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Fiscal Decentralization and the Mediating Role of Political Institutions

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Abstract

Scholars have long understood the key role played by political institutions in mediating the impact of decentralization on critical governance outcomes. In this chapter, we review the scholarship on these relationships and present some conclusions and ways forward. We organize our analysis according to the specific decentralization outcomes considered by scholars, grouping them into the following categories: (1) nation-state integrity, (2) accountability, participation, and corruption, (3) social equity, (4) macro-fiscal performance, and (5) service delivery and public spending. On the independent variable side, we consider numerous types of institutions writ large, including: (1) institutions governing accountability and democracy, (2) institutions related to vertical relationships among tiers, (3) institutions determining horizontal relationships at subnational level, and (4) the structure and nationalization of parties and party systems. We conclude that, while recent scholarship has greatly expanded our understanding of how political institutions mediate fiscal federalism, there is still much to learn.

Keywords: fiscal decentralization, institutions, political economy, governance

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Introduction: Political Institutions as a Mediator

Since at least the advent of second-generation research in fiscal federalism (Weingast 2014), scholars have pointed to the key role played by political institutions in mediating the impact of decentralization on critical governance outcomes. First generation thinkers (i.e. Oates 1972), sought to understand the economic conditions under which decentralization would improve a variety of key outcomes, especially efficiency, growth, and service delivery. For simplicity, and perhaps also to develop clear normative implications for policymakers, these early theorists assumed the existence of a benevolent government that sought to maximize positive outcomes for its citizens. First generation theorists set the foundation for subsequent research, framing decentralization as a mechanism capable of delivering significant benefits—but only under certain conditions—a perspective that has largely stood the test of time (see Vaillancourt, this volume).

At the same time, it became apparent very quickly that the assumption of a benign social planner was, in some contexts more than others, patently unrealistic. This is where second-generation scholars entered the conversation, drawing on broader trends in the social sciences to develop a positive, as opposed to a normative, approach to fiscal federalism. Such scholars pointed out that governments and leaders pursued their own goals when designing and implementing fiscal reforms, and that these were sometimes orthogonal to what might normally be defined as the public good. Bringing to bear the powerful tools of public choice, researchers were able to explain seemingly puzzling elements of decentralization reforms and structures.

More recently, insights from both of these schools, first and second generation, have informed attempts by scholars to understand better the political economy of fiscal federalism. Economists have begun exploring whether the normative interests of first-generation scholars can be paired with the greater sensitivity to politics of second-generation scholars. Political scientists, for their part, have brought their focus on political phenomena increasingly to bear on understanding decentralization and public finance. Together, this new wave of scholarship, which might be identified as a “third generation,” is concerned in part with understanding how political factors mediate the impact of fiscal decentralization on key governance outcomes (see Ahmad and Brosio, this volume). In this sense, while the research is rooted in positive social science, it has an important normative element, shedding light on how fiscal federalism can be designed to maximize its benefits, given what we know about political incentives (see, for example, Manor 1999, Eaton 2004, Lockwood 2006, Bednar 2009, Eaton, Kaiser, and Smoke 2010, Faguet 2014).

While this literature considers political behavior and ideology as well, the bulk of the research so far has focused on political institutions, again in keeping with broader trends in the social sciences. Scholars tend to see institutions as mediating factors between decentralization and outcomes such as economic growth and efficiency, political stability, service delivery, accountability, and so on. They have increasingly recognized that the quality of such institutions can determine whether decentralization reforms live up to their promises.

In this chapter, we review the scholarship on political institutions and decentralization and present some conclusions and ways forward. We organize our analysis according to the specific decentralization outcomes considered by scholars, grouping them into the following categories: (1) nation-state integrity, (2) accountability, participation, and corruption, (3) social equity, (4) macro-fiscal performance, and (5) service delivery and public spending. On the independent variable side, we consider numerous types of institutions writ large, including: (1) institutions governing accountability and democracy, (2) institutions related to vertical relationships among tiers, (3) institutions determining horizontal relationships at subnational level, such as those between mayors and assemblies, and (4) the structure and nationalization of parties and party systems. We conclude that, while scholarship over the past few decades has greatly expanded our understanding of how political institutions mediate fiscal federalism, there is still much to learn.

