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## Divided We Fall. Conflicts of Interests Regarding Fiscal Discipline in Municipal Hierarchies

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Working Paper 2013:42

Department of Economics  
School of Economics and Management

# Divided We Fall. Conflicts of Interests Regarding Fiscal Discipline in Municipal Hierarchies

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# Divided we fall. Conflicts of interests regarding fiscal discipline in municipal hierarchies.

Lina Maria Ellegård\*

December 4, 2013

## Abstract

Persistent budget deficits are commonly blamed on irresponsible governments. However, even if the government is fiscally responsible, the agents in charge of implementing the budget may be less concerned about fiscal discipline. According to the survey data analyzed in this paper, such conflicts of interests are associated with low fiscal performance and prevail in almost half of the Swedish municipalities. The empirical analysis points at some organizational features that may affect the prevalence of conflicts, and also indicates that conflicts may arise for reasons exogenous to the organization.

## 1 Introduction

The recent fiscal crises experienced by some European countries and by several U.S. municipalities highlight the importance of understanding causes and remedies for fiscal indiscipline, i.e. excessive spending and budget deficits. It has long been suggested that fiscal indiscipline may arise if the political system provides incentives for irresponsible behavior on part of the government (e.g Nordhaus, 1975; Rogoff, 1990; Tabellini and Alesina, 1990; Persson and Svensson, 1989). However, even if the government itself is prudent, fiscal discipline may be undermined if the agents in charge of policy implementation are less responsible. After all, the submission and approval of a balanced budget is only a prerequisite for fiscal discipline; the actual outcome is determined during the fiscal year, when policy is implemented by a multiplicity of ministries, authorities and street-level bureaucrats further down in the governmental hierarchy. As long as policy is not exclusively rule-based, the implementing agents have the opportunity to affect fiscal outcomes (von Hagen and Harden, 1996).

One reason why fiscal indiscipline may arise during the implementation stage relates to fact that agents at the lower hierarchical level are responsible only for sub-fields of policy. If the subdivisions care particularly much for their own policy fields, they may consider fiscal discipline to be the responsibility of other parts of the organization and thus pay little

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attention to their own, as well the overall, budget constraint. Policy-biased subdivisions may moreover have incentives to engage in excessive spending, as each subdivision enjoys all the benefits from spending on its field but does not fully internalize the costs, which are partly borne by taxpayers that the subdivision does not care directly about (cf. Weingast et al., 1981; von Hagen and Harden, 1995).

These arguments beg the question of whether and why agents at the lower hierarchical level are biased towards their own policy fields. Non-political agents, i.e. bureaucrats, often display a special interest in their own field (Prendergast, 2007; Brehm and Gates, 1997; Lipsky, 1980). Likewise, some political scientists have argued that standing committee members are biased in relation to the policy preferences of the legislature as a whole, because of self-selection into committees according to field of interest (e.g. Weingast and Marshall, 1988; Shepsle and Weingast, 1987). The view that committees are biased is not uncontested, however. Gilligan and Krehbiel (1990) argue that the main reason why legislatures delegate authority to committees is to enhance the flow of information upwards in the hierarchy. From this perspective, the legislature would be irrational if it appointed politicians with extreme preferences as committee representatives, as such politicians would likely manipulate the flow of information to their own advantage.

Empirical studies of the U.S. congress and state legislatures give support for both arguments, as committee bias appears to prevail in some but not all committees (e.g. Battista, 2006; Overby et al., 2004; Frisch and Kelly, 2004; Londregan and Snyder, 1994). Though it certainly would be preferable to be able to conclude that committees are perfect agents of the legislature, the fact that committee bias varies between contexts is hopeful insofar as it suggests that bias is not written in stone. For the centrally placed principal, the natural question is then how a currently biased lower hierarchical level can be influenced to adopt a more holistic view. In the present paper, I address this question using unique survey data from the Swedish municipalities. The survey contains a direct measure of conflicts of interests between the two levels of hierarchy with regards to the importance of fiscal discipline; by definition, such conflicts of interests can only prevail if the agents at the lower level are biased in relation to the preferences of the center. Additional data allows me to examine how organizational practices and features correlate with the prevalence of conflicts of interests, which may give some clues about how the central level can mitigate committee bias.

The municipalities play an important role in the Swedish welfare state: they are responsible for the financing and provision of public services such as schooling and elderly care, and their total level of spending amounts to about 14 percent of GDP. Though they all operate in the same broad institutional context and have the same areas of responsibility, the municipalities have large freedom in organizing their services. The municipal context thus provides variation to study, while limiting the institutional heterogeneity plaguing cross-country studies.

The center of the municipal hierarchy comprises a directly elected council and an executive committee (appointed by the council), while the lower level of hierarchy comprises

a set of standing committees, henceforth referred to as local committees.<sup>1</sup> According to the survey, committee bias is a concern to a varying degree: roughly half of the survey respondents report that the two levels of hierarchy have differing views on the importance of fiscal discipline. Where there are such conflicts of interests, the center is, as expected, the one that assigns greater importance to fiscal discipline. With regards to actual fiscal performance, it may be noted that the municipalities reporting a conflict of interests have lower operating surpluses and higher costs (Dietrichson and Ellegård, 2013b).

The empirical analysis offers some tentative suggestions for municipalities striving to eliminate committee bias in order to promote fiscal discipline: conflicts of interests are *less* common in municipalities where the local committees are chaired by members of the executive committee, and *more* common in municipalities with a relatively fragmented committee structure. Notably, these organizational features are under the discretion of the centrally placed politicians. I also find that the conflicts are more likely to appear in conjunction with deteriorations in the general economic conditions of the municipality. This finding can be understood as reflective of a 'war of attrition', i.e. that local committees try to shift the burden of fiscal adjustment onto other parts of the organization (Alesina and Drazen, 1991). As economic conditions are exogenous and some delegation of policy implementation is inevitable, it may be difficult to fully eliminate this latter mechanism by organizational redesign. Thus, it seems that a prudent principal also needs enforcement mechanisms to restrain the agents at the lower hierarchical level.

