

Review on doctoral dissertation*

The author of the dissertation: Meri Šuman Tolić

The title of the Ph.D. dissertation: Fiscal decentralization in function of the achievement of national development goals

Committee in charge: Helena Blažić chair; Nikša Nikolić mentor;
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Doctoral dissertation consists of 7 chapters (238 pages), a list of 420 used references (30 pages) and appendix (42 pages). The dissertation is written in Croatian. Abstracts in Croatian and English are added after preface.

The author of the dissertation starts her research with notion of the problem of negligence of multidimensionality of decentralization process in previous empirical research. That fact encouraged her to adopt more inclusive approach to the analysis of fiscal relations between levels of government. The further research follows the statement that the development is also a multi-dimensional process and that economic dimensions of development should be considered along with continuous improvement of the overall quality of life. The author concludes that, although the decentralization trend is spread all over the world, the problem of inadequate evaluation of fiscal decentralization effects on development goals is evident and that there is no consensus on the effects of fiscal decentralization. The author concludes that the empirical results depend on the application of various indicators of fiscal decentralization and development goals used in the analysis. Therefore, the author *defines the research problem as a necessity to compare actual, empirically proved and theoretically expected positive effects of fiscal decentralization on development variables, taking into account the multi-dimensionality of the dependent and independent variables and the impact of control variables*. The author also emphasizes that the majority of authors of analysed empirical studies neither take into consideration potential endogeneity among researched variables, nor the different effects in short and long run.

In the first part of the dissertation, Introduction, the author presents description of the research problem, states purpose, emphasizes the theoretical and applicative goals of her thesis, describes research *hypotheses of dissertation*, potential contributions, presents research methods and provides a brief clarification of the dissertation structure.

Taking into consideration that decentralization is multidimensional process, *in the second part* of dissertation the author gives clear conceptual explanations of political, administrative and fiscal decentralization, and additionally of de-

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concentration, delegation and devolution, which are the different types of administrative decentralization. In order to give a framework for continued research, the author defines and analyzes the four most important aspects of fiscal relations between different levels of government, also known as the “four pillars of fiscal decentralization”. The second part of the dissertation concludes with the synthesis of the factors that might influence the differences in the degree of decentralization among countries and factors which are the basic prerequisites for the successful implementation of decentralization process.

In the third chapter, the author analyzes the most commonly used indicators of fiscal decentralization and emphasizes the problems in measuring decentralization. The focus is on comparison of available decentralization indicators relevant to the assessment and analysis of the various aspects of multidimensional process of fiscal decentralization in Croatia and 23 European OECD countries.

The fourth part of the dissertation presents a summary of systematic analysis of scientific literature which deals with the impact of fiscal decentralization on developmental variables. The author first summarizes the theoretical arguments for and against the implementation of the fiscal decentralization process, taking into consideration the economic and political dimension and afterwards systematically analyzes theoretical assumptions, relevant and recent empirical work focused on the research of fiscal decentralization impacts on the quality of governance, public sector size, living standard and economic growth.

The fifth part of the dissertation, entitled “Empirical research of fiscal decentralization impact on national development goals”, foremost elaborates the analytical framework, sample and methodological approach used in empirical research. In this part of the dissertation the author develops the models which analyze the direct impact of fiscal decentralization on development variables: perceptions about the effectiveness of governance and control of corruption, government spending (as percentage of GDP) and the living standard. The empirical analysis is done using the Arellano Bond (1991) generalized method of moments. The author emphasizes that chosen methodology is suitable for analyzing samples constructed with a small number of periods (T) and a small number of observation units (n), which caused a shortening of the data base on time period 2005-2012. The selection of methodology is logical because it is suitable for the analysis of the linear relationship, in which a dependent variable is dynamic (it depends on its own past values) and when the independent variables are not strictly exogenous. Additionally, the author explains the methodology selection by the fact that it allows control of the endogeneity problem and that it enables distinction between the short run and long run effects of decentralization on the dependent variables. The empirical analysis proves that decentralization results in better perception of government effectiveness and control of corruption, and that decentralized provision and financing of public services allows the improvement of living standards in the short term. Indicators of fiscal decentralization have had the expected impact on all development variables, except the size of the government (the share of government

spending in GDP). The second hypothesis which assumes that fiscal decentralization reduces the size of the government (in the literature also known as Leviathan hypothesis) is rejected. In the short term all indicators of fiscal decentralization show a significant and positive impact on the variable size of the government, measured by the share of public spending in GDP, noting that the analyzed period covers the period of the last global economic crisis. These empirical results provide further support to the author's assumption of the existence of indirect effects of decentralization on economic growth, which is analyzed in the sixth part of the dissertation.

