

## THEORETICAL ANALYSIS OF THE FISCAL FEDERALISM

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### Abstract

Fiscal decentralization concept is highly discussed at various levels and aspects, and the Organization for Economic Co-operation and Development gives it an extreme attention as well as the World Bank. There is no complete overview of the sciences literature of the fiscal decentralization and economics of federalism and, even though scholarly interest in the topic has been increasing significantly over recent years. The fiscal federalism and decentralization sciences literature is grouped into two main groups: the first generation of theory and the second generation of theory. This research aim - critically analyse the fiscal federalism first and second generation theories. This article offers a critical and in-depth review and evaluation of the important elements of current knowledge and theoretical development of fiscal federalism and decentralization.

**Keywords:** fiscal federalism, fiscal decentralization, first generation of theories, second generation of theories.

**JEL Codes:** H3, H4, H7.

### Introduction

The theoretical issues on the decentralization questions are found in the 17th-19th century philosophers and politicians' such as Rousseau, Tocqueville, Mill, de Montesquieu and Madison works, when not relying on the central government, the less democratic government units were thought to be capable of providing basic human freedoms and rights

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(Faguet, 1997). In the second half of the 20th century, Western countries in order to reduce the long-term cumbersome and stagnant state government apparatus developed the theory of fiscal federalism. By using decentralization, the representatives of this theory were searching for ways to optimise the management of public finance. Even in the middle of the 20th century, fiscal federalism is included in public finance theories, which paved the way for the systematic analysis of the fiscal decentralization.

Fiscal federalism is basically a standard, rather than a positivist theory explaining "as it should be," instead of "why is that ". The theory of fiscal federalism (Tiebout, 1956; Musgrave, 1959) distinguishes between two public finance management levels - the central and local. The purpose of this theory is to determine at what level and what budget functions have been financed to achieve the set up targets at the lowest expenses. According to Musgrave (1959), who distinguishes two main reasons which are based on the theory of fiscal federalism, and may encourage financial centralisation- the pursuit of scale economy and external consequents beyond the countries' borders. Thus the public finance decentralization is more effective when dominated by large differences in the preferences of the citizens.

Scale economy can be achieved, by centralising the management of finance, when the threshold of "production" costs is decreasing, or the number of the users is increasing, herewith their obtained satisfaction grows (for example, network products). However, in this case, though, not necessarily, there is the loss of flexibility- the suggested "product" best meets the needs of the average consumer still the lack of diversity of supply appears. So, when citizens ' preferences are very heterogeneous, it is proposed to provide public services (and in most cases finance) on a decentralized basis. Finally, having external consequents crossed the countries' borders (to be more precise, air pollution or some cases of National Defence), if these consequents do not internalise or privately agree on their compensation, it is necessary to carry out centralized taxation/subsidy of the external consequents.

The main question relating to fiscal decentralization is the extent to which financial powers and responsibility should be transferred to the lower state management level. Researchers in this area have considerably increased, and scholars began to distinguish between the first and second generation of fiscal federalism theories. According to the Australian researcher Vo (2010), the theme of fiscal federalism is not as widely investigated as unemployment, inflation, foreign investment, interest

rates, exchange rates, however, the interest in this area is growing rapidly, with an average growth rate seeking 28%, and this theme is the second fastest growing among the mentioned above. Between of foreign and Lithuanian authors it is worth mentioning (Tiebout, 1956; Musgrave, 1959; Olson, 1969; Oates, 1972; Brennan, Buchanan, 1980; Brown, Jackson, 1990; Weingast, 1995; Seabright, 1996; Lockwood, 2002; Besley, Coate, 2003; Petchey, Levchenkova, 2003; Wagner, 2007; Prakash, 2015; Faggini, Parziale, 2016).

**The article object** – theories of fiscal federalism. **The aim of this article** is to critically analyse the theoretical aspect of the fiscal federalism first and second generation theories.