The next section describes the municipalities' responsibilities and organizational structure. Section 3 provides the empirical hypotheses, while the data and econometric model are presented in section 4. The estimation results are presented in section 5 and discussed in section 6. Section 7 concludes.

## 2 Institutional background

The 290 municipalities, Sweden's third layer of government, are responsible for the financing and delivery of several important public services such as pre- to upper secondary education, elderly care, social services, building and planning issues, environmental protection, and fire department services. Service provision is mostly financed by a proportional income tax, with the tax rate set freely by each municipality. Intergovernmental grants and fees are other sources of funding.<sup>2</sup>

According to Swedish legislation,<sup>3</sup> each municipality must have a council and an executive committee. The council is appointed in general elections, and the executive committee is appointed by the council. The executive committee can be thought of as the municipal analogue of a national government, with the distinction that the distribution of committee

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<sup>1</sup>The relation between politicians and bureaucrats is not directly studied in this paper, though I recognize that bureaucrats can play a crucial role in the determination of conflicts.

<sup>2</sup>In 2010, tax receipts made up about two thirds of total revenues; general intergovernmental grants made up about 12 percent and fees and directed grants approximately 20 percent (Statistics Sweden, 2010).

<sup>3</sup>*Kommunallag* 1991:900

seats between parties mirrors the distribution of seats in the council. Despite that most parties are represented in the executive committees, there is usually a stable coalition of parties forming a majority, thus in practice functioning as the governing coalition (or party, in case of single-party majority) of the municipality. It is the responsibility of the executive committee to prepare a budget proposal, which is to be approved by the municipal council; the budget will thus reflect the policy preferences of the parties collecting a majority of votes.

Although all municipalities have the same fundamental responsibilities, the principle of municipal self-government, written into Sweden's constitutional laws, implies considerable freedom to choose how activities should be organized and financed (Berlin and Carlström, 2003). Most municipalities employ a hierarchic organization with the executive committee at the top and several local committees at the lower level. Local committees are generally defined by policy area, though a few municipalities define committees by geography. At the very least, each municipality must have two committees in addition to the executive committee: an election committee and a chief guardian committee.

The local committees consist of politicians appointed by the council. Committee members may, but are not required to be, members of the the municipal council. It is not uncommon that the central level is directly represented in the local committees: in 2010, members of the executive committee chaired the local committees three out of four municipalities.

### 3 Determinants of inter-level conflicts

To understand the circumstances under which the local committees are less concerned about fiscal discipline than the center is, a fruitful starting point is to consider factors that may affect the local committee's bias towards their own policy area – that is, their policy bias from the viewpoint of the council and the executive committee. This is partly because such bias is a necessary condition for conflicts of interests in general (and regarding fiscal discipline in particular), and partly because such bias implies an incentive for excessive spending. There are at least two reasons why local committee representatives may be biased towards their own policy areas. *First*, politicians may self-select into committees according to field of interest (e.g. Weingast and Marshall, 1988; Shepsle and Weingast, 1987). *Second*, even if newly appointed local committee members initially are unbiased, the bureaucrats operating in their policy field may influence their view of optimal policy (Wildavsky, 1975; Niskanen, 1971). It is generally accepted that bureaucrats self-select into agencies that they are particularly interested in (Prendergast, 2007; Brehm and Gates, 1997; Lipsky, 1980), and the possibility to influence politicians has been argued to be an important reason behind the over-representation of policy-motivated agents in bureaucracy (Gailmard and Patty, 2007; Gailmard, 2010).

Nonetheless, as pointed out by Gilligan and Krehbiel (1990), the legislature (here, the council) should be able to use its appointment authority to counteract tendencies for bias. For instance, by appointing members of the executive committee as chair persons for the

local committees, the center's opinion can be advocated directly at the local committees' meetings. When the chair has one foot at each hierarchical level, the possible influence from local-level bureaucrats is moreover balanced by influence from bureaucrats at the center.

*Hypothesis 1: Inter-level conflicts of interests regarding fiscal discipline are less likely when members of the executive committee chair the local committees.*

The hypothesis may appear trivially true, as the appointment of central-level agents as chairs implies that the center's view gets more representation at the local level. Still, just because the center ensures more representation by appointing a central-level player as chair, it does not mean that the chair manages to influence the other committee members. It is thus interesting to examine the hypothesis empirically.

Previous research on national governments suggests that fiscal discipline is sensitive to the number of spending ministries, i.e. the size of the cabinet (e.g. Perotti and Kontopoulos, 2002; Schaltegger and Feld, 2009; Wehner, 2010). A proposed explanation is that each ministry fails to internalize the full costs of spending on its policy area, as some of the costs are borne by individuals for whom the ministry is not particularly concerned. This externality induces excessive spending (and deficits, in a dynamic context). The larger the number of ministries, the narrower is each ministry's policy field and the smaller is thus the population share for which each ministry cares about – that is, the more aggravated is this *fiscal common pool problem* (see e.g. Weingast et al., 1981; von Hagen and Harden, 1995). The same line of reasoning can be applied to the municipal context, where the number of local committees correspond to the number of ministries.

