed?

\_\_\_\_\_

8. How effective is civil society at keeping a check on local corruption (e.g. through budget or anti-corruption watchdogs, media etc.)

Not effective	1	2	3	4	5 Very effective

## Administrative

1. Is this a federal or unitary country?

Federal  Unitary

2. In practice, where does sovereignty lie (e.g. even in federal countries such as South Africa or India, the sovereignty lies at the center unlike the US where it lies at the state level)

Center  Intermediate

3. List the administrative tiers of government?

*Decentralization is greater when subnational governments have the authority to hire and fire their own civil servants. This provides them with greater flexibility as well as oversight of staff*

4. What tier of government is responsible for determining the salary and hiring of civil servants at each level of government?

	Center	Intermediate	Local 1	Local 2
Salary				
Hiring/Firing				

*Real decentralization requires that subnational levels have flexibility to determine at least some of their own priorities*

5. Who approves the line item budget at each level of government?

**Center** \_\_\_\_\_

**Intermediate** \_\_\_\_\_

**Local 1** \_\_\_\_\_

**Local 2** \_\_\_\_\_

## Fiscal

1. What share of general government spending is incurred at the national level as own spending ? (For reference: OECD, LDC)

2. What share of general revenue is raised and retained at the subnational level? (For reference: OECD, LDC)

*Note that the degree of fiscal imbalance varies considerably from country to country -- the proportion of grants ranges from 10% to 80% in a sample of industrialized countries. Developing countries are likely to have a much higher vertical imbalance since the major tax bases (e.g. trade taxes) are national.*

3. What percentage of subnational expenditures is financed by intergovernmental grants? (This is often referred to as “vertical imbalance) (For reference: OECD, LDC)

*Local residents are more likely to hold their leaders accountable for their spending decisions when their tax revenues are spent locally*

4. What percentage of local expenditure is financed from local revenues?

*Tax sharing refers to a system in which one government (usually the central government) collects revenue from a tax and shares it as subnational governments, usually on the basis of the geographic region of the revenues. These "revenues" are actually another form of an intergovernmental transfer, since (1) the subnational government does not determine the base or rate of the tax; and (2) the sum is included in the determination of other intergovernmental transfers. In short, "shared revenue should not be confined with devolved revenue*

5. What percentage of subnational expenditure is financed through “shared revenue”?

6a) What percentage of local expenditure is financed through extra budgetary funds?

b. (If unable to answer this, then answer “How important are extra budgetary funds to local finance?”

Not Important	1	2	3	4	5 Very important
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

*The amount of discretion available to formulate and allocate local budgets is important for determining the real amount of decentralization. Questions 7 – 10 relate to local budgetary flexibility*

7. What share of aggregate public expenditures do subnational governments have effective control over (i.e. can spend at their own discretion)?

8. Are norms (“minimum standards” or “budget norms”) used to determine the subnational budget?

Yes

No

9. Are norms used to allocate the subnational budget? To what extent can the budget be reallocated across/within program categories (i.e. do subnational governments have the flexibility to shift expenditures within their budgets, or do they need higher level approval?)

*Ideally for effective decentralization and Public Sector Management, local governments would have flexibility to spend resources as deemed locally appropriate, but still be held accountable for achieving certain outcomes of national importance*

10. To what extent do budgetary allocations depend on performance (e.g. achieving performance standards)



*Unfunded mandates pose a great threat to local finance, delivery of central priority services and ultimately may lead to pressure for additional central resources (a bailout).*

11. Are subnational governments given unfunded mandates by higher level government units?

Yes                       No

*When most of the local budget is consumed by salaries-- particularly when these are determined at a higher level-- local governments are left with very little flexibility to respond to local needs*

12. What percentage of the budget at subnational levels is taken by salaries? *Reference :OECD, LOCS*

## **Part B: Assessing the Design of Intergovernmental Relations**

Designing sound intergovernmental relations is critical for most aspects of development including macroeconomic stability, service delivery, provision of the social safety net, poverty reduction, privatization etc. The focus here will be on designing intergovernmental relations to avoid potential macroeconomic problems while enabling efficient and equitable service delivery.

The key concern with regard to decentralization and macroeconomic stability involves whether subnational governments do not bear the full costs of their actions – that is, they face a “soft budget constraint.” Soft budget constraints can lead to a cycle of moral hazard and an expectation by subnational governments that the national government will “bail them out” of any financial difficulty. This can lead to a situation of subnational governments acting fiscally irresponsible (overspending, under-taxing, over borrowing), national bailout, and central burden financed by money creation or over-borrowing.