Fiscal Decentralization, Political Institutions, and Nation-State Integrity

Scholars and practitioners have long been attuned to the impact that decentralization can have on the integrity of the nation-state. Does decentralization encourage territorial break-up by transferring fiscal, administrative, and political resources into the hands of potentially secessionist minority groups? Or does it reduce that threat by buying off these groups with additional autonomy? Does decentralization make it more difficult for national governments to implement their policies across the whole of their territory, or does it improve service delivery and citizen satisfaction by allowing variation in taxation and spending? These questions are fundamental to understanding whether devolving power to lower tiers stabilizes the nation-state or threatens to undermine it.

Past research into these issues, and particularly the question of decentralization's effects on secession and civil conflict, has failed to produce simple answers. This fact has led many scholars

to conclude that decentralization's influence must be conditional and context specific (Vaillancourt, Roy-Cesar, and Bird 2010). For every seemingly successful case of decentralization—for example Canada and Quebec—there seems to be a potential failure—take Jammu and Kashmir in India. But what intervening variables might help explain when decentralization reduces conflict and succession and when it foments them?

Scholarship which has tackled this question points clearly to the critical role played by political institutions. For example, exploring the success of peacemaking initiatives after civil conflict, Eaton and Connerley (2010) and Hartzell and Hoddy (2007) find that the promise of territorial autonomy for geographically-based rebels greatly improves the chances of a peaceful settlement. Similarly, Eaton (2006) highlights the importance of central (or potentially third-party) institutions strong enough to enforce the rules of the settlement in newly autonomous areas. These institutions are needed to offset the increased risk that opposition leaders could use their new positions to restart conflict in the future.

More broadly, research has identified a series of institutions that, if present, greatly increase the chances that decentralization will prove a boon to the long-term stability of the state. For example, many scholars, including for example Faguet, Fox, and Poeschl (2014), highlight the role of strong accountability mechanisms at the subnational level in creating stable forms of decentralization. Sharma (2025), for his part, emphasizes that coordination mechanisms between subnational and national leaders must be institutionalized to promote the stable relations across tiers that are necessary for success. Brancati (2008) points instead to the special risk posed by regional parties in decentralized, highly-divided societies. When these parties are strong, she contends, they may be especially prone to use newly devolved subnational governments as a jumping-off point for succession. By contrast, integrated national parties might provide a way of tying together disparate populations in devolved settings. Finally, Keil and Anderson (2018) show that grand coalitions of opposing groups can forestall conflict, as can institutions which incorporate veto players, which give reassurance to regional opposition movements that their rights will not be trampled.

Accountability, Participation, and Corruption

The relationship between accountability and decentralization is among the most consequential, complex, and indeed fraught in the literature. Most scholars would agree that accountability—whether upward to the center, downward to the people, or horizontal through competition with

other subnational units—is critical to the smooth functioning of decentralization. Nevertheless, scholars have extensively debated the nature of the accountability mechanisms that are created under different forms of decentralization, and which are more conducive to good governance. In this section, our focus is on which sorts of political institutions should be implemented in decentralized systems to maximum to salutary effects of accountability.

To begin with the fundamentals, a number of scholars have emphasized the critical role played by the downward accountability of subnational governments to voters. This form of accountability can be achieved, most directly, with competitive elections, but it can also result from participatory budgeting institutions, consultative bodies incorporating civil society organizations, the creation of transparency rules, and the like. Elections are perhaps the most obvious, and also the most important, institution of downward accountability, and their key role is emphasized by a number of scholars (i.e. Manor 1999, Bird and Vaillancourt 1998, Faguet, Fox, and Poeschl 2014). To take some specific examples, Enikopolov and Zhuravskaya (2007) show that many of the benefits of decentralization do not materialize with only administrative reforms, and Hecock (2006) links competitive subnational elections with improved performance in education. Hankla and Manning (2017), for their part, highlight the role of local elections in improving not only local, but also national democratic development.

At the same time, Ribot (2011) and Faguet (2012) warn against the risk of donors, NGOs, and central governments bypassing elected local governments to work directly with private local actors. It has long been recognized that weak local institutional capacity represents a major challenge for decentralization (see Grindle 2008), and this may create a temptation to work around seemingly dysfunctional local governments. Such an approach, however, threatens to undermine popular accountability and will leave local governments permanently unable to build their capacity.