*Hypothesis 2. Conflicts of interests regarding fiscal discipline are less strong in municipalities with fewer local committees.*

Of course, Hypothesis 2 can only be true if the local committees *may* be policy biased, i.e. if they are not always the rationally appointed unbiased agents hypothesized by Gilligan and Krehbiel (1990). This remark suggests that the chosen committee structure may be endogenous: perhaps the governing majority only chooses to use a heavily specialized committee structure (i.e. a lot of committees) in case it has confidence in its ability to appoint unbiased representatives to the committees. If so, there should be no relation between conflicts of interests and the number of committees.<sup>4</sup>

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<sup>4</sup>In a study of Norwegian municipalities, Hagen and Vabo (2005) find that municipalities that have one committee for each bureaucratic agency have higher operating surpluses than municipalities where the committee structure is not parallel to the bureaucratic structure. Hagen and Vabo interpret their finding as supportive of Gilligan and Krehbiel's argument: a specialized (i.e. parallel) committee structure allows the central level to extract informational gains, which translate into a higher surplus. Evidently, this informational advantage is not fully overturned by policy biased committee representatives. Note that Hagen and Vabo's finding does not reject the validity of Hypothesis 2. The effect of a more specialized committee structure (which supposedly implies a larger number of committees) on fiscal performance (the

The fiscal common pool problem has earlier been brought up in comparative studies of single-party majority governments and coalition governments. In this case, the externality arises because each coalition party only internalizes the part of the costs for spending that fall on its own voters. Though the empirical literature is inconclusive about the relevance of the fiscal common pool problem in coalition governments (Roubini and Sachs, 1989; Edin and Ohlsson, 1991; Persson et al., 2007; Freier and Odendahl, 2012), the possibility of such a problem suggests that the number of parties in the governing majority may be negatively correlated to the likelihood of an *inter-level* conflict about the importance of fiscal discipline: with more parties in the governing coalition, the central level is itself more likely to be fiscally indisciplined; thus, there is no breeding ground for an *inter-level* conflict about the importance of fiscal discipline.

*Hypothesis 3. Conflicts of interests regarding fiscal discipline are less likely when there are more parties in the governing majority.*

The opposite relation can also be advocated, though. In a coalition, several parties share the authority to appoint committee representatives. If the coalition parties engage in strategic trading of appointments to different committees (c.f Weingast and Marshall, 1988), committees consisting of preference outliers may well be the outcome. An alternative hypothesis to H3 is therefore that more parties in the governing coalition leads to more room for inter-level conflicts.

It seems plausible to conjecture that the broader economic environment affects the probability of conflicts of interests within the municipal hierarchy. Specifically, conflicts of interests may be activated if the general economic conditions deteriorate and the municipality has to make fiscal adjustments to retain budgetary balance. Alesina and Drazen (1991) argue that although a collective would gain from rapid fiscal adjustments, adjustments may be delayed because different groups try to shift the burden of adjustment onto each other.<sup>5</sup> The idea of such a "war of attrition" can be straightforwardly applied to the case of local committees (again given that committees *may* be biased towards their own fields). In bad times, each local committee continues with business as usual and argues that the required spending cuts should be shifted onto other policy fields. Thereby, the executive committee appears more concerned for fiscal discipline than the local committees.<sup>6</sup>

*Hypothesis 4. Conflicts of interests regarding fiscal discipline are more likely when the general economic conditions deteriorate.*

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outcome in Hagen and Vabo's study) is the sum of two counteracting effects: a positive effect due to better the informational flow in a more specialized structure and a negative effect due to the common pool problem.

<sup>5</sup>See also Alesina et al. (1998, 2006).

<sup>6</sup>See Fabrizio and Mody (2010) for an empirical analysis in similar spirit.



## 4 Data and econometric specification

### 4.1 Dependent variable

There are several ways to measure inter-level conflicts of interests. Previous studies (e.g. Battista, 2006) use opinion polls of individual legislators to compare committee members' opinions to the preferences of the legislature as a whole. With regards to the specific issue of fiscal discipline, another possibility is to use a measure of fiscal performance, e.g. the budget deficit, as a proxy variable for inter-level conflicts of interests. However, low fiscal performance reflects many other factors than inter-level conflicts. In particular, it is impossible to disentangle the contribution from inter-level conflicts of interests from the contribution of bad luck or from low ambitions on part of the central level itself. Instead, I use data from a survey sent to the budget managers in all 290 municipalities in June 2010 (see Dietrichson and Ellegård, 2013b, for further documentation of the survey). Each respondent was asked to indicate which situation that best described its municipality:

1. the executive committee and the municipal council are more concerned about fiscal discipline<sup>7</sup> than local committees;
2. the executive committee, the municipal council and the local committees do not differ significantly in their concerns for fiscal discipline;
3. local committees are more concerned about fiscal discipline than the executive committee and the municipal council.

According to the survey responses, politicians at the central level are in general more concerned about fiscal discipline than local politicians: of the 239 respondents, 56 percent indicate alternative 1 and only two indicate alternative 3. In the following analysis, I use a dummy variable,  $ci$ , which equals 1 if the executive committee and municipal council are more concerned about fiscal discipline (alternative 1) and 0 otherwise.

There are always reasons to be sceptic about the informational quality of subjective judgements. It may however be noted that the budget managers likely are the most reliable source of information about inter-level conflicts of interests, given their active role in the budget process and their close contact with committees and administrations during the fiscal year. It should also be emphasized that the survey question does not invite the budget managers to answer strategically (e.g. to put themselves in a better light), as the question refers to other people's preferences. Moreover, a study of fiscal performance in 2010 (see Dietrichson and Ellegård, 2013b) showed that operating surpluses were lower and costs higher in municipalities where the two levels of hierarchy had earlier been reported to disagree about the importance of fiscal discipline ( $ci=1$ ); this finding may be interpreted as an indication that the survey question does indeed pick up inter-level conflicts of interests

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<sup>7</sup>The translation of the Swedish survey question into English is not perfect, the question uses an idiom ("en ekonomi i balans") in use in the municipalities. Though the idiom does not literally translate as "fiscal discipline", this term conveys the meaning of the idiom better than the literal translation ("a balanced economy").

that worsen fiscal performance. However, an alternative interpretation is that budget managers in low-performing municipalities attribute their fiscal performance to an inter-level conflict, despite that the high costs and low surpluses are explained by other factors. In the estimations below, I perform some additional checks to further examine the adequacy of the measure.