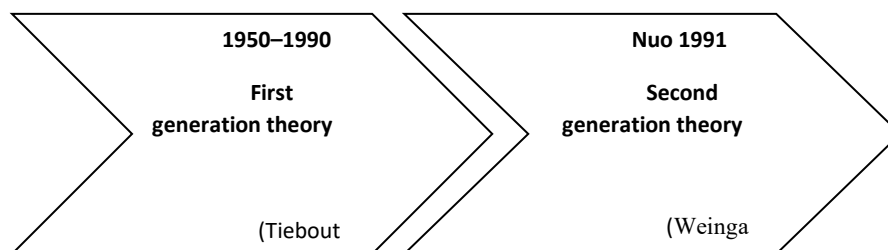
### **The Main Principles of Fiscal Federalism**

Fiscal decentralization is significant to the developing countries' economy in particular and is promoted through international institutions such as the World Bank (WB), the Organization for Economic Cooperation and Development (OECD). A number of scientific studies in the field of fiscal decentralization have been made, in order to systematically understand economic principles (Bird, 2004; Boadway, 2003; Collins, 2001; McLure, 1998). The following main principles of fiscal federalism are identified (Brown, Jackson, 1990; Slavinskaitė, 2014):

- *the principle of diversity*. The federal system should provide the ability to tax diversity procedures, taking into account the diversity of different countries and areas. The community may differ, and the provision of public services should not be performed according to the same model;
- *the principle of equivalence*. A spatial volume of different public services varies, for example, the benefit to all residents of the country is defence, to the residents of regions - it is road maintenance and construction, to local residents - it is the city's politics and street lighting. Fiscal measures would be really effective if each type of the service is assigned and implemented to the given area, which needs it the most;
- *the centralized principle of redistribution*. The redistribution function of fiscal policy must be centralized. Otherwise, the redistribution becomes ineffective and local decisions are distorted.

- *the principle of neutrality of the area.* Regional fiscal differences may interfere with the economic activity of the area. Small fiscal differences are unavoidable in fiscal federalism, but they have to be reduced. Differential taxes should be avoided as they distort the local government decisions;
- *the centralized principle of stabilisation.* Fiscal measures should be used at the national level that combines macro-politics (stabilization, growth) aims;
- *the control of the central government.* Decentralization is defined as the transfer of the central government functions to the local authorities, but the central government has to maintain a certain form of control and supervise the activities of the local government in spending, borrowing, taxes, budget, audit and other spheres;
- *the minimal most important public service provision.* The central government is to ensure each citizen minimum essential public services in health, safety, welfare, education and other spheres, no matter where the residence place of the member is;
- *fiscal position equalization.* This is the allocation of financial resources, in order to avoid the cost of public services and the local government revenue differences.

The evolution of the theories of fiscal federalism can be divided into two phases, the differences in content and extent, and the scientific works analysing the theoretical and practical aspects of fiscal decentralization, accordingly, are classified into two periods of fiscal decentralization analysis (Figure 1).



**Figure. 1.** First and second-generation theories of fiscal federalism

The first generation of the fiscal federalism theory (from 1950 till now) sought the efficiency of public services and strengthening of local government responsibility. The second theory of fiscal federalism (from

1980 to the present) is new and still not sustainable for the system analysis or is not well-known yet. Further on, the theoretical development of fiscal decentralization, distinguishing between the first and second generation of the theories of fiscal federalism, will be reviewed.

### **The first generation of the fiscal federalism**

The foundation of the first generation of the fiscal federalism theory was laid in the 1950s – 1960s by British and French colonial administrations, which were in the process of getting state independence, and transferred the responsibility of certain programmes implementation to the local authorities. This theory was created by the scholars Musgrave (1959), and Oates (1972) and developed as the public sector economy. The theory of fiscal federalism is focused on fiscal responsibility and distribution of public sector functions among various levels of the governmental public sector. According to Oates (1972), the theory of fiscal federalism is developed in line with the overall system for the allocation of the functions of various governmental levels accordingly distributing fiscal measures as appropriate, and carrying out these functions.

