

Small local governments between Scilla and Carriddi. Incentives for territorial reform.

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Abstract

Local governments role is not only to provide local goods, but also to interpret and represent the local citizens wishes to central government. In this paper, even if governments are non benevolent both at local and central level, the accuracy in interpreting citizens wishes is higher in small councils than in big ones, because citizens' control is higher in the former. On the contrary, the capacity of a council to make its requests be satisfied by central government is higher for a big council than for a small one. Thus, when the dimension of local government increases, the effectiveness of representation activity increases, but the objectives of citizens diverge from administrators ones. Thus the amount of grants received by central and regional governments changes according to a trilateral game among citizens, local government and central ones. In small city, citizens control the government but the effectiveness of their voice is limited by suboptimal grants from higher level of governments. Bigger cities, on the contrary, can better represent citizens and can receive higher amount of grants, but often they represent only a part of the citizens, by this way grants can be over the optimal level. A territorial reform which aims to reduce the number of municipalities modifies such trilateral game, providing different incentive schemes for local governments. In this paper we propose a model which can tackle these theoretical issues and we provide an empirical validation.

Keywords: Intergovernmental Grants, Accountability, Interests Representation, Territorial Reform

JEL: H71, H77

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1 Introduction

In many countries, small local governments are inefficient in public services provision. Small councils can neither exploit scale and scope economies, nor internalize externalities. Moreover, they have little fiscal capacity to provide services. For these reasons, Boadway and Hobson (1993) propose a system of intergovernmental grants towards small size local governments. The issue of optimal transfers to local governments is common in the literature and in political debate. Summing up, the prescription is to grant intergovernmental transfers to small size councils in order to compensate them for not achieving scale economies. Alternatively the dimension of councils should be increased. In effect, many countries are trying to design a territorial reform pushing local councils to compulsory amalgamation or to voluntary association in order to efficiently provide local public services to citizens.

In 2008, Denmark reduces the number of its municipalities from 350 to 100. In Finland, since 2006, from around 450 down to 320. In Greece (2010) from 1033 to 325 municipalities. Albania has planned a municipal mergers as well.

Other countries favour the ‘co-operation’ approach, in France municipalities continue to exist as entities after joining an inter-municipal body in a functional cooperation. A similar approach was followed in Italy from Dlgs 267/2000. Cooperation was promoted rethinking the “Unione di Comuni” as a new local inter-municipal body where municipalities voluntarily decide to provide jointly local public goods to citizens.

As in France, for stimulating such intermunicipal bodies were incentivated by extra state grant and permit to provide extra public goods.

Such a stimulus for functional cooperation diminished in recent time and Italy seems to abandon the co-operation approach in favor of mergers. Actually compulsory mergers it is entangled in the continuous extension granted by the laws that impose mergers. In 2012, with law 135, small municipalities have to jointly provide local public goods. In 2014, with law 56, provincial local government importance was reduced in favor of regions and municipalities. Small municipalities should merge fundamental functions and should provide jointly local public goods. At the same time both voluntaristic co-operation and compulsory associations of local governments are both maintained, thus in Italy municipalities could voluntarily co-operate in an intermunicipal body “Unione di Comuni” or signing an agreement (“Convenzione”) with other municipalities. They compulsorily have to join to the board of Optimum Territorial Area which have to provide local public goods, such board is regulated as a secondary cooperative local government... In any case small municipalities in Italy are perceived as inefficient, and in the last 15 years, each national government overlaps its own idea of territorial reform to previous ones.

The focus of territorial reform is usually the provision of local public goods. Generally speaking small municipalities face a dilemma: if they try to preserve their territorial identity they are not able to provide a sufficient level of public goods to citizens.

Furthermore, a local council has other tasks, is an institution devoted to

collect the local requests of its own citizens to be presented to central and regional government; hence, a local government interprets and represents the local citizens' wishes to central government. Thus, they bargain with central government¹ in order to represent local interests at central level. In any case, when local councils ask for resources from central or regional governments they do on the behalf of their citizens. Clearly, when the government is benevolent, the objective functions of citizens and of administrators coincide, and the representation of citizens' requests is consistent. On the contrary, a non benevolent government does not perfectly represent citizens' objectives.