51 budget managers (18 percent) did not respond to the survey question.<sup>8</sup> Reassuringly, the municipalities for which conflict data is missing are similar to the other municipalities in most observable dimensions. An exception is that they tend to be rather small: information on *ci* is missing for 20 of the 75 municipalities with fewer than 10 000 inhabitants (27 percent), as opposed to 31 of the 215 municipalities with larger populations (14 percent).

## 4.2 Independent variables

Appendix Tables 3 and 4 displays the definitions and summary statistics of the variables used in the analysis. With respect to Hypothesis 1, *LocalExecutive* is a dummy variable indicating whether or not the chair person of each local committee also is a member of the executive committee. The variable derives from the same survey as *ci*. Executive committee members chaired the local committees in three quarters of the (responding) municipalities in 2010.<sup>9</sup>

To examine Hypothesis 2 and 3, I use information from Statistics Sweden on the number of local *committees* of each municipality and the number of parties constituting the majority coalition (*majsize*). *committees* is measured in 2007 – that is, before the survey was sent out – and *majsize* refers to the situation during the mandate period ending in September 2010.

All municipalities have at least 4 committees and the maximum number of committees is 42. Only 4 municipalities, among them the two largest cities, have more than 25 committees though. As larger municipalities have good reasons to delegate the implementation to a larger number of committees than smaller municipalities, I control for *population* in the estimations.<sup>10</sup> Population size may also be related to the probability of conflict for reasons unrelated to the number of committees. All else equal, economies of scale in the production of municipal services may imply more slack in the organization and thus less reason for conflicts to arise. In addition, the larger distance between politicians and citizens in larger municipalities may make it easier to implement fiscal adjustments.

To examine Hypothesis 4, I include a set of variables capturing the general economic conditions of the municipality. These variables reflect the possibility to raise revenues and the demand for municipal services. The level and change (between 2007 and 2009) of taxable income per capita in thousands of SEK (*taxbase* and *taxbase0709*) relate mostly to the revenue side, while the level and change in employment rate (*employment* and *employment0709*) captures the possibility to raise revenues as well as the need for social

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<sup>8</sup>The overall response rate to the survey was 91 percent.

<sup>9</sup>Unfortunately, I do not have a measure of to which extent the local committee members are seated in the municipal council.

<sup>10</sup>Indeed, the two largest cities, Stockholm and Göteborg, have the largest numbers of committees.

assistance transfers. For the differenced variables, the change between 2007 and 2009 is chosen to capture the economic downturn starting in 2008. I also include the level and change (between 2004 and 2009) of the population share in working ages (i.e. 20-64, *WorkingAge* and *WorkingAge0409*).<sup>11</sup> A larger share of working-aged implies lower demand for the municipalities services, which are mainly used by children and elderly. Lastly, I include the level and change (between 2004 and 2009) of grants from the intergovernmental equalization system (*cggrants* and *cggrants0409*), which is supposed to compensate for changes in need.

### 4.3 Econometric specification

I estimate the following linear probability model using OLS with robust standard errors:

$$ci_i = \alpha + \beta \times \mathbf{fragmentation}_i + \gamma \times \mathbf{economic}_i + \theta \times \mathit{population} + \varepsilon_i \quad (1)$$

**fragmentation** is a vector including the variables related to the fragmentation of the organization (i.e. the variables related to Hypothesis 1-3: *LocalExecutive*, *committees* and *majsize*), and **economic** is a vector of variables capturing the economic conditions of the municipality (Hypothesis 4).

As a sensitivity check, I have also estimated probit specifications. The probit model is specially designed to handle binary outcome variables, however at the cost of stronger distributional assumptions (Cameron and Trivedi, 2005). As the probit estimates are similar to the linear probability estimates, I only display the latter.

## 5 Results

Column 1 of Table 1 shows the estimates from a specification including only the variables capturing fragmentation and population size. The estimates are consistent with Hypotheses 1 and 2, as the coefficients on *LocalExecutive* and *committees* are of the expected sign and statistically significant. Hypothesis 3 receives no support, as the coefficient on *majsize* is positive and statistically insignificant. As suspected, conflicts of interests are negatively related to population size.

In column 2, I instead include only the economic variables and population size. While some of the differenced variables are significant at the 10 percent level, the economic variables in levels are all far from significant. I then enter the levelled and differenced variables in separate regressions, and find that the F statistic of the model as a whole is markedly higher in the estimation including only the differenced variables; moreover, three out of the four differenced variables become statistically significant at the 10 percent level or less (column 3).<sup>12</sup> Municipalities experiencing a stronger growth in employment

<sup>11</sup>Demographic changes are more likely to be interpreted as trends (as opposed to noise), the longer they have continued. Therefore, I use the five-year change between 2004 and 2009 instead of the change between 2007 and 2009.

<sup>12</sup>Notably, the F test of joint significance of included variables is far from significant in the specification including only the variables in levels.

between 2007 and 2009 – that is, municipalities less hit by the economic downturn starting in 2008 – are less likely to report conflicts; similarly, relatively large increases in the share of working-aged (*WorkingAge0409*) are less likely to report conflicts. Interestingly, growth in the amount of grants from the intergovernmental equalization system is positively related to the probability of conflict. While it appears unintuitive that conflicts would become more intense when revenues in fact increase, the finding may reflect that the equalization system does not completely compensate for growth in structural disadvantages (such as population ageing) – that is, according to the local committees.

