



Voter involvement, fiscal autonomy and public sector efficiency: Evidence from German municipalities

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ABSTRACT

Social and/or political involvement within the population is often argued to enhance public sector performance. The underlying idea is that engagement fosters political awareness and interest and increases the public's monitoring ability. Still, weak fiscal autonomy can undermine voters' interest in and demand for an efficient production of public services. In our contribution, we test whether and how voter involvement in the political sphere is related to government performance – in terms of its efficiency – using a broad panel of German municipalities. Our results suggest that voter involvement indeed has a positive impact on cost efficiency. Crucially, however, this efficiency-enhancing effect of voter involvement is significantly positively affected by local governments' fiscal autonomy.

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1. Introduction

Engagement in social life has been argued not only to increase interest in and understanding of politics, but also to make one more willing and effective in demanding 'good' government (e.g., Boix and Posner, 1998). As such, voter involvement may well help tame the Leviathan. Clearly, however, two crucial assumptions have to be met for this argument to hold. Firstly, civic engagement should foster political awareness and interest. Scheufele et al. (2004), among others, provide some evidence that this is indeed the case. Secondly, this increased interest and involvement in the political sphere should improve government performance. The validity of this second 'assumption', however, has received little attention and was recently described as a "plausible, important but insufficiently tested proposition" (Toka, 2008, p. 31).

The present paper takes a first step to bridge this gap. It empirically assesses whether voters' political involvement improves government performance – and, crucially, whether fiscal autonomy of the local government is a prerequisite for such an effect to establish itself (see below). We thereby define good government performance as higher efficiency of public service provision (or, phrased more negatively, as a reduction in budgetary slack or rent-seeking).¹ The efficiency measure employed is based on the

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¹ Economic efficiency is obviously only one among many public concerns (besides effectiveness, equity, responsiveness, adequateness, appropriateness, and so on; Dunn, 2004, p. 223–231) and our focus on it should not be taken to mean that it is more important than the remaining issues. Yet, efficiency has received increasing amounts of attention in recent years (e.g., in the New Public Management (NPM) discussions since the late 1980s; Lindblad, 2006) and our study intends to add to recent attempts at understanding factors that affect or influence it (see below).

public sector as a whole, rather than on a given area of public good provision: e.g., waste collection, administration, road maintenance, and so on (e.g., Kalseth and Rattsø, 1998; De Borger and Kerstens, 2000). This ‘global’ approach is appropriate when “the explanatory variables characterize the local government institution rather than being sector-specific” (Borge et al., 2008, p. 476) – as is here the case. In such a setting, concentrating on “one particular element of service provision may be inadequate (or even misleading)” (Ashworth et al., 2007, p. 12).

While numerous studies examine local government efficiency and its determinants (e.g., De Borger et al., 1994; De Borger and Kerstens, 1996; Worthington, 2000; Geys, 2006; Balaguer-Coll et al., 2007; Bruns and Himmler, 2009; Geys and Moesen, 2009a,b), only one of these includes a measure of political involvement (i.e., Borge et al., 2008).² The latter study illustrates that the public’s democratic participation tends to improve efficiency – in line with theoretical predictions – even after controlling for numerous political, fiscal and budgetary variables. The present study intends to add to our understanding of the participation-efficiency nexus by diverging from and/or extending upon Borge et al. (2008) in four main ways.

- First, and purely methodologically, we exploit a stochastic frontier approach to measure efficiency (cf. Aigner et al., 1977; Meeusen and van den Broeck, 1977), whereas Borge et al. (2008) rely on the ratio between aggregate output and local government revenue. Our approach, although itself imperfect (see below), has the benefit of allowing a distinction between measurement error and inefficiency.
- Second, our empirical analysis is based on a broad panel of German municipalities (rather than Norwegian municipalities; cf. Borge et al., 2008). As a result, we have a larger dataset at our disposal including across-time variation in crucial variables. Moreover, it implies that we analyze the participation-efficiency nexus in a different political and institutional setting – making our results interesting also from a comparative perspective.
- Third, we assess a broad set of indicators of voter involvement – thus going beyond electoral turnout as a measure of citizen involvement (as in Borge et al., 2008). As such, we are able to examine how different ways through which voters can get politically involved affect government performance.
- Finally, and most importantly, we are – to the best of our knowledge – the first to assess how the participation-efficiency nexus is affected by the degree of local fiscal autonomy. Building on the fiscal illusion literature, fiscal autonomy (in contrast to dependence on external grants) may be seen as a crucial intervening variable since it implies that voters are effectively confronted with the tax bill for their desires. As a result, we argue that an active citizenry is more likely to value the careful use of public money when it originates mainly from own revenue sources rather than external transfers.

The remainder of the article is structured in four main parts. The first of these presents the theoretical background and our main hypotheses. Section 3 then introduces the German institutional and political setting. The empirical analysis is provided in Section 4. We show that voter involvement is indeed linked to increased government cost efficiency and that, in line with theoretical predictions, this effect is stronger in communities with higher fiscal autonomy. Finally, Section 5 reiterates the main findings and discusses some implications.

2. Theoretical background and hypotheses

From a theoretical perspective, the link between voter involvement and the efficiency of public policy can be analyzed in a standard principal-agent setting (cf. Migué and Bélanger, 1974; Niskanen, 1975; Borge et al., 2008). Local government officials act as agents for the population, who – as principals – desire the government to provide as many public goods as possible for a given fiscal cost. That is, “voters want more competent politicians in office, as they can provide more public goods for given levels of taxation and private consumption” (Alt and Lassen, 2006, p. 1404; see also Shi and Svensson, 2006). However, there is a clear conflict of interest in that politicians (or bureaucrats) in charge of public goods provision may benefit from less productive activities: e.g., higher salaries, lower effort, over-employment within their service, and so on. Given that politicians (or bureaucrats) tend to be better informed about the true cost of providing public goods than the general population, there exists an incentive to invest in such less productive activities. These, however, induce budgetary slack (or inefficiency).

Importantly, the extent of budgetary slack is likely to be affected by the formal as well as informal institutional setting. One crucial element in this respect is whether or not the principal assumes an active role in informing himself about and supervising the actions of his agent. Specifically, agency theory assumes that principals can resolve part of their imperfect information of the agent’s work effort through stricter monitoring (Alchian and Demsetz, 1972; Jensen and Meckling, 1976; Holmström, 1979; Laffont and Tirole, 1986). This reduces information asymmetries between principal and agent, thereby limiting possibilities for wasteful spending and rent extraction by the agent. In other words, the ‘information rent’ extracted by the agent is likely to become considerably smaller with monitoring such that budgetary slack is reduced when the principal is actively involved (e.g., Moene, 1986; Chan and Mestelman, 1988).³

² A large and related literature examines the relationship between the quality of institutions and satisfaction with democracy (see, e.g., Wagner et al., 2009; and references therein).

³ Recent experimental evidence is generally supportive of a *disciplining* effect of monitoring (e.g., Nagin et al., 2002; Dickinson and Villeval, 2008). Still, in personal interactions, this disciplining effect may be counterbalanced by a *crowding-out* effect because supervision diminishes the intrinsic motivation of the agent (see Frey, 1993a,b; Barkema, 1995). As the principal-agent relation in our setting is impersonal (i.e. voter-government), we assume dominance of the disciplining effect of monitoring.

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