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Fiscal Federalism at Work? Central Responses to Internal Migration in India

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Summary. — Internal migration is thought to have substantial benefits for migrants and for the development of migrant-sending and migrant-receiving areas. In order to facilitate such migration, central governments may need to use fiscal transfers to ensure services to migrants, address infrastructure shortfalls, and ameliorate labor market displacement of natives. In fact, an extensive, mostly normative "fiscal federalism" literature has argued that central governments ought to use transfers to reduce interjurisdictional externalities such as those due to population displacements. We extend this literature empirically by examining the degree to which exogenous, long-term migration prompts the redirection of central fiscal resources in India. Following the literature on distributive politics, we argue that transfers in decentralized systems addressing the costs of population movements are influenced by partisan politics. Using monsoon shocks to migration, we show that increases in migration are met with greater central transfers but that these flows are at least 50% greater if the state-level executive is in the Prime Minister's political party. Consistent with the theory, the influence of politics is greatest on parts of the budget subject to greater executive control. This politicization may explain why Indian states maintain barriers to internal migration despite the development costs of doing so.

Keywords — Migration, Federalism, Decentralization, Politicization, Asia, India

1. INTRODUCTION

The free movement of citizens within their countries is fundamental to democracy and to notions of equal citizenship. Migration has the potential to reduce poverty among migrants and in migrant-sending areas as well (Housen, Hopkins, & Earnest, 2013; Lokshin, Bontch-Osmolovski, & Glinskaya, 2010; Mendola, 2008; Zhu, Bell, Henry, & White, 2013). Economic development in both migrant-sending and migrant-receiving communities may be enhanced by more efficient allocation of labor (Lewis, 1954) and improved governance as regions compete for people (Tiebout, 1956). In other words, internal migration is both a right and has potential development benefits for migrants themselves, their home communities, and their adopted communities.

Internal migration produces stresses as well. Migration to urban areas can strain resources and can lead to the concentration of people in a few megacities, "raising commuting, congestion and living costs to excessive levels, raising costs of production of goods and lowering the quality of urban service provision" (Davis & Henderson, 2003, 101). An increasingly integrated labor market may displace some workers, potentially causing nativist backlash (Weiner, 1978), particularly when natives are politically weak (Bhavnani & Lacina, 2015). Migration can also be politically destabilizing (Horowitz, 1985; Peluso & Vandergeest, 1987; Wallace, 2013).

A key to reaping the benefits of migration is to minimize its costs. One way in which this can occur is through the channeling of resources to migrant-recipient areas. Such a directed use of resources could provide migrants with services in their new homes and compensate natives for losses due to migration (Angrist & Kugler, 2003). Central governments have a particularly important role to play in channeling resources in response to migration. A unitary political system should, in theory, accomplish this fairly seamlessly. However, in more decentralized systems, it is unclear if migration-induced redistribution occurs. That said, the fiscal federalism literature argues that central or federal governments ought to use the power of the purse to address spillovers, such as those caused by inter-jurisdictional migration (Oates, 1972; Riker, 1964; Rodden, 2006; Weingast, 1995). Fiscal transfers ought to "follow" people.

In this study, we consider whether and how the Indian central government responds to migration with changes in fiscal transfers. In order to do so, we apply the insights of the distributive politics literature to argue that politics intervenes in the management of inter-jurisdictional externalities. We hypothesize that helping a subnational government to mitigate the negative externalities of migration is an important political boon that the center is likely to target toward its co-partisans. Consistent with our hypothesis, we find evidence that the central government spends disproportionate resources on states where the chief executive is from the Prime Minister's party.

To address the potential endogeneity between fiscal policy and migrant flows, we instrument for an Indian state's migrant inflows by looking at exogenous shocks to the supply of migrants due to weather disasters in other regions of the country. We find that central transfers do indeed increase in response to longterm migration, with a 10% increase in internal migration causing a 2% increase in transfers. This suggests an attempt to address interjurisdictional spillovers. However, we also find that states that are politically aligned with the central government receive even larger transfers per migrant than unaligned states. In other words, the central government funds

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co-partisans' expansion of public spending in the wake of migration but does not extend commensurate resources to unaligned subnational governments. We find that the partisan alignment of state and central chief executives is associated with 56% more transfers per migrant. This result qualifies our finding that transfers respond to interjurisdictional spillovers, by showing that they particularly do so in states allied with the Prime Minister. The differential between copartisan and other states is even larger when we look at more discretionary subcategories of central transfers.