Column 4 reports the results from the full model, including both the fragmentation variables and the differenced economic variables. The results are similar to those in the partial models, though the standard errors of *employment0709* and *WorkingAge0409* increase somewhat.<sup>13</sup> Before drawing conclusions, there are however reasons to go deeper into some of the results. In particular, Hypothesis 2 deserves further discussion. The reason is that the variation in *committees* in large part derives from a handful of municipalities with an usually large number of committees: recall that only four observations have more than 25 committees. Column 5 shows that the results are somewhat sensitive to the removal of these observations. Though the estimated coefficient on *committees* is more or less unchanged, it is now only significant at the 15 percent level of significance, i.e. above conventional thresholds.

This sensitivity does not obviously mean that Hypothesis 2 should be rejected. It is of course no surprise that the statistical significance of a variable decreases when observations that increase its variance are removed. Moreover, the difference between columns 4 and 5 may simply indicate that the relation between the number of committees and the likelihood of conflict is non-linear. Most importantly, the relationship between *committees* and *ci* is robust to exclusion of the four outliers when the model is estimated on only relatively large municipalities (for which the response rate of *ci* is much higher). Table 2 shows the estimates for the sample excluding municipalities with fewer than 10 000 inhabitants. Column 1 of Table 2 corresponds to column 4 of Table 1, i.e. the estimates for the full model with no restriction on the number of committees.<sup>14</sup> The coefficients are similar to those in column 4 of Table 1; the only substantial difference is that *WorkingAge0409* is insignificant at conventional levels ( $p=0.153$ ). Column 2 of Table 2, which corresponds to column 5 of Table 1, shows that *committees* remains significant also when the four municipalities with more than 25 committees are excluded from the analysis.<sup>15</sup> It therefore seems reasonable

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<sup>13</sup>This appears to partly be explained by that the estimation samples in column 3 and 4 are slightly different (because of missing values on the fragmentation variables): running the specification in column 3 on only the 226 municipalities in the sample for the full model yields higher standard errors for the mentioned variables.

<sup>14</sup>215 municipalities have more than 10 000 inhabitants. Of these, 184 have responded to the survey question on *ci*; thus 11 have missing values on other variables, mainly on *majsize*. The estimated coefficients on the other variables are very similar when excluding *majsize* from the analysis, so I retain the full model from Table 1.

<sup>15</sup>When estimating the model on only municipalities with fewer than 20 committees, the coefficient on *committees* is very similar to that found in column 2, but the p-value increases to 0.125 – i.e. above, but

Table 1: Results; all municipalities

Variables	(1) Frag.	(2) Ec.	(3) Ec. diffs	(4) All	(5) <25
<i>LocalExecutive</i>	-0.181** (0.0766)			-0.190** (0.0760)	-0.186** (0.0763)
<i>committees</i>	0.0320*** (0.00967)			0.0276*** (0.00990)	0.0280 (0.0192)
<i>majsize</i>	0.0248 (0.0238)			0.0378 (0.0245)	0.0396 (0.0250)
<i>taxbase</i>		-0.000351 (0.00296)			
<i>taxbase0709</i>		-0.00207 (0.0250)	7.08e-05 (0.0221)	0.00235 (0.0232)	0.00135 (0.0233)
<i>employment</i>		0.00239 (0.0110)			
<i>employment0709</i>		-0.0415* (0.0249)	-0.0393* (0.0213)	-0.0395* (0.0220)	-0.0399* (0.0221)
<i>WorkingAge</i>		0.00183 (0.0201)			
<i>WorkingAge0409</i>		-0.0368 (0.0256)	-0.0378** (0.0190)	-0.0360* (0.0204)	-0.0386* (0.0205)
<i>cggrants</i>		-0.00139 (0.0129)			
<i>cggrants0409</i>		0.00354*** (0.00111)	0.00354*** (0.00109)	0.00296*** (0.00110)	0.00309*** (0.00111)
<i>population</i>	-0.00151*** (0.000434)	-0.000139 (0.000496)	-0.000132 (0.000383)	-0.00131*** (0.000447)	-0.00197 (0.00149)
Constant	0.333*** (0.115)	0.175 (1.877)	0.389** (0.164)	0.148 (0.202)	0.155 (0.238)
Observations	226	239	239	226	222
R-squared	0.048	0.028	0.028	0.071	0.058
F	4.832	2.262	4.125	5.178	3.574

Robust standard errors in parentheses. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Column 5 excludes observations with  $\geq 25$  committees.

Table 2: Results; municipalities with *population* > 10 000

Variables	(1) All	(2) <25	(3) Geo	(4) Proxies
<i>LocalExecutive</i>	-0.199** (0.0901)	-0.198** (0.0900)	-0.198** (0.0904)	-0.212** (0.0931)
<i>committees</i>	0.0320*** (0.0104)	0.0374* (0.0223)	0.0372* (0.0224)	0.0347*** (0.00980)
<i>majsize</i>	0.0319 (0.0288)	0.0353 (0.0292)	0.0348 (0.0293)	0.0354 (0.0303)
<i>taxbase0709</i>	0.00102 (0.0312)	-0.00223 (0.0315)	-0.00137 (0.0317)	0.00289 (0.0296)
<i>employment0709</i>	-0.0470* (0.0252)	-0.0478* (0.0253)	-0.0474* (0.0255)	-0.0517** (0.0239)
<i>WorkingAge0409</i>	-0.0391 (0.0272)	-0.0413 (0.0272)	-0.0421 (0.0274)	-0.0452* (0.0272)
<i>cggrants0409</i>	0.00260** (0.00121)	0.00270** (0.00122)	0.00275** (0.00123)	0.00265** (0.00113)
<i>population</i>	-0.00149*** (0.000479)	-0.00259 (0.00161)	-0.00279 (0.00170)	-0.00142*** (0.000443)
<i>geo</i>			0.103 (0.230)	
<i>consultant</i>				0.151* (0.0863)
<i>LTB</i>				0.138* (0.0767)
<i>bailout</i>				0.258** (0.115)
Constant	0.109 (0.265)	0.0928 (0.302)	0.0986 (0.303)	-0.117 (0.269)
Observations	173	169	169	171
R-squared	0.080	0.065	0.066	0.139
F	5.155	3.260	2.917	6.227

