1 Introduction

During the last century, local governments all over the world have confronted serious challenges. The process of globalization has put strong competitive pressures on local governments already suffering from high budgetary constraints and operating in changing environments due to demographic change. During the financial crisis, these pressures have become even more severe. There has been a widespread belief that public sector governments are performing their core functions inefficiently and ineffectively. This criticism is not new. However, when taking a closer look, there seems to be a consensus that local governments especially are prone to government failure and inefficient provision of public services, either because local governments structurally lack certain capabilities to tackle problems or because they are more affected by opportunistic behavior (e.g., Dollery and Wallis, 2001).

There are several potential reasons for inefficient service production at the local level. One source can be seen in the spatial allocation of local government territory and functions. The literature on fiscal federalism highlights that inefficiencies may then arise due to inadequate territorial configurations. For example, the presence of spillovers or economies of scale and scope may simply render existing municipalities too small to produce and provide these services all by themselves (e.g., Ostrom et al., 1961). Further explanations include arguments from political economy and principal–agent conflicts, which arise both between and within the tiers of government.

Finding ways of dealing with these issues is, generally speaking, a matter of local governance. Boadway and Shah (2009: 242) define local governance as "[…] the formulation and execution of collective action at the local level. Thus, it encompasses the direct and indirect roles of formal institutions of local government and government hierarchies, as well as the roles of informal norms, networks, community organizations in pursuing collective action by defining the framework for citizen-citizen and citizen-state interactions, collective decision making, and delivery of local public services." It becomes evident that the term governance describes a broader concept than the term government as used to describe specific institutions. Governance, on the other hand, also includes norms and the processes of finding the ways and means of solving problems of public policy.

New governance schemes intended to increase public sector efficiency and accountability and to strengthen democracy at the local level are implemented by means of public sector and especially local government reforms. These include territorial and functional reforms as conducted in many countries during the second half of the 20th century, as well as administrative reforms that started with the development of the New Public Management (NPM) concepts in the 1980s and 1990s. Although there are common goals for these reforms, the underlying processes, advantages, and disadvantages are quite different as they address different sources of inefficiency. The main insights and principles, so far, have been derived from several fields of research, such as fiscal federalism, public choice theory, and public administration research. This thesis explores two topics from these fields of research that advance the understanding of public sector reforms.

First, it provides a theoretical model to advance understanding of incentive schemes via competitive funding in vertical fiscal relations, i.e., between super- and subordinate units. The fundamental logic of the model can be applied to performance budgeting (within administration), as well as to conditional grant schemes between central and local governments. Such incentive schemes are applied in principal–agent frameworks to achieve goal congruence between the principal and the agents, and to induce the latter to improve their performance. Our[1] aim is to understand the conditions under which performance-based incentive schemes improve overall welfare. Furthermore, we compare the effects of two ideal-type schemes. The add-on we provide is that we explicitly account for the fact that performance indicators only give proxy information on units' performance. Contests may induce welfare gains, but also incentivize players to engage in socially wasteful influence and window-dressing activities.

The second topic of this thesis addresses an issue of horizontal fiscal relations: intermunicipal cooperation. Voluntary intermunicipal cooperation in public service delivery has become an important topic in local public policy (Hulst and van Montford, 2007). Via cooperation, local governments can exploit efficiency gains from scale and scope, and strengthen fiscal equivalence. For local policymakers, intermunicipal cooperation is more attractive than privatization or territorial and functional reforms. The reason is that intermunicipal cooperation allows municipalities to maintain autonomy over their affairs. We address two important research questions: First, what are the determinants of intermunicipal cooperation? Second, does intermunicipal cooperation increase efficiency?

[1] Two chapters of this thesis are written in coauthorship, the remainder in single-authorship. To avoid unnecessary confusion and style breaks with the use of personal pronouns the plural is used throughout the thesis.

Systematic econometric research on intermunicipal cooperation is rare, especially among non-US countries. To answer the first question, we use a unique survey dataset among Hessian municipalities to estimate a cooperation equation for cooperative activities in the field of general administration. Unlike former studies, we place a special focus on the spatial location and characteristics of the surrounding municipalities.

The second question is addressed by means of public sector efficiency measurement. For a sample of small Hessian municipalities, we employ a two-stage data envelopment analysis to investigate whether forms of intermunicipal cooperation, such as joint intermunicipal bodies or intermunicipal contracts, score better than self-provision. The analysis focuses on the wastewater sector, which permits a focus on cooperation within the public sector, as privatization virtually does not apply. One novelty is that our study is the first to study intermunicipal cooperation and relative efficiency in the wastewater sector. Another distinctive feature is that we are able to distinguish between technical or X-inefficiencies and scale efficiency. Hence, we discuss the risk of potential ex post transaction and control costs resulting from intermunicipal cooperation.