Without considering the role of a local government in representing citizens' interest at central and regional governments, it can be hard to understand the resistance to territorial reform and merger from citizens living in small municipalities, even if the provision of local public good could increase. Such consideration could also give some hints to have a successful reform.

2 Is it a question of accountability?

Actually, the accountability models in fiscal federalism theory do not apply a big effort in defining what accountability consists on. In effect these models neither describe the mechanism of accountability, nor analyse the relation between local councils and their stakeholders. It must be noted that the concept of accountability is "a comprehensive one, since it embraces three different ways of preventing and redressing the abuse of political power. It implies subjecting powers to the threat of sanctions; obliging it to be exercised in transparent ways; and forcing it to justify its acts" (Schedler, 1999). Each of these issues encompasses multifaced aspects. Regarding this paper, we can summarize that a local council is accountable towards its citizens through two channels. The first one is informal and depends on direct and personnel knowledge among citizens and their administrators. The second channel is the existence of formal institutions, such as media, political parties, unions and so on, which can collect the citizens needs and present them to councils. This second channel can be important in a big council, not in a small one where the behavior of the government cannot be verified by these institutions. Actually, in very small councils, what grants accountability is the first channel: citizens know directly and personally the administrators and thus they can daily control them, not only in the electoral dates. Since we are focusing on small councils we will analyze the informal channel and not the formal one². For very small municipalities, the informal

¹Bargaining among different tiers of governments is evident when intergovernmental grants are discretionary, but also when they are not. A bargain among different tiers of governments is important in defining formulas which assign grants to local governments and in all democratic nations there are some places where bargaining, i.e. lobbying activity, are institutionalized, German Bundestag, Usa's Senate, Italian Conferenza Stato-Regioni-EELL... A review on how different tiers of government can bargain on grants is in Feld and Schaltegger (2005).

²Moreover, Besley and Prat (2006) affirm that big councils can "capture" media and political parties do not represent citizens' needs, so when the councils are big the relations between dimension and accountability cannot be easily defined. A similar unclear link between formal

channel of accountability is important: the claims and the pressure of citizens on public administrators is stronger and administrators have to consider not only costs depending on non re-election but the costs of everyday claims³. Clearly this channel disappears when the municipality is too big to permit personnel knowledge of administrators⁴.

If we try to consider these aspects, two issues would emerge. The first is that, in small councils, the accountable relation between administrators and citizens is stronger than the one suggested by the idea that the control of citizens on politicians depends on voting as in models of fiscal federalism theory where accountability problem collapse in electoral decision and promises.

The second issue is that even if a local government is fully accountable, such accountability could be ineffective. The accuracy in interpreting citizens' wishes is higher in small councils than in big ones, because of the citizens' control is higher in the former. Similar results could be obtain following Mankur Olson's suggestion: in a big city local could be capture by a small well organized lobby. In this case local government just defends the interests of a small group and not of all the citizens. In a small municipality such a problem is less important.

On the contrary, the strength of representation is higher for a big council than for a small one. The strength of representation power consists in the capacity of a council to make its requests be satisfied by central government. It is worth to note that here "strenght of representation" does not mean that local government represents the true requirements of its citizens, but only that it is able to obtain what it asks for from central government, even if such requests correspond to the needs of only a part of its own citizens.

In order to bargain with central and regional governments there are three successful factors: 1) the weight of local government which depends on population; 2) personal connections between governors on board both at local and at central government; 3) the existence of few local lobbies which can determine the political requests that the local governments present to central one⁵.

Thus, when the dimension of a local government increases, the importance of representation activity (lobbying activity) increases, but the objectives of citizens diverge from administrators' ones. In other words, increasing dimension of local governments, lobbying power increases while accountability decreases. For citizens there is a trade-off between the strength of local councils in representing interests at central level and the accuracy (accountability) in representing them.

institutions and the size of governments can be found in the literature of corruption: also in this literature the linkages between the size of governments and corruption is unclear: Goel and Nelson (1998); Alesina and Angeletos (2005) provide empirical and theoretical support to a positive link between corruption and the size of governments; on the contrary La Porta and al. (1999); Billger and Goel (2009) give the opposite empirical evidence.