Other scholars have different warnings. Goldfrank (2007) worries that strong opposition parties at the local level (regional or national) can sometimes impede the quality of outcomes by derailing open participatory mechanisms. Grindle (2008) and Bardhan and Mukherjee (2000) instead fear the dominance of entrenched local elites who may attempt to run subnational governments as their fiefdom. And a third significant challenge can be found in the ways in which central governments might manipulate local institutions to achieve their own ends. Sorens (2016), for example, explains the aversion of many central actors to revenue decentralization, despite its many benefits, as a fear of losing the leverage that central transfers can bring. In a similar vein, Thomas-

Bohlken (2015) shows that central leaders sometimes seek to strengthen local governments for the explicit purpose of weakening elected regional or state authorities.

Many of the challenges discussed above can be partially offset with upward accountability mechanisms and strict, but tightly circumscribed, central oversight. Myerson (2014), Hankla, Martínez-Vazquez and Ponce-Rodriguez (2019), and Enikopolov and Zhuravskaya (2007) also highlight the beneficial effects of integrated national parties competing in local and regional elections, as these can help promote upward accountability through party structures as well as downward accountability through the ballot. For Hankla, Martínez-Vazquez and Ponce-Rodriguez (2019), such party mechanisms can help overcome the tendency of local governments to underfund goods with spillover effects. Finally, it may well be true that even flawed decentralized structures can generate enough information sharing and accountability to produce some benefits. Kosec and Mogues (2020), in a close examination of Ethiopia, demonstrate that decentralization can still matter even in imperfect, authoritarian contexts, at least for the provision of productive as opposed to social local services.

Nevertheless, it is important to highlight another source of skepticism towards political decentralization in the literature—the risk that it might obscure lines of accountability. When functions are split between different tiers of elected government, citizens may not know which tier to blame or reward for the quality of a service. When this problem arises, it can undercut the incentives of political leaders to respond to citizen preferences, since they may not be held accountable at the ballot box (Charbonneau and Anderson 2021). Lago-Peñas and Lago-Peñas (2010) find that Spanish voters are often unaware of which functions are the responsibility of which tiers, though citizens do become more informed the longer they live in a devolved system.

But elections are not everything. Public participation and engagement represent critical elements of accountability. Fiscal decentralization is widely theorized to improve democratic governance by bringing the government closer to the people. At the core of this concept is Oates' Decentralization Theorem (1972), which argues that local governments are better suited to customize public goods and services to meet local needs. By reducing information gaps and increasing government proximity, decentralization can make governments more responsive, encouraging citizen participation (Oates, 1999). Complementing this view, Manor (1999) and Faguet (2012) argue that fiscal decentralization strengthens democratic accountability by linking taxation and spending. Faguet's empirical work in Bolivia and Colombia highlights that when local

governments have financial autonomy and political accountability, they are more responsive, leading to higher levels of civic participation.

Crucially, the design and quality of political institutions condition these effects. Falleti (2010) emphasizes that the sequence of decentralization—whether administrative, fiscal, or political—determines its democratic impact. The study posits that fiscal decentralization leads to greater civic engagement when it follows political decentralization, such as introducing elections for subnational officials. Without such sequencing, fiscal reforms may consolidate elite power rather than empower citizens. Similarly, Rodden and Wibbels (2010) argue that the nationalization of party systems plays a critical mediating role. In centralized party systems, local leaders often remain accountable to national elites rather than local constituents, undermining the participatory benefits of decentralization. In contrast, localized party structures can enhance community responsiveness and grassroots mobilization. Such grassroots mobilization can be observed in the local councils (*panchayats*) of India's Kerala state, where Heller and Chaudhuri (2017) show that participatory budgeting improves development outcomes.

Another key theoretical mechanism is the connection between fiscal decentralization and social capital. According to De Mello (2000, 2011), decentralization can promote civic engagement by fostering trust, networks of reciprocity, and local associational life. However, this potential depends on supportive democratic institutions; without them, the benefits may be uneven or even regressive.