The general outline of this thesis is as follows: We start with a review of literature in chapter 2 to embrace the relevant fields of literature and to show how the contributions made in this thesis fit into the existing body of research. The subsequent chapters comprise papers, starting with the contribution on incentives and activities of influence in the public sector in chapter 3.[2] Chapter 4 addresses the determinants of intermunicipal cooperation, and chapter 5 the efficiency effects of intermunicipal cooperation.[3] Chapter 6 provides a concluding summary and points to perspectives for future research.

[2] Chapter 3 is coauthored with Prof. Dr. Ivo Bischoff, University of Kassel.

[3] Chapter 5 is coauthored with Dr. Peter Haug, Halle Institute for Economic Research (IWH).

2 Review of Literature

The following review of literature serves the purpose of introducing the reader to the key ideas in the related fields of research. It reveals where the contributions of the papers in this thesis fit in. After a general introduction to the core developments in fiscal federalism, the survey takes up two important strands, intergovernmental grants as part of the fiscal federalism literature and local government reform. The latter subject in particular reveals strong links to the economic theory of fiscal federalism as well as public administration research. The final section (2.5) introduces the methodology used in the subsequent contributions.

2.1 Fiscal Federalism and Local Governance

As part of the field of public economics, the key concern of fiscal federalism theory has been how to allocate responsibilities for delivering public goods services to citizens across different government layers. The main issue has been to understand which functions and instruments of the public sector are best centralized and which are best provided by decentralized levels of government (Epple and Nechyba, 2004; Oates, 1999). This fairly general issue applies to any nation, constitutional federations as well as unitary states. In practice, full decentralization is rarely the case: There is always a hierarchical dimension, i.e. coexistence between central and local governments, which leads fiscal federalism theory to the question of how tasks and responsibilities should be distributed between different layers of government. Two main traditions in fiscal federalism can be distinguished: first-generation theories of fiscal federalism and second-generation theories of fiscal federalism (Oates, 2005; Vo, 2010). Whereas the former share a “structural” view of decentralization and centralization, the latter focus on the nexus of decentralization and political agents, asymmetric information and/or transaction costs (Vo, 2010: 673).

First-generation theories of fiscal federalism adopt a normative approach to fiscal federalism, asking how federal relations should be organized to maximize overall welfare. This literature explores three basic problems: the assignment of government functions and responsibilities, the assignment of (tax) revenues, and fiscal equalization (see Oates, 2005: 352). A key assumption of first-generation theorists has been that decentralized (local) governments are better informed concerning citizens’ preferences than centralized government. Hence, decentralized governments are better able to differentiate their services according to local citizens’ needs, whereas a central government can only provide a uniform level of public services. The result has been the famous decentralization theorem: “[…]

each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalize benefits and costs of such provision" (Oates, 1972: 55). The welfare gain of decentralization depends on the degree of preference homogeneity. The greater the degree of preference homogeneity within a jurisdiction and the greater the degree of preference heterogeneity across jurisdictions, the greater the welfare gain from decentralized service provision (Oates, 2005: 354). Tiebout (1956) suggested the concept of voting by feet as an endogenous sorting mechanism to achieve an efficient match between jurisdictional provision and citizens' preferences in decentralized structures.

There are three important assumptions that have been subject to criticisms weakening the decentralization theorem's case for decentralization: the absence of spillovers, the uniformity of centralized provision, and the absence of economies of scale and scope. In the presence of spillovers, the benefits of certain goods provided by local governments also accrue to citizens of neighboring jurisdictions. In this case, decentralized provision will result in underprovision and hence be inefficient in terms of national welfare. The second criticism addresses the assumption of uniform provision, which has been challenged by contrary empirical observation. Using examples from the U.S. Highway Program, Besley and Coate (2003: 2612) point out that central government goods are likely to be provided unequally based on discretionary decisions and bargaining. Furthermore, centralization can be preferred over decentralization if the production of public services entails economies of scale.

Another strand of first-generation fiscal federalism theories started with Buchanan's (1965) club theory. The basic idea of club theory is that citizens may voluntarily form and join clubs that provide certain public goods.[4] There is a tradeoff in club formation: a higher number of members lowers the individual contribution level, but also leads to congestion costs. Thus, club theory has been concerned with providing an analytical rationale to determine the optimal jurisdiction size rather than to decide upon the allocation of functions and instruments between different tiers of government (see Dollery and Robotti, 2008a).

Two principles of assignment have shaped the debates on federalism and local governance, following from the first-generation theories. The principle of subsidiarity is a direct application of the decentralization theorem. It demands government functions be assigned to the lowest government level that can efficiently undertake the task. The principle of fiscal equivalence demands that functions be

[4] Again these models apply to a certain type of (local) public goods as club formation requires that non-members can be excluded from consumption.

assigned in a way such that taxpayers, beneficiaries, and decision makers of public services are congruent (Olson, 1969). A major implication for the division of functions is that those concerning national standards, or pursuing aims characterized by spillovers, such as equity considerations or macroeconomic stabilization policy, should be delivered by the central government; services for which efficiency considerations and local preferences matter should be provided by local governments. In cases in which the assignment is difficult, the central government can correct for misallocation by means of intergovernmental grants (see section 2.2).