In some countries, intergovernmental fiscal relations assign responsibilities to subnational governments without corresponding resources or resource bases. Subnational governments look for ways to cope with these “unfunded mandates” such as under funding public sector pensions, not delivering sub-national public goods, and building up debts (or arrears) through local and central government enterprises. These obligations may eventually be inherited by the central government and also result in unplanned fiscal outlays.

This section presents the channels through which hard budget constraints can be jeopardized or conversely through which subnational governments can potentially be disciplined. These include fiscal (particularly the design of intergovernmental fiscal relations), financial and political channels.

### **Fiscal Channel : Government Hierarchy and Intergovernmental Fiscal Relations**

The first component for designing sound intergovernmental fiscal relations is a clear assignment of functional responsibilities to each level of government. Where assignment of functional responsibilities is not clear (not assigned to one level) confusion in service delivery is likely to ensue. The second component, is to assure that each level of government has the resources (through transfers or local taxes) to finance the assigned function. The third component is ensuring that the design of the intergovernmental transfers enables local flexibility (where it's a local function) as well as ensures that central priorities are met. This third component is the most complicated of the issues to assess since there are several ways that local flexibility can be limited.<sup>2</sup>

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<sup>2</sup> For example, South African provinces are given responsibility for health, education and welfare and provided with a block grant to carry out these functions. Yet, civil service salaries are determined centrally, as are eligibility criteria and payment levels for welfare recipients. Since provinces don't have their own tax base, they must rely on their block grant to cover all these central mandates. The block grant is often barely adequate to meet the central mandates, let alone have resources left for their own priorities. Some provinces

There is no single or standard solution to address these issues. The actual design of local finance and intergovernmental fiscal relations varies from country to country, reflecting history, actual decision-making processes, distributions of political power, geography and cultural traditions. Thus it is important for an analyst to examine intergovernmental fiscal relations within the context of each country. Although normative proposals for intergovernmental fiscal relations exist (e.g. based on the principal of subsidiarity for expenditure assignment, and immobile tax bases for revenue assignment), more important than any one decision, intergovernmental fiscal relations must be designed as a "system" so that assigned expenditures will match with assigned revenues and transfers.<sup>3</sup>

1. Is there a clear assignment of expenditure functions to each level of government?

Yes  No

2. List the functions assigned to each level of government

Center:
Intermediate:
Local 1:
Local 2:

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are unable to meet the central mandates and thus, the quality of social services suffers until the central government bails out the province.

<sup>3</sup> See "Decentralization Briefing Notes" edited by Jennie Litvack and Jessica Seddon with contributions by many members of the Decentralization Thematic Group for further discussion. In particular see notes prepared by Anwar Shah. These notes are also available through the Bank's internet Knowledge Management System (KMS).

*Note: various levels of government can and should be involved in different aspects of service delivery( e.g. setting standards and oversight, financing, implementation etc.) but it is important that responsibility for functions be clearly assigned and not fall through the cracks (i.e. not be assigned to any level, or be assigned to multiple levels.)*

3. Are any functions assigned to multiple levels of government ( a “concurrent list”)? List these.

4. In what sectors or subsectors is this problem particularly acute?

5. Is there a clear assignment of revenues to each level of government?

Yes  No

*Sufficient tax instruments have to be reserved for the national governments due to redistributive objectives, tax efficiency, and the need for financing national policy objectives and national expenditures. Several factors should be considered in deciding which revenue source are appropriate for subnational governments. Taxes which are generally not good subnational taxes include those with mobile tax bases, redistributive taxes; tax bases which are unevenly distributed (e.g. natural resources), taxes subject to economies of scale; and taxes subject to cyclical fluctuations.*

6. List the revenues assigned to each level of government.

Center:

Intermediate:

Local 1:

Local 2:

*Stable and predictable intergovernmental transfers are important for enabling local governments to plan their budgets over the medium term (ensure a match between investment and recurrent costs, as well as create incentives for local revenue mobilization. For example if transfers are reduced when local governments raise more taxes they will have the incentive to collect less local taxes the subsequent year*

7. Are intergovernmental transfers stable and predictable? (are they discretionary or automatic; how are they distributed?)

8. To what extent does the central government delegate resources -- transfers or revenues sources (piggyback tax rate on national tax base, own tax base, or user fees) -- to subnational governments that match the delegation of functional responsibilities?