On the executive-legislative relations at the subnational level, the internal distribution of power between local executives (e.g., mayors or governors) and legislative bodies (assemblies) significantly influences the effectiveness of fiscal decentralization in promoting civic participation. Kim, Lee, and Kim (2022), examining the South Korean context, find that fiscal autonomy fosters higher public trust and engagement when local legislatures exert meaningful oversight over executives. Where such checks and balances are weak, transparency and participation decline.

Moreover, the method of selecting subnational officials—whether through elections or appointments—and the structure of political parties significantly shape citizen involvement. Garman, Haggard, and Willis (2001) demonstrate that in Latin America, elected local officials and decentralized party systems enhance accountability and civic engagement. In contrast, when local leaders are beholden to centralized party hierarchies, participation becomes symbolic or

constrained. De Mello (2000) concludes that elected subnational governments are more conducive to participation than appointed ones.

Empirical findings also underscore that social capital—defined as trust, associational networks, and civic norms—flourishes under conditions of democratic local governance and fiscal autonomy. De Mello (2000, 2011) finds that fiscal decentralization enhances civic trust and engagement, particularly when supported by participatory institutions and local electoral accountability. However, these benefits are highly contingent on broader institutional quality and are susceptible to reversal in settings with weak governance.

Both theoretical and empirical literatures converge on a critical insight: fiscal decentralization can enhance citizen participation and civic engagement, but only when embedded within enabling political institutions. The most conducive environments are those with clearly defined intergovernmental tiers and coordination mechanisms; balanced executive-legislative relations at the local level; elected and accountable subnational officials within decentralized party systems; and institutional support for the development of local social capital and civil society. Absent these conditions—such as under elite-dominated assemblies, centralized political parties, or ambiguous intergovernmental roles—fiscal decentralization may fail to democratize governance and instead reproduce existing power asymmetries.

Any discussion of decentralization and accountability would be incomplete without addressing the critical question of corruption. Does decentralization rein in unethical behavior among politicians, or does it make such behavior more rampant? A number of studies have addressed these issues, and the findings have been decidedly mixed. From a theoretical perspective, decentralization could either improve oversight by voters and make corrupt behavior more costly, or it could enable new, subnational actors to enter into corrupt relationships. Scholars finding that decentralization has a salubrious effect on corruption include Arikan (2004), Fisman and Gatti (2000), and Seabright (1996), while Fan et al. (2009) and Triesman (2000) are more skeptical.

Such mixed results have led many scholars to conclude that the relationship between decentralization and corruption is mediated, likely by political institutions. For example, Shrestha, Martinez-Vazquez, and Hankla (2023) find that corruption is mitigated when local parties and voters can select candidates for subnational elections, given their best knowledge of which politicians are honest. Lessmann and Markwardt (2010), for their part, point to the critical role of a

free press in containing local corruption through transparency. In a similar vein, Bardhan and Mookherjee (2015) and Zarychta et al. (2024) emphasize the need for government or civil society watchdogs to contain corruption. Finally, Fisman and Gatti (2000) implicate the transfer system in decentralized corruption, arguing that dependence on grants from the center rather than own-source-revenue is associated with more unethical public behavior.

Social Equity

When properly designed and implemented, fiscal decentralization holds promise for enhancing governance, service delivery, and equity for vulnerable populations, including women, minorities, and low-income groups. In theory, as Williams (2018) posits, federalism is normatively neutral with respect to gender equality, with its outcomes largely shaped by institutional and contextual factors. On the one hand, decentralization may facilitate greater women's political participation while bolstering gender focused policy agendas. Conversely, decentralization can reinforce conservative local norms, thereby constraining gender equality objectives, especially where local communities have differing policy agendas on gender roles and ideologies than their national counterparts.

The impact of decentralization on social equity aims is highly contingent upon political institutional configurations. Key factors such as clearly delineated governance structures, competitive local elections, robust intergovernmental relationships, and institutionalized party systems are crucial for achieving equity-enhancing outcomes. Policymakers must be attentive to the financial mechanisms of decentralization and the political and social architecture that supports or undermines its potential.

As Ahmad and Tanzi (2001) note, effective decentralization hinges on the functional clarity of intergovernmental relations, empowering local authorities to address community needs effectively. Ukraine's post-2014 decentralization reforms transferred authority from regional to local levels, empowering elected city mayors and councils, with Romanova (2023) noting a decline in protest activity in newly amalgamated communities as a response to perceived improvements in service provision.