³In other words, in a small council if snow should be removed, citizens do not contact an office in the council claiming for snow remotion and threatening not to re-elect the mayor in case of inefficiency, they directly go to the mayor with a shovel.

⁴An indirect proof of the importance of informal knowledge is supplied by Hart, Haughton and Peck (1996) which affirm that in small councils many stakeholders seeing accountability an exercise in public relations with administrators.

⁵From this point of view a big local municipality which is not accountable can bargain easily with central government.

3 The model

3.1 The public goods provision

We assume J local councils having N_i population, national population is $N = \sum_i N_i$. Let us assume that per capita income is equal everywhere⁶ and let us normalize it ($Y_i = 1$).

G_i and G_N are, respectively, local and national public goods. For simplicity we assume that they are non rival. Local governments provide local public goods using local tax revenues (t_i) and intergovernmental transfers they receive from central government as matching grant ($S_i = N_i s_i$). Thus

$$G_i = N_i t_i + S_i = N_i(t_i + s_i) \quad (3.1)$$

where S_i is the intergovernmental transfer received by council i , s_i is the per capita transfer and N_i is the population of region i .

Central government provides national public goods using the central tax revenue minus the transfer to local governments

$$G_N = N t_N - \sum_i N_i s_i = N \left(t_N - \sum_i n_i s_i \right) \quad (3.2)$$

where $n_i = \frac{N_i}{N}$, thus $\sum_i n_i s_i$ is the average per capita transfer.

Moreover let us assume that institutional rules set $\sum_i n_i s_i = \pi$, the average per capita transfer is a constant share of national revenue.

3.2 Citizens objective functions and Pareto Optimum

In each local council i citizens have the following utility function:

$$\begin{aligned} U_i^C &= \alpha \ln G_i + \beta \ln G_N + (1 - t_N - t_i) \\ \text{s.t.} \quad &G_i \geq \hat{G}, \forall i \end{aligned} \quad (3.3)$$

The constraint implies that there is a minimum provision of local public goods in all council i , such a minimum is the same in all municipalities.

Thus the pareto optimum is obtained maximizing the following lagrangean

$$\Lambda = \sum N_i U_i^C + \sum_i \phi_i (G_i - \hat{G}) + N \epsilon (\pi t_N - \sum_i n_i s_i) \quad (3.4)$$

if the constraint is not binding ($G_i \geq \hat{G}$), then $\phi_i = 0$, otherwise $\phi_i > 0$. The

⁶Thus local councils differ only for population.

constraint on π is always binding. Substituting 3.1 and 3.2

$$\begin{aligned}\Lambda &= K + \alpha \sum N_i \ln(t_i + s_i) + \beta N \ln(t_N - \sum n_i s_i) + \\ &+ N - N t_N - \sum_i N_i t_i + \\ &+ \sum_i \phi_i \left[N_i(t_i + s_i) - \hat{G} \right] + N\epsilon (\pi t_N - \sum_i n_i s_i)\end{aligned}\tag{3.5}$$

Equation 3.5 FOCs are

$$\frac{\partial \Lambda}{\partial t_i} = \alpha \frac{N_i}{t_i + s_i} - N_i + \phi_i N_i = 0 \tag{3.6}$$

$$\frac{\partial \Lambda}{\partial s_i} = \alpha \frac{N_i}{t_i + s_i} - \beta \frac{N_i}{t_N - \sum n_i s_i} + \phi_i N_i - \epsilon N_i = 0 \tag{3.7}$$

$$\frac{\partial \Lambda}{\partial t_N} = \beta \frac{N}{t_N - \sum n_i s_i} - N + N\epsilon \pi = 0 \tag{3.8}$$