This theory provides the understanding of the tools and functions that would best work through centralisation or decentralization. The first generation of the theorists (Musgrave, 1959; Oates, 1972) tend to associate the fiscal decentralization process with the public degree of response, depending on the demand, and, finally, an increase in economic efficiency for better linking the allocation of resources with the needs of the citizens. Tiebout (1956), Musgrave (1959), Oates (1972), laid a solid basis for discussions on fiscal decentralization issues.

An important contribution to the theory of fiscal federalism made Olson (1969) by introducing the concept of "fiscal equalization". Brennan and Buchanan (1980) with their theoretical studies presented the public choice approach to various levels of the government and contributed with a new scientific publication "The Power to Tax in Analytical Foundations of a Fiscal Constitution" (table 1) to the replenishment of the scientific literature of the first generation of fiscal decentralisation.

**Table 1.** Researchers of the first generation theories of fiscal federalism

| <b>Author<br/>(year)</b>       | <b>Issue</b>  | <b>Contribution to the theory of fiscal federalism</b>  |
|--------------------------------|---|---|
| Tiebout<br>(1956)              | A Pure Theory<br>of Local<br>Expenditures   | For the first time defined the concept of "local public goods." He stated that the mobility of the citizens improves the efficiency of government expenditure, because each region offers different service packages and a variety of taxation.   |
| Musgrave<br>(1959)             | The Theory of<br>Public Finance –<br>A Study in<br>Public Economy   | He stated that the fiscal decentralization brings an efficient allocation of the resources. He has introduced three features of the government: the stabilisation of the economy, resources and the distribution of income. The stabilisation of the economy and income distribution must be centralized, and the allocation of resources is decentralized. |
| Olson<br>(1969)                | Principle of<br>fiscal<br>equivalence: the<br>division of<br>responsibilities<br>among different<br>levels of<br>government | Introduced the concept of "financial equalization". Stated that each common good has a certain limit, which is necessary for any government in order to avoid a competition among those who pay and those who receive the benefits of the collective good.  |
| Oates<br>(1972)                | Fiscal<br>Federalism  | Created decentralization theorem. He declared that welfare is maximized, when the specific public goods are provided by the local government whose jurisdiction corresponds to the subset of the country's citizens, and the demands for public goods and services are the same.  |
| Brennan,<br>Buchanan<br>(1980) | The Power to<br>Tax – Analytical<br>Foundations of a<br>Fiscal<br>Constitution  | Introduced the public choice approach to different levels of power. Stated that the fiscal decentralization reduces the size of the government and that the state's income and expenditure must be decentralized.   |

*Source:* Slavinskaitė 2015

The first Musgrave's (1959) book "The Theory of Public Finance" was the largest contribution as the textbook in the public field of

Economics. Musgrave (1959) introduced three different governmental functions: economic stabilization, income redistribution and allocation of resources. Each feature has been individually and sequentially analyzed. According to Musgrave (1959), specific perspectives of fiscal federalism are defined after establishing fiscal decentralization constraints (economic stabilization and redistribution of income) and evaluating the potential fiscal decentralization benefits (efficiency).

The first function of the government is economic stabilization. Fiscal and monetary policy can contribute to the stable development of the economy. The most important question is whether fiscal decentralization increases or reduces economic stability and general government macro-economic target compromises. This point was clearly expressed by the representatives of the first generation: fiscal decentralization does not help strengthen the objectives of the agreements in order to reach macro-stabilization goals. The transfer of powers from the central government to the local authorities has possible macro-stabilization constraints (Oates, 1972).

The second function of the government is the redistribution of income. The government usually produces economic goods and at the same time assumes the role to take part in the distribution of the goods among the members of the society and change the settings of the market. Taxes may be progressive, and welfare services may target lower-income members of the citizens. Thus, this shows that in fiscal decentralization there is no exact system to efficiently distribute social income because of the economic dependence between the jurisdictions of the local government which reduces the diversity of service provision existing among the lower-level authorities. With regard to the distribution income objective between the central and local government, income redistribution policies have greater success if carried out at the national level (Oates, 1972).