Related to assembly-executive relations at the local level, the balance of power between local councils and executive officials (mayors or governors) can also influence the degree to which marginalized groups are represented and served. Where assemblies have meaningful oversight and electoral mechanisms incentivizing accountability, local governance tends to better respond to

social needs. Calca and Ruel (2024) provide indirect evidence showing how multilevel institutional arrangements shape candidate selection and electoral dynamics. When these institutions are designed to ensure inclusive representation within local assemblies, they have the potential to amplify and affect representation. In particular, the study finds that female candidates are less likely to be placed in the top three positions on party lists for national elections, resulting in persistent gender disparities in political representation, even within decentralized political structures.

Concerning subnational elections and party system nationalization, direct elections at the local level are among the most powerful tools for improving the representation of vulnerable populations. When marginalized groups have a real chance of electing candidates who understand their needs, the government becomes closer and more responsive. The shift to greater fiscal autonomy in municipalities and competitive local elections in Italy led to significant social gains. The study by Bianchi et al. (2021) shows that local governments expanded childcare provisions to meet demands from working mothers, particularly benefiting women with limited access to market-based alternatives. Greater decentralization increased the public provision of childcare and female labor force participation. The impact was greater among women under 35, highlighting the significance of affordable childcare in influencing women's participation in the labor market.

Conversely, the nationalization or fragmentation of party systems can mediate these outcomes. Harbers (2010) finds that decentralization in Latin America often results in more localized party systems, which can better reflect regional diversity and needs, but may also challenge cohesion and policy consistency. In Colombia, decentralization was linked to the deinstitutionalization of national parties, giving regional actors greater influence over local priorities. This shift enabled greater attention to the needs of local communities, as local leaders can better address specific regional concerns (Dargent & Muñoz, 2011).

Lastly, how subnational leaders are selected is a fundamental determinant of whether decentralization enhances equity. Appointed officials may remain accountable to central authorities, but elected leaders tend to align more closely with local preferences and needs, especially under open and competitive systems. The global analysis by Gushchina (2021) emphasizes that women's political representation is more robust in decentralized contexts that also feature strong electoral systems and party support for female candidates. Similarly, local political empowerment in Brazil has found links to improved child health outcomes, particularly where female mayors or legislators hold office, underscoring how representative leadership can translate into enhanced social policy.

Thus, while fiscal decentralization can bring government closer to the people, its effectiveness in promoting social equity depends on more than administrative proximity. It is not simply about transferring responsibilities downward, but about creating institutional channels through which marginalized voices can shape policy and hold officials accountable. Political institutions—particularly local elections, legislative structures, and party systems—determine whether decentralization becomes a vehicle for greater social justice or a mechanism that deepens inequality. When underpinned by democratic accountability, transparent intergovernmental relations, and inclusive political structures, decentralization can serve as a powerful for advancing social justice and improving the lives of vulnerable populations.

Macro-Fiscal Performance

The theoretical basis for the relationship between fiscal decentralization and macroeconomic and fiscal performance is rooted in fiscal federalism, public choice theory, and endogenous growth theory. While there is vast literature examining the effects of fiscal decentralization on economic growth, fiscal stability, and sustainability, there is a limited examination of how political institutions fundamentally shape these relationships.

Empirical findings on the growth-enhancing effects of fiscal decentralization are mixed and often conditional on various institutional, political, and economic factors. Research indicates that positive outcomes are more likely where institutional quality is high (Hanif et al., 2020), where subnational units possess meaningful autonomy (Canavire-Bacarreza et al., 2019), and where investment is targeted and responsive (Vo 2019 and Giting et al., 2019).

Importantly, political institution-related factors such as the number of government tiers and their functional coordination can influence policy coherence, service delivery, macroeconomic stability, and fiscal sustainability. For instance, the division of responsibilities and functions, such as education and healthcare, across different government levels affects the quality of public sector outcomes and the equitable distribution of economic gains (OCED 2018). Faguet (2014) investigates how weak institutions impose insufficient limits on government power, with adverse implications for political accountability, fiscal sustainability, civil conflict, innovation, and economic growth. This study further examines the connection between multilevel fiscal governance and macroeconomic stability and how, when tiers of government are not clearly delineated or overlapping responsibilities exist, inefficiencies and intergovernmental conflicts can negate the benefits of decentralization.