$$\phi_i > 0 \perp N_i(t_i + s_i) > \hat{G} \tag{3.9}$$

$$\pi t_N = \sum n_i s_i \tag{3.10}$$

thus

$$t_i + s_i = \frac{\alpha}{1 - \phi_i}$$

$$t_N - \sum_i n_i s_i = \beta$$

$$\epsilon = 0$$

$$\phi_i = 0 \quad \text{if} \quad N_i \alpha > \hat{G}$$

$$\phi_i = 1 - \alpha \frac{N_i}{\hat{G}} \quad \text{if} \quad N_i \alpha \leq \hat{G}$$

hence, assuming $t_i = t = \alpha \quad \forall i$, then

$$t_N = \frac{\beta}{1 - \pi}$$

$$\sum n_i s_i = \beta \frac{\pi}{1 - \pi}$$

$$s_i = 0 \quad \text{if} \quad \phi_i = 0, \quad N_i \alpha > \hat{G}$$

$$s_i = \frac{\hat{G}}{N_i} - \alpha \quad \text{if} \quad \phi_i > 0, \quad N_i \alpha \leq \hat{G}$$

According with Boadway and Hobson (1993), intergovernmental grants increase when population decreases.

3.3 Government objective functions

Since we assume that governments are non benevolent, pareto solutions we describe is not the actual solution. Local and central government maximizes an objective function which is different from citizens' one. Local governments consider only the utility which citizens receive by local public expenses and the disutility of taxation over local citizens:

$$U_i = N_i \gamma \ln G_i + N_i(1 - t_N - t_i) \quad (3.11)$$

where $\gamma > \alpha$ means that the importance of local public expences for government is higher than for citizens.

In this case it is easy to demonstrate that local government set the tax rate in order to $t_i + s_i = \frac{\gamma}{1-\phi_i}$, obviously an intergovernmental transfer permits to local government to reduce the tax rate.

In the same way, central government maximizes an objective function considering only the utility which citizens receive by central public expenses and the disutility of taxation over all citizens:

$$U_N = N \delta \ln G_N + \sum_i N_i(1 - t_N - t_i) \quad (3.12)$$

where $\delta > \beta$ means that the importance of public expences for government is higher than for citizens. Also in this case the central tax rate is higher than Pareto optimum $t_N = \delta \frac{1}{1-\pi}$.

3.4 Citizens' control on local governments

In local councils, citizens control their own local governments not only by voting, but through daily contact with administrators. Such direct control could be the only accountability channel for small councils and it decreases when the population of the local government increases, since the frequency of daily contact with administrators decreases. Hence, even if local administrators are not benevolent, it is easy to think that citizens can obtain higher utility than reservation one. Thus the appropriate way to model this control is a Nash's bargaining between citizens and their local governments.

$$W_i = \lambda(N_i) N_i U_i^C + (1 - \lambda(N_i)) U_i \quad (3.13)$$

where $\lambda(N_i)$ (with $0 \leq \lambda(N_i) \leq 1$, $\lambda(1) = 1$) is the weight of the sum of citizens' utility and depends on daily controls on administrators (voice strength), let us assume that voice strength decreases when local population increases $\left(\frac{\partial \lambda(N_i)}{\partial N_i} < 0\right)$ because the daily contact are no more possible and the voice has to be express using more formal instruments (political parties, union, ...) ⁷. In order to have an explicit formula we assume $\lambda(N_i) = 1 - n_i$.

⁷In this case there are no conclusive results on the impact of municipality size on citizens' control (Besley and Prat, 2006)

It is easy to show that the solution for local taxation is $t_+ s_i = \frac{\lambda\alpha + (1-\lambda)\gamma}{1-\phi_i}$

Hence, larger the population is, higher the local tax rate is. When the number of citizens decreases, the control on administrators increases, and local politicians provide an higher utility since tax rate is not different from pareto optimum.

Thus, if policies depends on a bargaining between citizens and local government, government raises a lower tax revenue and provide less local public good than it wants. It is clear that in this case, without intergovernmental transfers, small municipality could not provide the minimum level of local public goods and could face the dilemma of raising taxes higher than the ones raised by bigger municipalities or to provide a not adequate level of local public goods.