The third function of the government is the allocation of resources. Here, the first generation of fiscal federalism theorists stress the importance of fiscal decentralization and indicate two main reasons: first, the limited resources can be more efficiently allocated for the fiscal system being decentralized, because the local government can better know how to maximize the benefits of the use of resources in their areas. Secondly, goods of the local authorities apply the dimension for the provision of local services items, for which the central government is not ready. The result is that local government has the ability to play an important role in the effective allocation of resources in fiscal

decentralization. It is proposed to mobilise the allocation of resources in the region, in order to better serve and identify the heterogeneous preferences and tastes of the citizens.

So the first generation of fiscal federalism theory, taking into account Musgrave (1959) in particular, stresses that public economic goods are related to the effective allocation of resources. The theory of public finance has links with the stabilisation of the economy (that is, to maintain a high level of employment and a stable price level) and the distribution of income (both to achieve horizontal and vertical justice in all jurisdictions, in order to avoid inefficiency and mobility of households and enterprises). Public finance theory is considered to be the first generation fiscal decentralization theory.

Tiebout (1956) introduced the concept of "local government goods" (local public goods) in the theory of public finance. He used this concept in terms of political and fiscal decentralization while analyzing the mobilisation of the local population between the areas, which are in the competition having to consolidate the preferences. Tiebout's (1956) essence of the hypothesis is that the consumer demand for local government goods may be revealed, when users select the jurisdiction, providing the maximum net benefit. The hypothesis claims that the mobility of the user within the electoral preferences can be revealed and the consumer demand will be at that point or close to it, where the local government expenditure items correspond to the demand. Now this hypothesis is generally known as Tiebout sorting (Tiebout sorting). First of all, it was a response to the lack of the public goods problem provision, which at the time was examined by Samuelson (1954).

Tiebout (1956) stated that public goods are provided by the regions being at competition and taking into account the wishes of the users, which encourage the efficient provision of public services, whereas Samuelson (1954) stated that public goods are produced when no one can reject them, and the fact is that the increasing number of the users does not change the consumption of public goods, that is, the limit remains the same. Policy, promoting the mobility of the citizens and developing knowledge of the benefits and costs of public goods, encourages migration, which performs as a force for improving the efficiency of government expenditure. Samuelson (1954) also stated that greater mobility of households from one region to another and greater efficiency of the allocation of resources are ongoing constantly.



Tiebout (1956) believed that the local authorities have more accurate and more detailed knowledge of the local needs of the citizens, so local citizens can be taxed easier and more accurately. He said that each region has different service baskets and a variety of taxation, which promote the mobility of the citizens. To sum up, it can be remarked that Tiebout (1956) established two major innovations in the field of fiscal decentralization: first, the main idea is the existence of non-public goods provided by the local government; secondly, he showed that the movement of taxpayers and voters between the jurisdictions create the mechanism according to which the persons reveal their priority to non-net public goods.

Olson (1969) has defined a new concept – "fiscal equalization" theory in fiscal federalism. The definition of fiscal equalization states that each of the common goods has a certain limit, which is necessary for any government to avoid competition between the paying and receiving the benefits of the collective good. In a broad sense, it creates a positive parallel with the public economic efficiency purpose to provide public goods costs and supply benefits in the multi-tiered federal systems.

Another contribution to the theory of fiscal federalism was Oates monograph (1972) "Fiscal federalism". Oates' fiscal federalism theory was based on Olson's (1969) proposed fiscal equalization concept and Tiebout's (1956) approach to the provision of public goods, rejecting mobility and sorting. He stated that there should be a different variation of the provision of public services or goods because residents have different needs and tastes. Oates (1972) formulated his approach to this question by defining public goods as net and non-net ones. The scientist created a theorem of decentralization, which has a clear basis. According to the theorem, welfare is maximized, when the specific public goods are provided by the local government whose jurisdiction corresponds to the subset of the country's citizens and the public goods demand and services are the same.