The sixth chapter of the dissertation is focused on the analysis of fiscal decentralization effects on economic growth. Initially, the author sets an empirical model that analyzes the direct effects of fiscal decentralization on economic growth. The author has made a systematic review of empirical studies which deal with the impact of fiscal decentralization on economic growth directly, and afterwards the literature review that analyzes the impact of development variables: the quality of governance, living standards and the size of the public sector on economic growth, which has been the basis for the development of an original model that assumes indirect impact of fiscal decentralization on economic growth. As it has been hypothesized, the results of econometric analysis show that all indicators of fiscal decentralization, except indicator which represents the share of sub-national spending funded by grants, demonstrate the positive direct impact of decentralization on economic growth. It is particularly important to point out that the empirical analysis confirms the assumed positive indirect impact of fiscal decentralization on economic growth through the indirect transmission channels, in the short run and in the long run (only the indicator of the size of the government is not significant in the long run).

The conclusion of this dissertation systematically represents the results of theoretical and empirical research and the answers to the questions posed in the introductory part of the dissertation. In addition, the limitations of the research and perspectives for the future research work are pointed out.

The main contribution of this dissertation is the estimation of the positive direct impact of fiscal decentralization on developmental goals, peculiarly the estimation of indirect impact of fiscal decentralization on economic growth, through the transmission channels, which is original approach to the corresponding research issues. In conclusion, the empirical part of the dissertation rejects Leviathan hypothesis and shows deviation from the theoretically assumed effects of fiscal decentralization on reducing the size of the public sector. The empirical finding is that decentralization affects the increase in the share of public spending in GDP, but also that such an effect has had a positive impact on economic growth in the short term, which means that pressures on public sector reform with the main aim of reducing public spending is not always good, especially in times of economic crisis.

These research results have to be emphasized regarding actual crisis in the EU and especially in Croatia which has been in recession i.e. stagnation for sixth

consecutive years. Austerity measures are often suggested and taken as a mainstream policy concept for (post)transition economies. In Croatia, such measures prejudice decentralization efforts and reduce productive public spending. Local government in Croatia have larger ratio of productive expenditures so further fiscal decentralization would, most likely, support economic growth and development. The research results can offer suggestion for policy makers: public sector reforms regarding local government should avoid a decrease of local (productive) expenditures in order to ensure a positive economic potential.

Extensive literature review given in the fourth and sixth part of dissertation expands scientific knowledge on fiscal decentralization and its potential effects, given the conceptual demarcation and systematization of previous theoretical knowledge about the investigated variables. In the empirical parts of the dissertation the author takes into consideration the dynamic nature of development variables, potential endogeneity problems among the analyzed variables and the differences in the impact in the short and long run.

This dissertation also opens numerous theoretical, empirical and methodological issues which should be taken into consideration in further research. Such an approach allows comparison of theoretical assumptions of the positive effects of fiscal decentralization with its actual effect on developmental variables. The author lists limitations of the research as well. Although the literature emphasizes the importance of fiscal and expenditure autonomy indicators for lower levels of government, a basic lack of systematic analysis is the availability of data. Standard indicators of decentralization are most commonly used in empirical studies, due to the availability in time and spatial coverage. Unfortunately, they do not distinguish between the own local revenues and revenues generated by sharing among different levels of government or between the own local consumption, about which local units decide independently, and consumption which is determined by the central government. Therefore, the author highlights the need to develop more accurate indicators of fiscal decentralization, focusing on indicators of fiscal autonomy of lower levels of government and to create the database that will enable and facilitate further empirical analysis.

The contribution of this doctoral dissertation is not just in fact that it adds important empirical proof of positive direct and indirect effect of fiscal decentralization on developmental goals. It also facilitates the achievement of operational objectives which aim to create a starting base for the relevant institutions in the strategic and operational guidelines for the implementation and application of decentralization reforms.

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