4 The role of municipalities

In the previous section, we show that small municipalities could provide a low level of local public goods, both in a benevolent and in a non benevolent framework. Intergovernmental transfers in that section as the only role to permit to smaller municipalities to provide a sufficient amount of local public goods. From this point of view a territorial reforms which reduce the number of small municipalities could face such a problem and it could help to provide an adequate level of local public goods.

The cost of a reduction of small municipalities is only a potention reduction in accountability. Actually we assume that the citizens' direct control decreases when population increases. Such reduction of accountability could be compensate by an istitutional control throughout media, unions, political parties.

The main point of this paper is that provision of public local goods is not the only tasks of a municipality. Moreover the solution to non benevolent behaviour is not only an increase in institutional accountability.

A big role of local government is to bargain with central one in order to induce central government to provide the right level and quality of central public good and to receive an higher amount of intergovernmental transfer. Actually, governments commit themselves in political bargaining. In effect local governments make lobbying activity in order to gain better results for their own citizens.

In this paper, in order to have explicit solution, we assume that central government contracts with all local ones jointly, μ is the cumulate weight of local government in the bargaining. Each local government weight is $\mu \frac{N_i}{N} = \mu n_i$; the weight of each local government (μn_i) increases with population. Intergovernmental grants and national and local tax rates are set maximizing the following function:

$$\Omega = (1 - \mu) \frac{U_N}{N} + \mu \left(\sum_i n_i \frac{W_i}{N_i} \right) \quad (4.1)$$

subject to $G_i > \hat{G}$ and $\sum n_i s_i \geq \pi t_N$.

Substituting we can write the lagrangian

$$\begin{aligned}
\Theta = & (1 - \mu)\delta \ln(t_N - \sum n_i s_i) & + \\
& + \mu \sum [n_i^2(\gamma - \alpha) + n_i \alpha] \ln(t_i + s_i) & + \\
& + \mu(1 - H)\beta \ln(t_N - \sum n_i s_i) & + \\
& + 1 - t_N - \sum n_i t_i & + \\
& + \frac{\sum [N_i(t_i + s_i) - \hat{G}]}{N} + \epsilon(\sum n_i s_i - \pi t_N)
\end{aligned} \tag{4.2}$$

Where $H = \sum_i^J \left(\frac{N_i}{N}\right)^2$ is the Herfindal's concentration index. Solving the FOCS system we obtain

$$t_N = \frac{(1 - \mu)\delta + \mu(1 - H)\beta}{1 - \pi} \tag{4.3}$$

$$\sum n_i s_i = \frac{\pi}{1 - \pi} [(1 - \mu)\delta + \mu(1 - H)\beta] \tag{4.4}$$

$$G_N = N[(1 - \mu)\delta + \mu(1 - H)\beta] \tag{4.5}$$

Central tax rate, central public good and the average per capita transfer decreases with concentration. Central government overspends in central public goods if $\delta > \beta + \frac{\mu}{1-\mu}H\beta$, otherwise central public goods is less then optimal. When concentration increases it is easy to move from an overspending condition to a towards a suboptimal level of central good. Non concentrated municipalities have low power on respect to central government, we may think that they compete in order to represent local needs to central government and such competition permits the central government to overspend. Few big municipalities, on the contrary have the power to force central government to reduce the central tax pressure, by this way they gain possibility to raise local taxes without reducing citizens utilities.

In effect solving the FOCs we obtain that

$$t_i + s_i = \mu \frac{n_i(\gamma - \alpha) + \alpha}{1 - \phi_i} \tag{4.6}$$

on respect to pareto optimum we have an overspending in local public goods if $n_i(\gamma - \alpha) > \alpha \frac{1-\mu}{\mu}$. In this case subspending is likely in small municipalities, overspending in big one.

If we multiply 4.6 by n_i and we sum by i , assuming that $\phi = 0$ we have:

$$\sum n_i t_i = \mu H(\gamma - \alpha) + \mu \frac{\pi}{1 - \pi} H\beta + \mu \alpha - \frac{\pi}{1 - \pi} [(1 - \mu)\delta + \mu\beta] \tag{4.7}$$

In very concentrated regions local tax is higher then pareto optimal local tax rate, for two reasons, local governments should be relatively big and inter-governmental transfer are lower (because of equation 4.6). From equations 4.6 and 4.7 we obtain the following testable proposition:

The per capita intergovernmental transfer is increasing with population of municipality and decreases with regional concentration of cities.