If the national government has undertaken to provide the same service or a package of public goods in all sub-national jurisdictions, it will be impossible to achieve the efficiency level if the preferences are the same for all members of the population. According to Oates's statement (1972), the national government's provision of public goods does not reflect the reality. In fact, this assumption has been criticised by Brennan, Buchanan (1980), however, it may be justified for two reasons: first, the national government does not have detailed information on the wishes and tastes of the local citizens. Secondly, although the national

government can provide different levels and different types of public services in different regions, still there are certain political constraints.

In this respect, the national government, to a certain extent, is constrained to provide equal public services or goods for only a certain region, avoiding the possible negative political impact that may arise through differentiation of levels of all of the goods or services in sub-national jurisdictions. For example, in Australia, members of the government must behave the same - tax rates for goods and services cannot be different in New South Wales and Western Australia, even though the public service levels are different.

Already in 1660 the philosopher Hobbes (1660) in his work "Leviathan," described the so called community or the state as an artificial human being of greater height and stronger powers than a normal person whose sovereignty is a fictional soul giving life and movement to the whole body. Brennan, Buchanan (1980) revived the definition of state according to Leviathan. As these researchers state the government is a monolithic Leviathan, who always seeks to increase the maximum tax revenue. The only way to restrain the government is to apply political and financial decentralization. In their submission, the competition between government agencies reduces the growth of the public sector.

Brennan and Buchanan (1980) considered that, if the security functions are imposed on the national government, such government has a real incentive to increase the net surplus, because there are no effective measures to control the powers of taxation. Fiscal decentralization limits power, by promoting the transfer of the relevant jurisdictions in the provision of services and goods to its own citizens, increasing efficiency; so the local residents will choose the best local government. The existing fiscal decentralization arouses the pressure from all governmental units not to exempt too much. In general, Leviathan's hypothesis on the government presented a new fiscal federalism approach, which identifies the main fiscal decentralization advantage – a smaller quantity of the government.

### **The second generation of the fiscal federalism**

The second generation fiscal federalism theory (beginning 1991). In the context of globalization processes when global economic interoperability is growing and societies are becoming complex and increase their interdependence between themselves due to the expansion of the network of technological development in the world of

communication, the team system parties transform to a market economy and democracy, thus making it possible to be involved in a more open mindset towards political and economic governance. The evolution of the state management determines the forces of globalization and localization of the interface (Ebel, Peter, 2007). For the following processes in the twentieth century, at the end of the 1990s, began to emerge the fiscal federalism theory of the second generation, which is based not only on the public finance ideas.

The latter researches involve not only the economic disciplines but also political and other sciences. Unlike the first generation, the second generation researchers assume that in order to increase one's target functions, there cannot be pursued the maximization of social welfare. The impact of the fiscal decentralization modelled by the scientists is materialized in the political process and the possibility of asymmetric information between policy agents. The investigators of the second generation of fiscal federalism (Weingast, 1995; Seabright, 1996; Lockwood, 2002; Besley, Coate, 2003; Petchey, Levchenkova, 2003; Wagner, 2007) started to examine the fiscal decentralization based on the principles of company and contract theories, economic information and agents' problems.

According to Oates (2005), it is difficult to give a simple and systematic description to the second generation theories, however, he distinguishes two main arguments that have been highlighted in the second generation of the proponents of fiscal federalism:

- The first argument was related to the conduct of the political processes and political agents, where participants can have their own objectives, for example, government officials may not seek the common good, as it was considered by the first generation proponents of fiscal federalism. Instead, they may seek to increase the prosperity of their districts. The process involves the modelling of political institutions. This fact has the obvious link to the public choice theory, which was not the main thing to the theoreticians of the first generation (Piccotto, Wiesner, 1998). Inman, Rubinfeld (1997) who described the first generation theories as economic federalism in contrast with newer models, clearly constituting political processes and their effects on results;
- The second related question was the analysis of the political agents. First of all, the asymmetric information in the settings clarified that some of the participants, when compared with others, have more knowledge on local tastes and the cost structure which are inaccessible to other participants. The investigation has shown that the optimal procedure or institutions may be of quite a different level, while estimating the perfect information. In order to

examine these issues, fiscal federalism analyzes the macro-economic theory and industrial organization work perspective.

