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Income inequality, decentralisation, and regional development in Western Europe

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Devolution can have incongruous effects on equality. Decentralisation of powers and resources to lower tiers of government can either increase or reduce interpersonal inequalities, depending on characteristics of the devolved region. This column uses data from regions of Western Europe to show that greater fiscal decentralisation is associated with lower income inequality.

Devolution is a global trend, advocated by international organisations, including both the World Bank and the OECD, as a mechanism for achieving local prosperity. Decentralisation of powers and resources to lower tiers of government can – under different circumstances and in different contexts – contribute to *both* an increase and a reduction interpersonal inequalities.

Decentralisation can *reduce* interpersonal inequalities by:

- Exploiting the information advantage over central government and increasing the degree of efficiency in the allocation of resources, better matching to the preferences of local citizens.
- Bringing government closer to the people and providing better information about local preferences to inform the optimal mix of local policies.
- Promoting greater voice, transparency, and participation through enhanced accountability to local citizens.
- Limiting the opportunities for corruption and interest-group capture of the returns of public policies through greater transparency and accountability.
- Conversely, decentralisation can *increase* interpersonal inequalities in the following ways:
 - It weakens the capacity of central government to play an equalising role to achieve a balanced distribution of income through social and territorial transfers from the rich to the poor.
 - Diversity and variation in the availability and quality of public services between places generates unequal individual access and provision, regardless of preferences – in England, for instance, this is the so-called ‘postcode-lottery’ issue.

- Subnational institutions are likely to attract less skilled and capable officials and decision-makers and can be less efficient at policy design and delivery.
- Increasing social fragmentation and inequality can result if local vested interests are powerful and accountability is weak – a situation most likely to happen in less developed and less equal territories.

Whether decentralisation is good or bad for interpersonal inequality may be highly dependent upon the level of development of a territory. The reasons for this include:

- Poor territories with relatively greater needs face greater budget constraints than richer territories with relatively less need and intergovernmental grants can constitute the main source of local revenues. Greater decentralisation can curtail these equalisation transfers from richer to poorer areas and poorer places can end up with inadequate independent resources to tackle local inequality and develop meaningful fiscal autonomy.
- The greater capacity of richer local and regional authorities to rely on their own revenues means that they are often in a better shape to address inequality problems and a 'threshold level of economic development' exists at which fiscal decentralisation becomes attractive and more likely to deliver a reduction in inequality.

As a consequence, poorer areas can be argued to be limited in their ability to deliver greater interpersonal equality. Although when there are strong inefficiencies within a system and these are properly addressed by decentralisation processes and under-utilised resources are tapped, it may be the case that the efficiency gains may be greater in those areas where the inefficiencies were originally larger. If such efficiency gains are put to good use, interpersonal inequality would decrease faster in less developed than in more developed areas, although large institutional and capacity constraints may operate in an opposite direction.

Overall, little is known about the potential implications of decentralisation for interpersonal inequality. Hence the questions of whether decentralisation has an effect on within-region interpersonal inequality and whether this possible relationship is mediated by the level of local economic development remain open and have to be addressed from an empirical perspective. To date, with one or two exceptions (*eg* de Mello 2011, Sepúlveda and Martínez-Vázquez 2011), most attempts to measure the impact of devolution have focused on territories. Our [research](#) (Tselios *et al* 2011) focuses on its impact on *individuals* and, more specifically, on intraregional inequalities among individuals.