Similarly, relations between subnational executives (mayors or governors) and assemblies are critical. When assemblies are powerful and partisan fragmentation is high, decision-making may become gridlocked, leading to underinvestment or inefficient fiscal management (Treisman, 2007). Whether subnational governments are elected or appointed also plays a crucial role. Enikolopov and Zhuravskaya (2007) find that strong national political parties are associated with better outcomes from fiscal decentralization, including enhanced economic growth, improved governance, and more effective delivery of public services. Conversely, placing local officials in their positions through appointment rather than election fails to yield similar improvements in decentralization outcomes.

Related to the effects of fiscal decentralization on fiscal stability and sustainability, the literature investigates the role of political institutions from the perspective of the soft budget constraint problem, formalized by Kornai, Maskin, and Roland (2003). Research on fiscal decentralization has examined how political institutions influence the emergence and persistence of soft budget constraints in subnational governments. These constraints, which occur when local authorities anticipate financial bailouts from higher levels of government, are closely tied to the institutional design of intergovernmental relations, the nature of political representation, and the mechanisms of accountability.

A key dimension is the structure of intergovernmental relations, particularly the number of government tiers and their fiscal interdependence. Pisauro (2001) argues that multiple layers of government often lead to common-pool problems where each level competes for shared resources, anticipating central bailouts and thus weakening fiscal discipline. The institutional relationship between local assemblies and executive authorities, such as mayors or governors, also plays a significant role. Rodden (2006) explores how political alignment between local executives and national governments can increase the likelihood of bailouts, weakening fiscal discipline.

The mode of subnational representation—specifically, whether local officials are elected or appointed—affects fiscal outcomes through the channel of accountability. Jin and Zou (2003) investigate how the effectiveness of budget constraints is undermined when local officials are not restrained by any form of institutionalized local political participation, leading to weakened accountability mechanisms. Hankla and Downs (2010) emphasize the design of local political institutions, particularly the balance of power between local assemblies and executives, where strong, locally elected councils provide an essential oversight function contributing to a more stable

economic environment and macroeconomic discipline. In contrast, elected officials are more attuned to local fiscal preferences and face incentives to manage budgets prudently, as Remmer and Gélinau (2003) explore electoral accountability in Argentina. Another critical factor is the nature of the party system. Ong (2011) finds that the centralized appointment system within China's single-party structure reduces local accountability and undermines fiscal discipline, highlighting how party structure interacts with electoral mechanisms to influence budgetary behavior.

Collectively, these findings underscore the importance of how political institutions shape the macro-fiscal effects of fiscal decentralization. Whether decentralization fosters fiscal responsibility or generates instability depends on how well institutional structures manage intergovernmental relations, enforce accountability, and align local incentives with national priorities. Designing technically sound decentralization reforms that are also politically robust is essential for contributing to preserve or even enhance macro-fiscal stability and performance.

Spending and Service Delivery

Fiscal decentralization is often advocated for its potential to enhance public service delivery by aligning resources with local needs (see Oates 2005 and Martínez et al., 2017). However, the effectiveness of decentralization is no doubt contingent upon the political landscape since outcomes associated with fiscal decentralization are determined by a complex interaction of institutional regulations such as the rules of electoral systems (Hankla, Martinez, and Ponce 2019), the distribution of preferences of voters (Turnbull and Mitias 1999, Brunner and Ross 2010), the process of voters' preference aggregation into policies performed by parties (Knight 2000, Reed 2006), the political actions of interest groups (Brunner and Balsdon 2004, Cattaneo and Wolter 2009, and Walden and Eryuruk 2012), and the incentives of policymakers.

The complexity in how parties tailor policies to different voter groups helps explain the mixed evidence found in the literature on the influence of party control in determining local spending. Indeed, partisan studies arrive at widely varying conclusions regarding the significance of party control. This divergence is not surprising, as these studies employ different estimation methods, examine diverse outcome variables across varying time frames, utilize distinct measures of party control, and incorporate different local and state-specific control variables. For instance, Knight (2000) finds that control by Democrats in both houses of the state legislature leads to increases in

tax rates as a percentage of state GDP, Reed (2006) shows that state tax burdens are higher under Democratic control of state legislatures, De Benedictis-Kessner and Warshaw (2016) indicate that Democratic mayors in the US spend substantially more than Republican mayors, and Gerber and Hopkins (2011) estimates that Democratic mayors spend less than Republicans on public safety.