Many of the works of the second generation fiscal representatives on fiscal federalism review the balance between centralisation and decentralization, so often the question is to decentralise or centralise? They acknowledge that there may be a risk if the degree of fiscal decentralization is too high. The second generation theory has been characterized by two motivating words: incentive and knowledge. Both motives should contribute to the higher economic efficiency: incentives to local authorities to make a better job to prevent people leaving the companies; and the knowledge of the wishes of the local citizens and the taste is very important in order to achieve economic efficiency, when public goods and services are provided by the local authorities.

The basic scientific studies, assigned to the second generation of proponents on fiscal federalism were carried out, Weingast (1995), Seabright (1996), Lockwood (2002), Besley, Coate (2003), Petchey, Levchenkova (2003) and Wagner (2007) (Table 2).

**Table 2.** Researchers of the second generation theories of fiscal federalism

| <b>Author (year)</b> | <b>Issue</b>   | <b>Contribution to the theory of fiscal federalism</b>   |
|----------------------|--|--|
| Weingast (1995)      | The economic role of political institutions: market-preserving federalism and economic development | Introduced the concept of the market in the federalism theory. Stated that federalism provides the political framework of the single market.   |
| Seabright (1996)     | Accountability and decentralisation in government: an incomplete contracts model                   | Established an incomplete agreement concept. Stated that political accountability can be organisational motivation for fiscal decentralization.  |
| Lockwood (2002)      | Distributive politics and the costs of centralisation  | Unlike Oates said that public services provided by the national government may not necessarily be homogeneous, and the central government is composed of locally elected representatives in the regions and, therefore, may well represent them. |

|                              |  |  |
|------------------------------|--|--|
| Besley, Coate (2003)         | Centralized versus decentralized provision of local public goods: a political economy approach               | Submit the political economy approach to the provision of public goods on a decentralised and centralised basis.   |
| Petchey, Levtchenkova (2003) | The welfare effects of fiscal equalisation in a federal economy with factor mobility and strategic behaviour | They state that fiscal equalisation (grants) is not determined externally, it is carried out in accordance with the fiscal standards, which shall be determined, taking into account the actual fiscal behavior, and this model gives a better efficiency. |
| Wagner (2007)                | Fiscal Sociology and the Theory of Public Finance: An Exploratory Essay                                      | His point of view on a polycentric government is more important than the government's hierarchical aspect, which defines the solution of the questions and options must be provided at the national and sub-national levels of the government.             |

Source: Authors

The first review of the new literature stream considers the decentralization theorem in the context of the political economy. The second group of researchers explores the principles of electoral accountability in the agents' models, searching for a compromise on the centralisation and decentralization. Essentially, voters are directors, and politicians are agents, so the existence of asymmetric information between them may be seen as the main reason why the government is ineffective. Decentralization can reduce the generation criteria of information asymmetry and tax competition among the levels of government sub-national authority levels, in this way voters can increase the control of politicians, and promote greater voters' responsibility, which would increase government efficiency.

Weingast (1995) presents the market concept in federalism theories in order to examine how the competing jurisdictions create incentives for smaller transactions costs and reliable commitments. He assumes that the hierarchy of the governments with the autonomy of each governmental level is institutionalized. Weingast (1995) modelled market, where: 1) local government has regulatory responsibility for the economy; 2) the common market ensures that the local government could not prevent the marketing of goods and services from other jurisdictions;

3) local authorities are faced with a limitation of the budget. The main findings have been designed for Great Britain and the United States: 1. federalism provides a political framework for the common market; 2) bans for national government to use economic regulation drastically reduces the government's policy regulation to the interest groups; 3) the internal trade barriers allow entrepreneurs, new companies and new economic activities develop new areas, which are likely to outlive the previous.