9. Do transfers create bad marginal incentives for subnational behavior (i.e. is it possible to increase future transfers by performing poorly e.g. overspending, undertaxing, overborrowing). Are transfers reduced if local governments increase revenues? Explain.

10. Do subnational governments have much flexibility in cutting expenditures in response to a crisis?

None  Minimal  Moderate  Considerable

## Capital Market Channel

The issue of subnational borrowing is a controversial one.<sup>4</sup> On one hand, lumpy local investments are most efficiently and equitably financed through borrowing. On the other hand, if a hard budget constraint does not exist between levels of government (through the fiscal and regulatory channels) a situation of moral hazard can result whereby subnational governments borrow beyond their means to repay and rely on central government bailouts – through the banking system (leading to inflation) or fiscal systems (leading to greater fiscal deficits)<sup>5</sup>.

In the ideal world, local governments borrow in competitive markets and they are disciplined by the competition for capital. They do not borrow from the central government or from locally-owned public sector enterprises or banks. In practice, arrangements vary widely between countries. The extent to which subnational borrowing is a fiscal risk (and can become a macroeconomic problem) depends on the existence of a “hard budget constraint”. The central questions in this section are (1) does the central government have the requisite constitutional authority to impose hard budget constraints through the financial system, (2) Is this authority enforceable and credible?

First of all, it is useful to assess the central government’s authority over local borrowing. Ideally, local governments would internalize the costs and benefits of their own fiscal decisions, and would have no expectation of future bailouts. If local governments have any reason to suspect that opportunistic fiscal decisions will be rewarded in the future, however, the central government may need to mitigate this moral hazard problem by regulating sub-national borrowing.

There are many ways for the central government to do this. The most blunt of these is to simply ban all autonomous sub-national borrowing and allocate all credit through a centralized process. More subtly, it may limit only certain kinds of borrowing, place numerical restrictions on borrowing, or specify that borrowing be only used for investment. The questions below first ask which assess the market mechanisms for disciplining sub-national governments; it then poses questions regarding the hierarchical regulations. If the former are weak, the latter are necessary.

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<sup>4</sup> See J. Ahmad , “Decentralizing Borrowing Powers”, 1999 Public Sector PREM note #15, Jan. 1999 for full discussion of the issues.

<sup>5</sup> The most notable case of this is Brazil central bank continually rolled over the debt of subnational banks when they were unable to pay. This led to a moral hazard problem whereby the states' expected central bailouts and continued to borrow beyond their means to repay. Ultimately, this resulted in a major fiscal burden for the central government.

1. Which tiers of government has the authority to access capital markets?

Center:
Intermediate:
Local 1:
Local 2:

*Even when central governments have firm control over sub-national borrowing on the credit market, sub-national governments have a variety of ways—some of them rather creative—of “borrowing.” A common method is to pay for goods and services with promissory notes (backed up by the flow of future intergovernmental transfers). Alternatively, local governments may simply run up arrears to suppliers and personnel.*

2. Do subnational governments borrow abroad? If yes, what percentage of total local government debt is foreign? \_\_\_\_\_

Yes  No

3. Can subnational governments issue promissory notes (not formally considered debt, but in effect, a fiscal liability)?

Yes  No

*The competition for credit might be an important source of discipline for sub-national governments. For instance, if local governments wish to protect their credit ratings, they may face strong incentives to balance their budgets.*

*This market-driven accountability does not work, however, if creditors know that the central government ultimately backs up the debt of local governments. Creditors are likely to believe in implicit central government responsibility if local governments rely heavily on intergovernmental grants, or if a large portion of their borrowing comes from the central government*

4. Does the subnational government run up arrears to suppliers and personnel?

Yes  No

5. Do they borrow from the central government?

Yes  No

6. Do they have any reason to worry about credit ratings?

Yes  No

7. If there are credit ratings, do they correspond to real fiscal outcomes, or do they reflect the creditworthiness of the public sector as a whole?

