

ABSTRACT

Title of Dissertation: WHAT TYPE OF FISCAL DECENTRALIZATION SYSTEM
HAS BETTER PERFORMANCE?

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Fiscal decentralization has been a pressing issue in the academic discipline of public finance as well as empirical economics for years. The conventional wisdom of fiscal decentralization advocates is that fiscal decentralization can facilitate the economic development of a country. In addition, the World Bank and IMF have identified over sixty countries where decentralization is an important element of development strategy. However, with the proliferating implementation of fiscal decentralization, the actual outcome has varied from country to country. Indeed, some countries did benefit from the introduction of fiscal decentralization policy. Meanwhile, quite a few other countries with a high degree of decentralization have suffered from economic crisis. In other words, the relationship between fiscal decentralization and economic performance is still inconclusive.

A major barrier to understanding is the lack of well-defined theoretical framework to empirically measure fiscal decentralization in a policy relevant way. The most widely used measurement is the ratio of sub-national government expenditure/revenue to total government expenditure/revenue. But this indicator is criticized too simple to capture

the dimensions of fiscal decentralization. Specifically, it ignores key qualitative dimensions, such as taxing power, borrowing power and the independence of local officials, which are also very important to implementing fiscal decentralization.

The primary contribution of this dissertation is a novel theoretical framework for empirical measurement of fiscal decentralization. The research question is: what types of fiscal decentralization system produce better economic performance? The innovative methodology, the application of cluster analysis, enables us to incorporate the quantitative measurement of fiscal decentralization as well as qualitative dimensions. We go beyond the traditional way of measuring a country's fiscal decentralization, treating it instead as a system with its own institutional design. Adopting this method requires us investigate the institutional arrangement for fiscal decentralization in a country. The institutional arrangement we review in detail includes: supra-national government, federal or unitary state, numbers of tiers of governments, taxing power, borrowing power, and independent local official. These components have also been recognized by many economists and policy analysts. What is original to this work is that, after identifying these institutional arrangements, we can group different countries with similar institutionally similar fiscal decentralization systems together in broad categories by using cluster analysis. We are then in a position to measure the successes of each cluster according to several indicators, such as: economic performance, fiscal performance, and governance performance. An inter- and intra-cluster comparison and one empirical model thus give a snapshot of the relationship between fiscal decentralization and economic performance. The ultimate goal, for policy analysis, is to be able to distinguish the desirable institutional arrangements of fiscal decentralization from the less desirable ones.