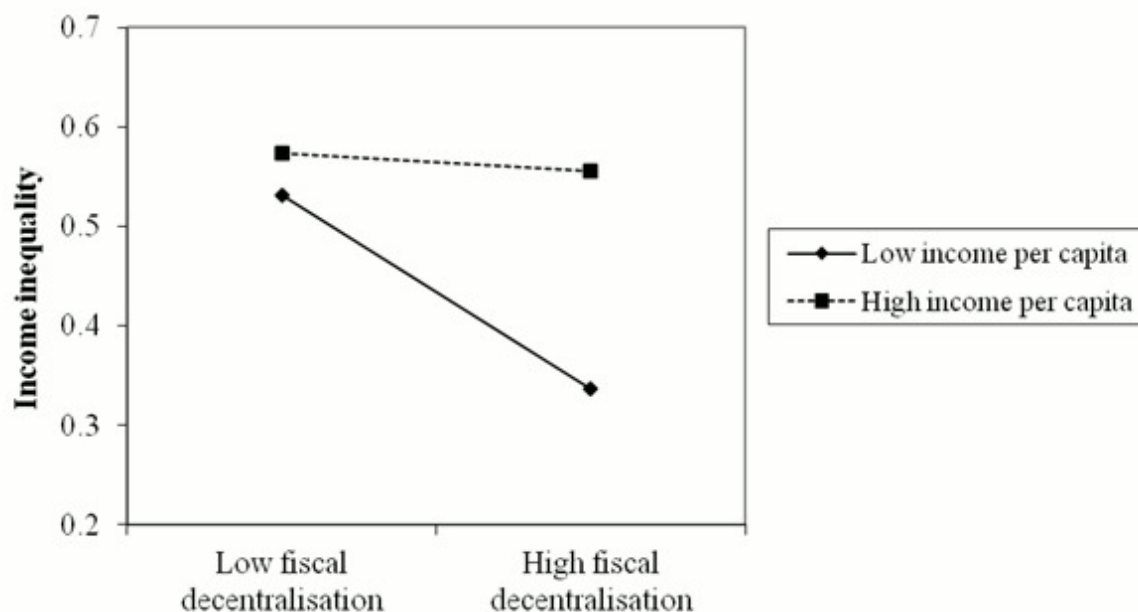
We use a moderated multiple regression analysis to examine whether regional

per-capita income intervenes in the relationship between fiscal and political decentralisation and income inequality within regions. In other words, we examine whether the magnitude of this relation varies across different development levels and then plot the relationship between decentralisation and income inequality at high and low levels of regional per-capita income.

Fiscal decentralisation and income inequality

The results of our analysis highlight that the influence of decentralisation on interpersonal inequality is much stronger than expected. Although the direction of the theoretical relationship between both factors was uncertain, our results demonstrate that greater fiscal – more than political – decentralisation is associated with lower income inequality. The results also suggest that this relationship is highly influenced by the level of development of the region to which authority and funds are being decentralised. Against the view that worse-off regions would be disadvantaged because of capacity and funding constraints, which could prevent them from effectively implementing policies which could reduce interpersonal inequality, it is precisely these less well-off regions which seem to be benefiting the most from the inequality-reducing effects of fiscal decentralisation processes. Our results do not show evidence of an identifiable threshold level because as income rises, further fiscal decentralisation is connected to a lower decrease in inequality, although the association between both factors remains negative (Figure 1). There appears to be potential, then, for particular kinds of decentralisation to address interpersonal income inequalities in specific contexts and this capability is influenced by overall levels of development (see also Tomaney *et al*, 2011).

Figure 1. Relationship between decentralisation and income inequality in low- and high-income regions



Policy implications

The findings suggest:

- Increased fiscal – more than political – decentralisation should be considered given its positive association with lower levels of income inequality.
- Less well-off regions in particular could benefit from the inequality-reducing effects of enhanced fiscal decentralisation.
- Consideration needs to be given to how further decentralisation might affect the high levels of inequality within already highly decentralised and high-income regions.

In contrast to the studies which have focused on aggregate outcomes of greater levels of autonomy on aggregate growth and on interterritorial disparities, the focus on the impacts of decentralisation on individuals creates a potentially richer and useful field for the study of the implications of changing the scales at which policies are implemented. If decentralisation is all about delivering better policies to individuals, looking precisely at those individuals may offer a more accurate evaluation of its outcomes.

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