Robust standard errors in parentheses. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1  
Columns 2-3 excludes observations with  $\geq 25$  committees.

to interpret the data as consistent with Hypothesis 2, at least for larger municipalities.

The result for *committees* may capture more than the effect of increasing the number of committees, however. For instance, *committees* may also pick up the effect of using a geography-based, rather than sector-based, division of committees: a geographical division may mechanically entail more committees, as some services (e.g. garbage collection) will likely remain centralized.<sup>16</sup> In column 3, I therefore check whether the estimate for *com-*

not very far from, the 0.10 threshold. Notably, when the model is estimated on a sample consisting of only the 34 municipalities with more than 50 000 inhabitants but fewer than 20 committees, the coefficient on *committees* more than doubles in magnitude and is significant at the 10 percent level.

<sup>16</sup>In line with this interpretation, three of the four municipalities with more than 25 committees use a geographical division. However, two of these – Göteborg and Stockholm – are large enough to likely have had a lot of committees anyway. Apart from Stockholm and Göteborg, Malmö, Umeå, Västerås, Borås,

*mittees* changes when I include a dummy for geographical division *geo*. The estimate for *committees* does not appear to be overly sensitive to the inclusion of *geo*, which itself is far from significant ( $p=0.667$ ).<sup>17</sup>

A crucial aspect with regards to the interpretation of the results is that the dependent variable is reliable, i.e. that the measure manages to pick up conflicts of interests of substance. A feasible way to examine the reliability of *ci* is to check whether it is positively correlated to other variables that should correlate positively with the prevalence of inter-level conflicts of interests. To find such variables, I recall that inter-level conflicts of interests regarding fiscal discipline are expected to arise because the center is more concerned than the local committees, rather than because the local committees are more concerned than the center. This suggests that conflicts of interests are more likely in municipalities where the center cares a lot about fiscal discipline than in municipalities where the center cares little. Along these lines, column 4 of Table 2 shows the estimates from a model incorporating a set of proxies for the center's preferences for fiscal discipline. *consultant* is a dummy variable indicating that the municipality has bought consultant services from the Swedish Association of Local Authorities and Regions (SALAR) to get input on how to improve fiscal discipline. Obviously, there is no reason to buy such services if one is not interested in fiscal discipline (though the group of non-buyers also includes municipalities with similar interest in fiscal discipline, but less demand for consultant services). Almost a third of all municipalities bought such services during the first decade of the 21<sup>th</sup> century. The second proxy, *LTB*, is a dummy variable indicating that the long-term budget is viewed as an important commitment (according to the survey); the reference category ( $LTB=0$ ), which comprises about 40 percent of the observations, contains municipalities that either view the long-term plan as a projection only, or even ignore the statutory requirement to prepare a long-term budget. *LTB* arguably reflects the central level's planning horizon, a concept that connects closely to preferences for fiscal discipline: with a short planning horizon, there is no reason to care about budgetary balance.

I also include an indicator variable for the municipalities that received a conditional bailout from the central government at the beginning of the 21<sup>th</sup> century (*bailout*). Previous research suggest that these municipalities are, or at least have been, motivated to conduct a fiscally disciplined policy (SOU, 2003; Siverbo, 2004; Dietrichson and Ellegård, 2013a). The *bailout* variable is however not unambiguously indicative of higher-than-average concern for fiscal discipline. Obviously, many municipalities did not even apply for a bailout, simply because they did not need financial assistance. Thus, though the reference category  $bailout=0$  clearly contains relatively unmotivated municipalities, it also contains municipalities with a relatively large concern for fiscal discipline but little need for assistance. The main argument to include *bailout* is instead that the conditions attached to the bailout may have directly induced inter-level conflicts of interests. To receive the transfer from the

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Kalmar, Södertälje, Eskilstuna and Köping also had at least one committee based on geographical division.

<sup>17</sup>These conclusions do not depend on the specific estimation sample used in column 3. *geo* lacks importance also when adding the 4 outliers to the estimation sample as well as when adding the municipalities with fewer than 10 000 inhabitants.

central government, the municipalities first had to reduce their operating costs. Following these initial cost reductions, it seems likely that policy biased local bureaucrats intensified their pressure on local committees to call for more funds, which may have intensified the conflict of interests between the two hierarchical levels.

As shown in column 5, all three proxies are positively and significantly related to the probability of  $ci=1$  in the sample of larger municipalities. All proxies are still positive, but only *bailout* is significant when also the municipalities with fewer than 10 000 inhabitants are included in the estimation sample (not shown).<sup>18</sup> Though these findings do not prove that  $ci$  provides meaningful information on inter-level conflicts of interests, the results are at least consistent with what would be expected if  $ci$  is meaningful.