Seabright (1996), unlike Weingast (1995) has defined the concept of "incomplete agreement". The author has submitted the election in the context of the "incomplete agreement", as such where some information is not fully confirmed. Political accountability can be organizational motivation for decentralization. Seabright (1996) defined the concept of accountability as accountability of elections, as it is formulated, taking into account the probability that the levels of wealth in certain jurisdictions is determined by the election of the government. The decisive argument is that accountability is a major force in the elections, in which the fiscal decentralization can contribute to a more efficient governmental activity.

First of all, Besley and Smart (2007) noted that the elections provide responsibility based on two different phenomena: the effect of selection, because the voters may decide not to re-elect the bad former incumbents, and the effect of discipline, the bad government incumbents can improve the quality of work, in order to increase the chances of re-election. On the contrary, centralisation would be even a better process, as some of the mechanisms related to the "incomplete agreement" give more opportunities for policy cooperation between the different levels of the government.

In Lockwood (2002) and Besley, Coate (2003) fiscal federalism theory the starting point is Oates (1972), decentralization theorem, however the authors state that the goods and services, which are provided by the national government, does not have to be homogeneous as it was originally believed by Oates (1972). These scholars clearly deviate from the fundamental theorem of decentralization, when examining the compromise between centralisation and decentralization of political economic environment. They believe in the more appropriate realistic environment, where the provision of public goods may be set at different levels in all regions, as well as in the case of centralisation – the negotiation process between regional representatives.

Another contribution to the theory of fiscal federalism for the second generation was Australian researchers Petchey, Levchenkov's (2003, 2004) fiscal equalization in scientific researchers, which, stated that grants for equalization are not determined externally. Fiscal equalization is carried out according to fiscal standards, which are determined, taking into account the actual fiscal behaviour.

The scholars of the second generation of fiscal federalism do not oppose the first generation of fiscal federalism theories, only classify the fiscal decentralization. Although the used model spectrum of the proponents of the second generation of fiscal federalism theory is different, most of them are looking for a compromise between centralisation and decentralization, however, we can find a good number of the first generation scholars' insight.

And finally, the second generation of fiscal federalism theory appears in the public choice theory, developed by researcher Wagner (2007). His attention moved from the powers and responsibilities of the government at all levels, focusing the attention on the competing polycentric characteristics of the government. This is related to the concentration in the process, during which various centres of the government respond to the needs of the services provided to the public, in such a way that they are integrated into the market economy.

In Wagner's (2007) point of view, a polycentric government is more important than the governmental hierarchical aspect, where the defined functions must be carried out at the national and sub-national levels of the government. In the process, during which the government will respond to the new demands of the community, is directly linked to the ability to increase their earnings in an innovative way. In addition, the main attention is paid to the government company where some government units fulfil the role of the public manufacturer services and some who take the role of the public service role of articulatory.

### **Conclusion and Recommendations**

The evolution of the theories of fiscal federalism can be divided into two phases, the differences in content and extent, and the scientific works analysing the theoretical and practical aspects of fiscal decentralization, accordingly, are classified into two periods of fiscal decentralization analysis.

The first generation of fiscal federalism theory stresses that public economic goods are related to the effective allocation of resources. The theory of public finance has links with the stabilisation of the economy (that is, to maintain a high level of employment and a stable price level)

and the distribution of income (both to achieve horizontal and vertical justice in all jurisdictions, in order to avoid inefficiency and mobility of households and enterprises).

Many of the works of the second generation fiscal representatives on fiscal federalism review the balance between centralisation and decentralization, so often the question is to decentralise or centralise? They acknowledge that there may be a risk, if the degree of fiscal decentralization is too high.

The scholars of the second generation of fiscal federalism do not oppose the first generation of fiscal federalism theories, only classify the fiscal decentralization. Although the used model spectrum of the proponents of the second generation of fiscal federalism theory is different, most of them are looking for a compromise between centralisation and decentralization, however, we can find a good number of the first generation scholars' insight.

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