While these studies highlight clear partisan effects on spending and taxation, others present a more ambiguous picture. For instance, Ferreira and Gyourko (2009) show that party labels have no significant impact on the size of government and city crime rates in the US and argue that this is explained by Tiebout sorting leading to homogeneous preferences from households at the local level (creating incentives to parties to select centrist policies). In addition, Gilligan and Matsusaka (2001) find weak evidence that partisan preferences affect state expenditures and revenues in the US.

International evidence of partisan effects on policy of local governments includes, among many others, the analysis of Mertens et al (2021) indicating that party affiliation affects the choice of risky loans to finance local spending in the UK, Toubeau and Vampa (2021) show that “left” parties increase total and health care spending relative “right”- oriented parties in Spain and Italy.

In sum, the relationship between electoral competition and public service delivery is complex and shaped by various theoretical perspectives and empirical findings. While classic models suggest parties converge toward the median voter’s preferences, more recent frameworks suggest that parties may instead target specific voter groups based on electoral uncertainty or internal party dynamics. Studies show that distinct groups—such as low-income voters, the elderly, or politically influential coalitions—can shape spending on health and social security to an aging electorate, while others associate partisan registration ratios with infrastructure spending.

Researchers have also studied the role of party control in determining health, security, and infrastructure outcomes; however, this literature on partisan effects shows mixed results. Some studies find that party control matters while others show little to no impact of party labels. International studies also reveal partisan effects, including differences in borrowing behavior, health care spending, and access to intergovernmental transfers, further illustrating that local policy is shaped by a wide range of political and institutional factors.

Local legislatures play a crucial role in shaping the policies that directly impact communities. These policies incorporate the needs of residents as well as the interests of parties and special interest groups, as decisions ultimately reflect the priorities, ideologies, and compromises of elected officials. Local legislators typically balance constituent demands with available resources, often making politically strategic choices to secure re-election (Balaguer-Coll, et al 2015). Political parties and interest groups, for their part, might influence budget allocations advocating for funding in their areas of interest (Singhal 2008), and partisan divides of members of legislatures can lead to differences over taxation, debt, and spending limits, shaping local policies (Knight 2000, Reed 2006, among many others).

Another issue that is relevant to explaining local public service delivery is the role that local, state, and national elections play in public spending and the distribution of resources. While most of the literature has focused on how local political institutions and elections influence tax and spending decisions, state and federal institutions and elections might be relevant to local spending due to partisan alignment between different tiers of government (Solé-Ollé and Sorribas-Navarro 2008), electoral incentives for strategic targeting of state and federal resources (Corvalan et al. 2018), political business cycles created by multilevel elections, divided government among different tiers of government, and coordination failures leading to tax and spending competition.

For instance, Dynes and Huber (2015) show that presidents in the US allocate more federal resources to electoral competitive districts and the control of the House is linked to increases in spending within districts represented by members of the majority party (a partisan effect). Atlas et al., (1995) suggests that congressional delegations from less populous states can obtain greater per capita net federal spending for their constituents compared to those from more populous states in the US. Ponce-Rodriguez and Ponce-Rodriguez (2023) demonstrate that if the central government is controlled by left or left-center parties, then more resources to state and local governments are allocated in Mexico, but under party control of the national Congress, federal transfers decline, likely because there are fewer political incentives to cater to legislators from diverse regions. However, Timmons and Broid (2013) do not find a partisan bias in regional transfers in the case of Mexico because institutional constraints in tax revenue sharing limits the scope of politically driven transfers to state and local governments, highlighting how institutional arrangements between different tiers of government can limit politically motivated fiscal behavior of local governments.

Corvalan et al (2018) show that extra transfers to municipalities in Chile are directed toward mayors who are politically aligned with the governing party (a partisan motivation), Quinckhardt (2023) estimates that party alignment between a local mayor and the state government in Germany leads to a 20% annual increase in intergovernmental transfers, a similar increase of 19% in Portuguese municipalities (Migueis, 2013), and Solé-Ollé and Sorribas-Navarro (2008) suggest that municipalities with political alignment receive more than 40% additional grant funding compared to those without such alignment in Spain.