## 6 Discussion

The results can be summarized as follows. *First*, consistent with Hypothesis 1, conflicts are less common in municipalities where representatives from the executive committee are appointed as chairs of the local committees. In relation to the mean conflict rate of 55 percent, the estimates point at a 30-35 percent lower conflict risk in municipalities where *LocalExecutive*=1. *Second*, the data is consistent with Hypothesis 2, though not robustly so for small municipalities. At a given population size, the conflict risk increases with about 5 percent for each additional local committee; a one standard deviation increase in the number of local committees implies a 25 percent higher conflict risk. *Third*, contrary to what was expected from Hypothesis 3, the prevalence of inter-level conflicts is independent of the number of coalition parties in the governing majority. *Fourth*, consistent with Hypothesis 4, conflicts are more likely to appear in conjunction with shocks to the employment rate and the dependency ratio (proxied by equalization grants). However, none of the economic variables are correlated to the conflict risk when measured in levels.

It is highly plausible that conflicts of interests are less likely when executive committee members chair the local committees (Hypothesis 1). Furthermore, it is reassuring to find that the survey measure  $ci$  is correlated to a conceptually related but objective measure. The key concern about this finding is whether the estimated correlation follows trivially from the survey respondents conception of the local and executive committees: if the respondent in a municipality where *LocalExecutive*=1 has the same person (the chair) in mind when thinking about the two hierarchical levels, there is by definition no room for inter-level conflicts of interests. As the committees consist of more members than only the chair, it seems reasonable to interpret the result as more than trivial, though the estimated correlation of course does not prove that there is a direct causal link from *LocalExecutive* to  $ci$ .

With regards to fiscal discipline, it should be noted that the finding for *LocalExecutive* says nothing about which side that has to give in to resolve the conflict. The implications for fiscal discipline of *LocalExecutive*=1 are unclear, because a lack of conflict can reflect

<sup>18</sup>Of all 290 municipalities, 36 have *bailout*=1. 20 of these 36 have more than 10 000 inhabitants. Due to non-response to  $ci$ , one of the 20 is discarded in the estimation shown in column 4.



either that the two levels agree on the virtues of fiscal discipline (in which case the center is more influential), or that that neither cares (in which case the local committees are more influential).

The positive relation between *committees* and *ci* supports Hypothesis 2 and suggests that committees are more narrow-minded, and therefore perceive themselves as less responsible for fiscal discipline, the smaller is their area of responsibility. By contrast, in municipalities with relatively few – and therefore large – committees, local committee politicians recognize that their actions have implications for the municipality’s ability to retain fiscal discipline and internalize more of the costs when making spending decisions.

As for alternative interpretations of the result for *committees*, it should be noted that reverse causality is not a very plausible driver, *first*, because *ci* was measured three years after the committee structure was recorded, and *second*, because it would seem a more intuitive strategy to integrate the organization (i.e. reduce the number of committees) if the central level perceived that the local level was overly imprudent (i.e. if  $ci=1$ ). However, it cannot be ruled out that the correlation is driven by omitted factors correlated to both the committee structure and the level of conflicts.

Why is the correlation between *committees* and *ci* stronger in larger municipalities? One reason can be that in small municipalities (i.e. fewer than 10 000 inhabitants), the closeness between politicians and taxpayers make all politicians feel responsible for the whole municipality’s undertakings, regardless of the organizational structure. But it is also possible that the result relates to the larger non-response rate in smaller municipalities.

On grounds of the unexpected sign on *majsize*, it seems safe to reject Hypothesis 3. As can be recalled from section 3, the positive correlation between the number of parties in the majority and the likelihood of conflict may be explained by strategic trading during the appointment of committee members. It may be noted that the correlation is significant at the 15 percent level in some of the estimations. Rather than discarding the relation as irrelevant, it may therefore be worthy of future examinations.

The finding that conflicts are more common in municipalities where the employment rate has developed unfavorably can be understood as indicative of a "war of attrition", in which each local committee tries to protect its own area from the spending cuts necessitated by worsened conditions. Similarly, the significant positive relation between growth in equalization grants and the likelihood of conflict indicates that the additional grant revenues are not sufficient to compensate for the unfavourable demographic development – that is, according to the local committees.

When conflicts of interests arise as a consequence of the formal organizational structure, it is easy to see how they can be mitigated. It is arguably more difficult to prevent conflicts of interests that arise from deteriorations of the economic conditions, which are exogenous to the local government. The correlation between unfavourable economic conditions and conflicts instead suggests that the central level has to restrain the discretion of local-level agents to retain fiscal discipline in bad times. Previous research suggests that certain

features of the budget process, e.g. a relatively centralized process<sup>19</sup> or a comprehensive system of fiscal rules<sup>20</sup> can promote fiscal discipline, at least when applied to national governments or the local government itself. Dietrichson and Ellegård (2013b) draw similar conclusions for a set of rules and processes applied directly to local committees.

What about the insignificance of the economic variables in levels? Are the measured conflicts of interests really problematic for fiscal discipline, if they are not more common in municipalities that have structural disadvantages? Here, it should be noted that it is perfectly possible to run a balanced budget or even a surplus even with a relatively small tax base. Moreover, recall that  $ci$  is negatively related to fiscal performance according to Dietrichson and Ellegård (2013b).<sup>21</sup> Though the measured conflicts are unrelated to levels of some of the prerequisites for public spending, the conflicts thus seem relevant with respect to the fiscal performance of the municipality.

## 7 Concluding remarks

It should be emphasized that an inter-level conflict of interests does not *per se* lead to fiscal indiscipline; a conflict between the central level and the committees is merely a symptom that the organization possesses characteristics that may lead to fiscal problems. I have used this symptom to examine some possible ways to enhance fiscal discipline, but it should be stressed that the absence of inter-level conflicts does not imply absence of fiscal problems: both hierarchical levels may in principle agree on pursuing a fiscally irresponsible policy, just as they can agree on the virtues of fiscal responsibility.