Assessing government responses to migration in India is important for several reasons. Empirically, internal migration across the developing world is increasing, particularly in Asia (Montgomery, 2008). The 2001 Indian census reported that 14% of people lived outside the state of their birth. Despite an increase in welfare spending in the 2000s—which has ameliorated some of the economic reasons for migration—it is likely that internal migration has increased over time.[1] Approximately 40% of Indian migrants move for economic reasons (for employment, "business" or education), while an equal proportion (mostly women) move for marriage. The balance move for miscellaneous reasons, including natural disasters (estimated at less than 1% of the total) and conflict.[2]

The political science literature on the consequences of migration has concentrated primarily on popular, nativist movements (Bhavnani & Lacina, 2015; Fearon & Laitin, 2011; Weiner, 1978), and, more recently, on discrimination and identity change (Adida, Laitin, & Valfort, 2016). Studies of other policy responses to internal migration are frequently prescriptive and focused on improving outcomes for migrants (e.g., Deshingkar & Farrington, 2009; Landau, Segatti, & Misago, 2013; Suykens, 2011). We take a more empirical perspective, hoping to explain variation in government responses to migration. We also examine the fiscal response to migration rather than more well-known, anti-migrant phenomenon like legal restrictions on mobility. Development experts endorse fiscal responses to migration, unlike migration bans. Yet we know little about to what degree governments use fiscal tools to address negative externalities of migration or why a government might underspend in this respect.

We further the fiscal federalism literature (Oates, 1972; Weingast, 1995, 2009), which examines the ways in which federations can be structured to remedy vertical and horizontal imbalances (the focus of the first generation literature) and promote economic development (the focus of the second generation literature). We move beyond the normative focus of these works to examine how, in fact, a prominent federation operates in response to migration, which is a classic example of a spillover that might motivate separate units to federate. Existing empirical literature examines variation in the degree to which federalism and decentralization generate externalities in sectors like the environment (as reviewed by Millimet, 2014) and infrastructure spending (e.g. Gramlich, 1994). However, there is almost no empirical research on the extent to which central governments actually use fiscal policy to address these interjurisdictional (horizontal) externalities.[3]

The vast theoretical literature on fiscal federalism also ignores any role for electoral politics in central government responsiveness to externalities.[4] We make the argument that partisan ties between central and subnational governments influence responses to migration externalities, linking the study of federalism and jurisdictional spillovers to the substantial literature on the politicized distribution of public spending.

Our findings also extend to the question of how decentralization interacts with economic development (Treisman, 2007). We show that the political alignment of subnational with national governments boosts transfers in response to migration. This result raises the question of whether decentralized systems respond appropriately to migration-related externalities when the central and subnational governments are not controlled by copartisans. Politicized aid to migrant-receiving states may explain why subnational governments are often hostile to migrants rather than competing for them (de Brauw, Mueller, & Lee, 2014; King & Skeldon, 2010), as research on inter-jurisdictional competition would predict. In India, for example, de facto barriers to internal migration have kept the labor market segmented (Kundu & Saraswati, 2012).

2. INTERNAL MIGRATION AND PUBLIC SPENDING

In this section, we develop our theoretical expectations for state responses to migration, drawing on the literatures on migration, fiscal federalism, and the partisan distribution of resources.

Economic migration serves multiple functions for individuals and families:

> household members act collectively not only to maximize income, but also to minimize risks, diversify income earnings and loosen financial constraints through remittances.
>
> [Mendola, 2012, p. 105]

The indirect benefits of economic out-migration include increased wages in the community of origin, investment of remittances, and an expansion of the local economy due to consumption of remittances (Housen *et al.*, 2013; Mendola, 2012; Zhu *et al.*, 2013). Migration may also be a necessity because of environmental degradation, natural disasters, or political conflict. Such circumstances underline why free migration is considered a human right.

Nonetheless, migrants frequently face shortfalls in public services in their new homes.[5] This is the case for two related reasons: first, migrants lack the political power with which to access resources (Jha, Rao, & Woolcock, 2007). For example, they may not vote in their new communities. And second, they might be actively discriminated against by politicians and bureaucrats when and if they do in fact attempt to access resources. Political disempowerment prevents the expanded public spending necessary to ensure migrants receive services to which they are entitled. When public services do not address migrant needs, migration may be deterred, foreclosing opportunities for individuals to move out of poverty.

As suggested in the introduction, migrant-receiving destinations both enjoy the benefits and incur costs of migration. The influx of human capital in migrant-receiving areas is both a consequence and cause of economic growth. Internal migration allows the application of labor where it will be used most efficiently, induces inter-jurisdictional competition that can improve public policies (Tiebout, 1956), and allows for the reallocation of under-employed agricultural workers to industry (Lewis, 1954). Migration may also create economic dislocation and negative externalities for non-migrant populations, particularly in the short-run. Migrants may compete with locals for resources, especially employment (Weiner, 1978). Competition between migrants and locals for natural resources may cause conflict, as well (Barnett & Adger, 2007; Faist & Schade, 2013; Homer-Dixon, 1999; Swain, 1993). An influx of migrants can intensify demand for public services that are in scarce supply, at least in the short term:

> The proliferation of filthy urban slums, pavement dwellings, extreme squalor with very poor living standards characterize metros because they have failed to provide to the migrants minimum shelter and minimum subsistence employment. Ultimately this causes the growth of urban poverty,