In the next section we test such a proposition, in effect if the per capita transfer is really increasing with city dimension we contrast with theoretical prescription of Boadway and Hobson (1993). Moreover in several country, and also in Italy, small municipalities received extra transfer in order to compensate the difficulties to provide a sufficient level of local public goods.

5 Empirical analysis

Theoretical model suggests some testable results.

1. Intergovernmental transfer should increase with municipality dimension
2. Intergovernmental transfer should decrease with territorial concentration
3. Local taxation, should increase with concentration and municipality dimension.

The first result seems to be both against citizens optimality and against norms which provide small cities with transfer in order to face the lack of scale economy. The second result depends on bargaining: in a concentrated region the bigger municipality exerts a bigger pressure on central government and by this way central government reduces its own spending. The third result underlines a new cost for territorial reform, in order to grant local public goods in a concentrated country all the councils should apply higher local taxes. We test the three propositions in the next pages, while we discuss the policy implications in the last one section.

5.1 The data

In order to test both propositions, we cannot analyze the national grants to lower tiers of government in only one country. We should compare the capita grants from higher tiers of governments to lower ones in different countries or regions. Obviously, the legal framework and other structural differences should not be too high in order to not introducing too much heteroskedasticity. The data of “Ministero dell’Interno” on councils budgets can be considered a good dataset for our exercise. In particular we study the regional transfers received by the 8116 Italian councils from their own regions from 2006 to 2010. In such a period rules on national grants and on local taxes change, but this change cannot be considered a mayor one as the change to ‘Fondo di Solidarietà Nazionale’ which completely redesigns the rules on national transfers.

From this database we calculate the per capita transfers that each municipality receives from the central government (National grants), from its own region (Regional Grants) not paid for the delegated functions and the per capita

regional transfers paid for delegated functions (Delegate function) since municipalities act on the behalf of regions, finally we calculate per capita local taxes. In order to compare regions which are different for population and income, we normalize this per capita figures by the average per capita of each region. From data on Population we calculate the regional Herfindal concentration index that we normalize between 0 and 1.

Finally from regional accounts we take the per capita regional GDP (PIL_PC).

We estimate panels both for regional grants and for local taxation. We estimate a pooled OLS, a between model on unit means, a within model (fixed effect) and a GLS model (random effect), Hausman's test suggest that random effect is inconsistent thus the fixed effect models seem to work well. In our estimation we consider only the council which belong to ordinary law regions or "Regioni a Statuto Ordinario", moreover we exclude from the database 44 councils bigger than 100000 inhabitants, since national law provide them with higher per capita national transfer and they behave as outlier (we use 6666 councils as cross-sectional units).

5.2 Results

TABLES 1 AND 2 about here

6 Conclusions: The territorial reform of a nation

TO BE REVISED

In order to provide some suggestion for a territorial reform of a nation we have to summarize the main results of the paper.

On respect to traditional theory Boadway and Hobson (1993), in this paper we consider that a municipality has not only the task of providing local public goods but also to represent the local needs to central governments. If a proposal of regional reform focuses only on the low level of local public goods provision, on the cost that central government has to pay in order to grant intergovernmental transfer to small municipalities, it is possible to design a territorial reform which does not work. Firstly, we demonstrate, theoretical and empirically, that small local governments receive small transfers in spite of Boadway and Hobson prescription and even if norms state that some transfer must be corresponded to small municipalities.

A reform which reduce the number of councils, concentrating them, does actually reduce the total amount of intergovernmental grants, but in this model it is not due to an efficient provision of local public goods because the reduction of scale diseconomy. It is due to a stronger competition among municipalities and central government which reduce central taxation and by this way also average per capita grants. In this case municipalities act on behalf of their citizens mitigating the national tax pressure and asking for a correct provision of national public goods. At the same time bigger municipalities push up their

own fiscal pressure providing an excessive local public good. Basically, a big municipality is more able to ask to central government a correct level of national policy, but at the same time citizens control decreases.

