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Regionalization, public spending and growth: a stylized model dealing with ‘predatory states’

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Abstract

In this paper, a micro-founded model analyzing the effects of ‘regionalization’ on economic activity is developed. It shows that the spatial division of public competencies can have an impact on the growth rate via the efficiency of governmental choices: initially advantageous for weak levels, decentralization (/reduction of regional size) becomes limited due to the risk of underestimation of the real profitability of public expenditure by local governments (non-internalized cross-border effects). In accordance with the theory, a transversal estimation for a sample of 51 countries for the 1990s establishes a ‘bell-shaped’ relation between indicators of regionalization and the quality of governance.

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1. Introduction

The territorial organization of the State is a striking element of the complementarities installed between the private logics of accumulation and the public logics of allocation, regulation and redistribution. The question is how, and to what extent, the level of decentralization really favors growth? In order to answer this question, we suggest a theoretical model which analyses the effects of regionalization on the ‘predatory behavior’ of governments, showing a bell-shaped relation between these two variables: initially

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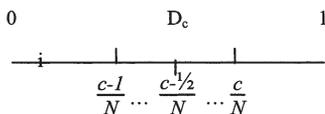
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beneficial for weak levels, the positive effect of regionalization becomes limited due to the risk of underestimation of the profitability of public expenditures by the local governments (non-internalized overflows of the yield of the expenditure) and the deterioration of their ‘bureaucratic efficiency’ (increase in local predations).

The paper is organized as follows. Section 2 describes the spatial model and its political division into autonomous regions. Section 3 calculates the equilibrium of the different regional governments, showing the risk of coordination failures between these governments with regard to their level of public spending on regional infrastructure. Section 4 proposes an empirical verification of the main theoretical result. To conclude, we briefly discuss the respective advantages of ‘federalism’ vs. ‘limited regionalization’ as defined in the paper.

2. A modelization of space and its political division

Space is reduced to a straight-line segment with a size of 1. Moreover, we suppose that the agents (population continuum normed at 1) are distributed uniformly within this space: for each point with co-ordinates $i \in [0, 1]$ on the straight-line segment is a corresponding agent i . For this space and population, the regional borders are distributed as follows:



There are N regions, with the index c natural integer, $c=1, \dots, N$. The government of region c —situated on the straight-line segment (the limits and the center of region c are shown in italics)—receives the fiscal revenues and carries out public spending D_c . The whole of the straight-line segment is distributed between the N regions. In the model, we propose the hypothesis that each region is of the same size² (we thus note that an increase in N causes an inevitable reduction in the size—equal to $1/N$ —of each regional entity). Following Barro (1990), each agent is given the following production function:

$$y_{i,t} = (k_{i,t})^\alpha \left[\sum_{c=1}^N \gamma_{i,c} D_{c,t} \right]^{1-\alpha} \tag{1}$$

With k_i the private capital of agent i ; D_c the public spending carried out by region c ; $\gamma_{i,c}$ a factor of efficiency of public expenditure D_c with regard to agent i . The production of agent i benefits from an aggregate of the total of the regional public expenditures (the

² This assumption is made for simplicity. The results obtained in Sections 2–4 are not essentially affected by the hypothesis (the bell curve still exists in the model for a given region c chosen in a set of multiple sized regions). However, the result in Section 5 (Eq. (9)) is impossible to obtain.

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