Democracies, such as the United States and Canada, have direct democracy provisions such as tax and expenditure initiatives and referendums. While referendums allow citizens to vote directly to approve or reject fiscal policies, initiatives allow voters to design tax and expenditure amendments that are voted directly by residents. Therefore, a thorough analysis of the influence of political institutions on fiscal decentralization outcomes should consider not only the institutions of representative democracies but also the presence (if any) of direct voting mechanisms that enable voters to have a broader scope of political participation.

Political scientists often consider direct democracy provisions as institutions that promote political participation and enhance accountability of local governments. However, Damore and Nicholson (2014) show that direct democracy institutions can lead to an increasing number of ballot measures promoted by the competition of special interest groups who engage strategically and design initiatives to further their narrow interests.

One example of the voters' initiatives are tax and expenditure limitations (TELS); Mullins and Joyce (1996) estimate that TELS have limited the capacity of local governments to respond to changes in demand of public services of residents and, have created incentives for local governments to rely on non-tax revenue sources such as user fees, fines and charges (see also Sun 2014), which can introduce inefficiencies and equity issues since TELS might have increased the burden of financing public goods and services on lower income residents (for a review on TELS see Matsusaka 2018).

Comprehensive studies also support the analysis from Mullins and Joyce (1996), further indicating that tax and expenditure limitations (TELS) have contributed to greater fiscal centralization (see Mullins and Wallin, 2004). Regarding public service delivery, particularly in education, Figlio and Rueben (2001) find that TELS are associated with a decline in educational quality. However,

Downes et al. (1998) suggest that the differences in student performance between states with TELs and those without are modest.

In summary, direct democracy provisions are typically viewed as tools to enhance political participation and government accountability. However, political scientists have emphasized that these mechanisms can be exploited by special interest groups to advance narrow agendas through ballot initiatives. A prominent example is tax and expenditure limitations (TELs), which can constrain local governments' ability to meet service demands and lead to a reliance on regressive revenue sources like user fees and fines. In addition, TELs have also contributed to greater fiscal centralization. Regarding public services, evidence is mixed: TELs are associated with reduced education quality while others find limited differences in student performance between states with and without TELs.

Conclusion

What, then, can we conclude about the role of political institutions in mediating the impact of decentralization on governance outcomes? A significant research tradition has developed, especially during the past twenty years or so, which brings scholarship on political institutions into conversation with research on fiscal federalism, greatly enriching both fields. It is now undeniable that fiscal decentralization cannot be understood fully without exploring the role of political institutions, meaning that the same decentralizing fiscal reforms could produce very different outcomes in different political contexts.

If there is anything to lament about the literature, it is the fact that it remains quite disparate. There are numerous interesting findings, ones which can inform both theory and policy. But these findings tend to stand on their own without contributing to an overall, integrated picture of how political institutions might matter across both institutional type and outcome. Exploring these connections would be a fruitful next step for scholars. Moreover, researchers have tended to assume, at least implicitly, that some institutions are “good” and others “bad” for the outcomes that matter. In this context, it is worth considering the possible existence of certain institutional trade-offs, meaning that some political arrangements might help generate positive outcomes in one sphere and negative in another. This sort of argument has appeared in the literature on political parties, for example, which points to party integration and nationalized party systems as beneficial for service

delivery and state integrity, but problematic for corruption. More such trade-offs are almost certainly waiting to be discovered.

A third direction for the literature would be to focus on political institutions in authoritarian and mixed regimes, which still represent the most common political arrangements in the world. Despite the fact that most non-democratic countries employ some form of decentralization, research on how various autocratic institutions impact the success of local governments remains sparse, at least outside case studies of China and other large countries.

Whatever else we can say, the interaction between governments at local, state, and national levels reveals that fiscal decentralization is embedded within a multilayered political system. Political institutions, including partisan alignment across levels of government, party integration, institutional rules, and electoral incentives, all influence the quality of governance that decentralization can produce. Thus, outcomes should not be viewed merely as the result of local autonomy but rather as the product of strategic behavior within a broader, interconnected political framework. As the literature moves forward, our understanding of these important dynamics will only grow.

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