The trade-off between control (direct voice) over local government and political strength on respect to central government (representation power) is more important in defining the incentives for accepting a territorial reform than the low provision of public goods. The claims of local government in favour of concentrating the municipalities are that they are not considered by central government in provision of central public goods (school, roads among cities, justice, health care). The claims against concentration usually considered as localistic ones reflect the difficulty of having a direct control on local governors.

The literature on accountability does not consider all the relevant elements of the complex relation between citizens and governments. In effect, even if the assignment of various tasks to local governments permits to better account citizens for public expenses, it does not mean that citizens will actually receive better services. When public goods are provided by different levels of governments, the possibility to control local governments is not sufficient for having better services. It is very important that local governments could act correctly on the behalf of their own citizens in front of central government. From this point of view citizens in small municipalities have to face a trade-off between the possibility to personally and directly control their administrators and the strength of their administration in representing their interests to higher level of governments. Small municipalities can permit informal and direct control of citizens but have low political power in front of higher governments. Local administrators involved in councils associations actually stress that the importance of the association is the possibility to bargain with more power with regional and national governments. By this way citizens could prefer to reduce some direct controls on local governments and to increase local requests at central level. The paper focus on small councils and try to model theoretically this trade-off.

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Table 1: Dependent variable: Regional grants

	Pooled OLS	Between	Within	GLS
const	0.001152 (0.002051)	0.01716 (0.05912)	0.002061 (0.001842)	0.001303 (0.001549)
National grants	0.1958 (0.1531)	0.3898** (0.02351)	0.02325 (0.01977)	0.04811** (0.006826)
Delegated functions	-0.1355** (0.03570)	-0.1626** (0.007524)	-0.03667* (0.01909)	-0.07283** (0.004257)
PIL_PC	-3.581e-05 (6.992e-05)	-0.0005818 (0.002066)	-4.942e-05 (6.553e-05)	-4.004e-05 (5.484e-05)
Population	1.043** (0.1370)	0.9022** (0.02364)	0.6914** (0.1954)	1.078** (0.01365)
Herfindal	-0.006481 (0.004000)	-0.02200 (0.05003)	-0.009291** (0.002986)	-0.007220** (0.003411)
Regional dummies	YES*	YES*	NO	YES**
Time dummies	YES**	NO	YES**	YES***
n	32676	6666	32676	32676
\bar{R}^2	0.4997	0.5945	0.0124	
ℓ	1.243e+05	2.653e+04	1.455e+05	1.241e+05

Standard errors in parentheses

 p -values in brackets

* indicates significance at the 10 percent level

** indicates significance at the 5 percent level

Table 2: Dependent variable: local tax

	Pooled OLS	Between	Within	GLS
const	−0.0004869 (0.0006565)	−0.08080* (0.04205)	2.832e-06 (0.0006586)	−8.186e-05 (0.0007126)
National grants	0.04563 (0.1534)	0.1225** (0.01672)	−0.03969** (0.01303)	−0.03495** (0.003203)
Delegated functions	−0.05040 (0.04324)	−0.06576** (0.005352)	0.005200 (0.008309)	−0.005466** (0.002158)
PIL_PC	2.120e-06 (2.210e-05)	0.002791* (0.001469)	−1.227e-05 (1.986e-05)	−1.002e-05 (2.510e-05)
Population	1.076** (0.2008)	1.040** (0.01681)	1.033** (0.2057)	1.104** (0.008646)
Herfindal	0.005303** (0.002262)	0.04414 (0.03558)	0.002942** (0.001496)	0.003431** (0.001563)
Regional dummies	YES*	YES*	NO	YES**
Time dummies	YES	NO	YES	YES
n	32676	6666	32676	32676
\bar{R}^2	0.6879	0.7314	0.0889	
ℓ	1.386e+05	2.88e+04	1.71e+05	1.384e+05

Standard errors in parentheses

 p -values in brackets

* indicates significance at the 10 percent level

** indicates significance at the 5 percent level