For local governments that are firmly determined to conduct a fiscally responsible policy, the estimates give two tentative policy suggestions: *(i)* use the appointment authority to influence the local committees and *(ii)* minimize the number of local committees. Still, though the findings are consistent with a causal relation running from these factors to the likelihood of inter-level conflicts, it would be overly confident to argue that the present analysis establishes causality. The fact that conflicts of interests are more likely to arise when the general economic conditions of the municipality deteriorates moreover suggests that the center only has a limited ability to mitigate conflicts of interests. To retain fiscal discipline in bad times, the center of the municipality may therefore in addition want to restrict the discretion of the local committees.

Though the present study focuses on fiscal discipline, the analysis is also interesting in relation to the broader discussion of committee bias conducted in political science. It is especially notable that the very different measure of committee bias used here confirm previous findings that committees should not *ex ante* be assumed to be neither preference outliers nor perfect agents of the legislature (here: the council). To validate the analysis

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<sup>19</sup> von Hagen and Harden (1995); Perotti and Kontopoulos (2002); Hallerberg et al. (2007)

<sup>20</sup> Alt and Lowry (1994); Poterba (1994); Bohn and Inman (1996); Fabrizio and Mody (2006); Hallerberg et al. (2007); Debrun et al. (2008); Foremny (2011); Grigoli et al. (2012)

<sup>21</sup>The results in Dietrichson and Ellegård (2013b) are robust to the inclusion of the significant predictors of  $ci$  detected in the present paper.

in the present study, it would be interesting to replace the dependent variable with the kind of bias measures used by other authors, i.e. measures comparing the distribution of policy preferences of different committees to the preference distribution of the council as a whole. This is left as a topic for future research.

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## A Variable descriptions and summary statistics

Table 3: Variables

Variable name	Description
<i>ci</i>	conflict of interest in 2010 =1 if executive committee and council more concerned for fiscal discipline than local committees, 0 otherwise
<i>committees</i>	Number of local committees in 2007
<i>majsize</i>	Number of parties in the majority coalition
<i>LocalExecutive</i>	= 1 if chairs of local committees also are members of the executive committee, 0 otherwise
<i>population</i>	Population size/1000
<i>taxbase</i>	Taxable income per capita (KSEK)
<i>taxbase0709</i>	Percentage change in <i>taxbase</i> between 2007 and 2009
<i>employment</i>	Employment rate (population aged 20-64)
<i>employment0709</i>	Percentage change in <i>employment</i> between 2007 and 2009
<i>WorkingAge</i>	Share of population aged 20-64 (%)
<i>WorkingAge0409</i>	Percentage change in <i>WorkingAge</i> between 2004 and 2009
<i>cggrants</i>	Transfer from/to the redistribution system (KSEK per capita)
<i>cggrants0409</i>	Percentage change in <i>cggrants</i> between 2007 and 2009
<i>geo</i>	= 1 if at least 1 committee defined by geography = 0 if all committees defined by policy area
<i>consultant</i>	1 if municipality has bought consultant services from SALAR, 0 otherwise
<i>LTB</i>	=1 if the long-term budget viewed as directive or strong commitment =0 if the long-term budget is viewed as a forecast, or if the municipality
<i>baillout</i>	1 if municipality received conditional bailout in early 2000's, 0 otherwise



Table 4: Summary statistics, all municipalities

Variable	Mean	Std. Dev.	Min.	Max.	N
<i>ci</i>	0.535	0.5	0	1	226
<i>committees</i>	9.628	4.3	4	42	226
<i>majsize</i>	3.372	1.368	1	7	226
<i>LocalExecutive</i>	0.752	0.433	0	1	226
<i>population</i>	35.322	72.441	2.46	847.073	226
<i>taxbase</i>	163.697	20.701	129.988	313.423	226
<i>taxbase0709</i>	5.154	1.503	-0.912	9.005	226
<i>employment</i>	77.462	4.103	61.3	86.400	226
<i>employment_0709</i>	-4.289	1.604	-10.742	-0.943	226
<i>WorkingAge</i>	56.151	2.409	48.173	66.389	226
<i>WorkingAge0409</i>	-0.109	1.706	-5.256	5.46	226
<i>cggrants</i>	10.686	5.425	-11.077	26.213	226
<i>cggrants0409</i>	-0.532	10.537	-151.566	16.61	226
<i>geo</i>	0.035	0.185	0	1	226
<i>consultant</i>	0.336	0.473	0	1	226
<i>LTB</i>	0.536	0.5	0	1	224
<i>bailout</i>	0.128	0.335	0	1	226

Table 5: Summary statistics, municipalities with *population* > 10 000

Variable	Mean	Std. Dev.	Min.	Max.	N
<i>ci</i>	0.549	0.499	0	1	173
<i>committees</i>	10.462	4.535	4	42	173
<i>majsize</i>	3.387	1.37	1	7	173
<i>LocalExecutive</i>	0.78	0.415	0	1	173
<i>population</i>	44.028	80.86	10.053	847.073	173
<i>taxbase</i>	167.085	21.839	140.438	313.423	173
<i>taxbase0709</i>	5.163	1.286	1.947	9.005	173
<i>employment</i>	77.519	4.093	61.3	85.400	173
<i>employment_0709</i>	-4.229	1.633	-10.742	-0.943	173
<i>WorkingAge</i>	56.644	2.372	52.255	66.389	173
<i>WorkingAge0409</i>	-0.408	1.559	-5.256	3.951	173
<i>cggrants</i>	9.462	4.571	-11.077	23.237	173
<i>cggrants0409</i>	-0.769	12.016	-151.566	16.61	173
<i>geo</i>	0.046	0.211	0	1	173
<i>consultant</i>	0.289	0.455	0	1	173
<i>LTB</i>	0.602	0.491	0	1	171
<i>bailout</i>	0.11	0.314	0	1	173