*Locally-owned banks and public enterprises can be a source of easy credit for local governments. Local governments may receive loans from publicly owned banks for poorly conceived projects based on political connections. Politically dominated local banks might assume high levels of bad local government debt, which undermines local government budget constraints, and can under some conditions undermine the stability of the entire banking system. The potential problem with local public enterprises is two-fold. First, local governments may manipulate the diffuse boundaries between government and enterprise budgets, using the enterprise to engage in extra borrowing. Second, local governments may face strong political pressure to bail out struggling enterprises; that is, the relationship between the local government and the enterprise may be characterized by moral hazard*

8. Do creditors believe that local debt is ultimately guaranteed by the central government?

Yes  No

*It is important that the central government be able to make credible commitments not to provide bailouts in the event of opportunistic local over-borrowing. Bailouts will be hard to resist, however, if the debt issued by local borrowers becomes a significant portion of the portfolio of a large, important national investor or network of investors, who will lobby the central government for bailouts. Ideally, the central government will consider the interests of national tax-payers over influential*

*borrowers or creditors. Thus regulations might help insure that local debt is widely held.*

9. Legal authority: Does the central government have the authority to:

a. ban all borrowing

Yes  No

b. ban foreign borrowing

Yes  No

c. limit the magnitude of borrowing

Yes  No

d. limit how debt can be used (e.g. only for investment purposes)?

Yes  No

*When local governments do experience fiscal crises and run into debt troubles, it is important that clear, enforceable rules are in place ex ante. For instance, a well-crafted bankruptcy procedure might make it clear that opportunistic over-spending will ultimately be costly for the local government. Alternatively, local governments may think twice about seeking bailouts if they know that debt repayment will be withheld from future transfers*

10. Are there portfolio restrictions to require diversified holding of local debts?

Yes  No

11. Is there a bankruptcy code with required co-pay, penalties and oversight?

Yes  No

12. Are local governments required to comply with uniform accounting requirements?

Yes  No

13. Can the central government withhold debt repayment from transfers?

Yes  No

14. Are there any formal, legislated rules about public sector bankruptcy?

Yes  No

a) What are they?

15. What are the associated penalties when violation of these rules occur?

16. Is the information gathering system dynamic (i.e. can it pick up and signal an evolving or emerging fiscal crisis? Are data available to monitor sub-national debt?

*It is useful to understand the nature and origin of sub-national borrowing*

Yes  No

17. Do they borrow from local public enterprises or local banks?

Yes  No

18. Do SOEs/banks perform or finance government functions?

Yes  No

*There are strong reasons to believe that, as a whole, fiscal discipline will be more tight in public sectors where access to easy access to the money supply is prevented by a strong, autonomous, inflation-averse central bank.*

19. Are municipal utility companies considered financially autonomous from local governments, or must the local government assume its liability.)

Financially autonomous   
Liability assumed

20. Is the central bank autonomous?

Yes  No

21. Does the central bank have a strong anti-inflation mandate?

Yes  No

22. Does the central government strictly control subnational borrowing ex ante?

Yes  No

23. Do subnational governments face ex post consequences and resulting incentives to service debts?

Yes  No

24. Has the central government credibly committed to not bailing out subnational governments?

Yes  No

25. Did a bailout of local government occur over the last 10 years? If so, how many times? What was the regulatory response? explain

## The Political Mechanism for Subnational Fiscal Discipline

This section asks two kinds of questions about political institutions. The first set of questions addresses the likelihood that local governments will act irresponsibly, and the second set of questions asks whether the central government faces incentives to bail them out. First of all, we ask whether the local political process facilitates fiscal discipline. More precisely, do local citizens have the authority, incentives, and information necessary to monitor the fiscal activities of their local officials? In general, we ask whether elections provide constraints on subnational fiscal decisions. Voters will face greater incentives to punish deficits if the tax-benefit link is strong (low level of vertical imbalance). Local voters are more likely to hold their elected representatives accountable for local decision making if decisions affect the allocation of their own resources rather than those sent from the central government. In addition to this basic insight, we ask several more specific questions below.

The second line of questions looks at the organization of the central government, and asks whether it faces incentives to provide bailouts to subnational governments when pressured to do so. Thus the second line of questions pays a good deal of attention to the nature of representation of subnational governments at the center. Both lines of questioning pay close attention to the links between politics at the national and subnational level.

The first line of questions starts with the most basic issue of local accountability.

*The mere presence of elections need not translate directly into strong accountability. For instance, local elections might have little to do with local affairs. They may be referenda on national political issues. Or alternatively, local elections may have very much to do with local affairs, but they may focus more on the ability of politicians to deliver personal services (admission to university, subsidized electricity, etc.) than public goods (like prudent budgetary policy).*

1. Are local governments elected?

Yes  No

*While it is important for local politicians to be responsive to citizens in the districts they represent, it is also important that local governments be concerned with a wider agenda-- public goods for the entire jurisdiction. If a local government is merely an uncoordinated group of individuals, each seeking to procure public spending projects for their districts in order to get reelected, fiscal discipline will be difficult to maintain. Thus it is important that coordination and leadership are possible in local government. One source of coordination and leadership might be a strong, coherent party system. Optimally, the incentives set up by electoral and legislative institutions will strike a balance between strong*

*local accountability and responsiveness on the one hand, and a coordinated public goods agenda on the other.*

2. To what extent are local politicians responsive to local voters?

Not responsive                      1                      2                      3                      4                      5 Very responsive

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3. Is campaign finance a source of corruption? Does it give local politicians incentives to be excessively responsive to small, wealthy groups?

Yes                       No

*We are trying to get a sense of fragmentation versus coordination in local politics. If party leaders play a strong role in selecting candidates, they might have a valuable tool with which to condition the behavior of self-seeking politicians. This question also addresses the nature of the link between central and local politics. Perhaps a strong role for national party leaders in selecting local candidates will give central government leaders an important tool with which to discourage local fiscal irresponsibility.*

4. What are the effects for the accountability of local incumbents?

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The next two questions follow directly:

5. In general, how important is the party label to the local officials' ability to gain reelection? (add comment why this is important for accountability)

Not at all                      1                      2                      3                      4                      5 To a great extent

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6. To what extent is the value of this label determined nationally?

Not at all                      1                      2                      3                      4                      5 To a great extent

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*Accountability might be very difficult if political coalitions are constantly falling apart and reforming*

7. How important is it for local officials to concentrate on “service to constituents” (e.g. gaining admission to universities for individuals, helping with social security checks etc.) rather than the provision of public goods for the entire jurisdiction? *Fiscal responsibility is more likely when local politicians are rewarded and punished based on their ability to provide public goods.*



8. How stable are political coalitions?



*Campaign finance can be a source of inefficiency and poor accountability. If politicians rely on large contributions from wealthy individuals or firms, they may be less accountable to large groups of citizens and less concerned with the provision of public goods.*

9. Is campaign finance a source of corruption? Does it give local politicians incentive to be excessively responsive to small, wealth groups?

Yes                       No

Now we move on to the second set of questions. These questions address the incentives of the central government to succumb to demands for bailouts and relates to the organization of the central government’s institutions. At one extreme, perhaps, is an institutional structure in which the central government is little more than a log-rolling collection of regional legislators, each voting in favor of bailouts for the other. At the other end of a spectrum, one might consider a single individual, say a president with a national constituency, who would have few political incentives to provide bailouts. The questions below address the same problem addressed above in the local context. Bailouts are in

essence socially inefficient private goods. Central legislatures that face incentives to favor the interests of the public as a whole, rather than the interests of minorities with intense preferences, are less likely to provide bailouts.

Again, parties are important. The problem of regional self-seeking described above might come into play at the national level as well. Individual politicians from fiscally troubled regions or districts might demand not just bridges and dams, but explicit bailouts. In a legislature without strong parties, and in particular, strong party leaders, vote-trading might lead to the easy formation of pro-bailout coalitions.

In addition to parties and presidents, independent courts may play an important role as well. For example, the central government can make a more credible commitment not to provide bailouts if a well-structured bankruptcy law is overseen by autonomous courts. In the event of a dispute between a bankrupt local government and its creditors, arbitration is best conducted in the courts rather than the political process.

10. Does central government face institutional or political incentives to look out for local government interest?

Yes  No

11. Do electoral rules orient congress toward national or local interests?

Local  National

12. Are the states directly represented in the legislature? (Direct representation might increase the ability of fiscally troubled states to press a pro-bailout policy agenda).

13. Is there an independent court?

Yes  No  Moderately

16. Is there a strong president?

Yes  No

17.

a. Is it relatively easy for him to put together legislative coalitions?

Yes  No

b. If so, are representatives of states important parts of such coalitions?

Yes  No

18. Is there strong party discipline in the legislature?

Yes  No

19. Is there a national, vertically integrated party system?

Yes  No

20. If so, are the small states over represented? (Over-represented small state might be in a particularly strong “blackmail” position. Since their votes are valuable, and the costs of bailing them out might be lower, they may be in a good position to “hold out” for bailouts)

Yes  No

21. Does the constitution implicitly or (explicitly) require bailouts under some conditions?

Yes  No