Second-generation theories of federalism have contributed to the federalism discourse by adopting new perspectives on federal structures. As Oates (2005: 356) points out, second-generation theories have been inspired by economic disciplines such as public choice theory or new institutional economics, as well as other disciplines such as political science. Two major issues predominantly characterize second-generation theoretical reasoning: political processes and problems of information (see Oates, 2005).

Taking a public choice perspective, in which public officials act opportunistically, decentralization may be feasible in preference to centralization as it constrains the public officials' scope of action to abuse their position for their own goals (e.g., Besley and Coate, 2003). Second-generation theories inspired by the institutionalist perspective have focused on the role of information asymmetries and principal–agent relations. The literature has provided some variations on the theme of asymmetric information (e.g., Seabright, 1996; Tommasi and Weinschelbaum, 2007). For example, principal–agent relationships may arise between different tiers of government, especially if jurisdictions act as agents to implement central government objectives. Another form of principal–agent relationship may arise between voters and public officials.

Second-generation theories have offered a variety of new of arguments, but they have not altered the key results of traditional first-generation theories. The trade-off between decentralized and centralized provision continues to exist, but for slightly different reasons. Oates (2005: 357) comments on this phenomenon as follows: "It is interesting that although the models under the SGT [second-generation theory] umbrella differ in fundamental ways from the FGT [first-generation theories], many of them produce a tradeoff between centralization and decentralization that is in a somewhat similar spirit to their earlier counterparts." Centralization, on the one hand, facilitates policy coordination to internalize interjurisdictional interdependencies. Decentralization, on the other hand, offers a higher degree of local accountability for political officials. The trade-off hence becomes a problem of coordination versus accountability.

Any system of decentralized public service provision necessarily involves interaction between governments of the same or different tiers. These interactions can take the form of competition, coordination, or cooperation. Yardstick competition strengthens the accountability of opportunistic policymakers at the local level as citizens can use policy outcomes in neighboring jurisdictions as a benchmark to evaluate their incumbents' performance (e.g., Besley and Case, 1995; Revelli, 2005). Thus, competition can remedy the problem of imperfect information. Other forms of competition, such as tax or welfare competition, arise from an endogenous kind of spillovers caused by decentralization and can be detrimental to welfare (see Brueckner, 2008; Lockwood, 2006). Whereas competition in federal systems has gained considerable attention from both theoretical and empirical points of view, the understanding of cooperation is still underdeveloped.

Another strand of federalism literature, functional federalism, adopts the view that the state and its institutions primarily work as service providers. The concept of functional federalism has evolved from club theory (see above) as well as public choice ideas. Behind this concept stands the observation that real-world jurisdictional borders and local government functions have grown historically and do not fulfill the principle of fiscal equivalence. Functional federalism emphasizes that instead of traditional multi-task government, public agencies can be created to provide specific local public goods in order to achieve fiscal equivalence (Dollery and Robotti, 2008a). Territorial jurisdictions may accommodate specific services and can have a different scope than political jurisdictions. Taking this idea to the limit, the result would be a bottom-up system of myriad functional overlapping and competing jurisdictions (Eichenberger and Frey, 2006). In reality, we do not observe such an extreme system as beyond a certain threshold, the benefits are outweighed by transaction costs. However, lessons from the concept can be applied to instances of intermunicipal cooperation, such as U.S. special districts or German single-purpose associations, whereby additional government bodies are created to provide certain public services (Casella and Frey, 1992). We will return to this in chapters 4 and 5. Chapter 5 focuses on German single-purpose associations as an important arrangement of intermunicipal cooperation.

2.2 Intergovernmental Grants

One field of specific concern to fiscal federalism is the vertical fiscal relations of different government tiers. Intergovernmental fiscal transfers (grants) can be understood as the “adhesive” between different tiers of government. Vertical grants are present in any federation.[5] Several reasons justify the use of grants in federal relationships. First, whereas public expenditures are easily decentralized, it makes sense to have a nationwide tax system through which the federal government collects taxes. This leads to vertical fiscal gaps (see Boadway et al., 1998)[6] as the federal government will raise more revenues than it needs for its own expenditures. Grants then serve the purpose of distributing the surplus across state governments. Second, grants are employed to pursue the goals of fiscal equalization, i.e., to reduce differences in lower tiers' net fiscal benefits to ensure fiscal equity and improve efficiency. Third, intergovernmental grants can be applied to correct for inefficiencies arising from interstate spillovers. Fourth, intergovernmental grants can be devised to ensure fiscal equity or national minimum standards in the provision of certain public services and implementation of national policy objectives (Boadway and Shah, 2009: 323–327). In the course of this section, the primary focus will be on the effects of conditional grants rather than equalization issues.

[5] This paragraph and the subsequent discussion of grant types are based on Boadway and Shah (2009, ch. 9). For further details, please refer to their textbook.

[6] The terms "vertical fiscal gaps" and "vertical fiscal imbalance" have been used differently in the literature. A recent overview and proposal by Sharma (2012) suggests an alternative concept, which distinguishes between desirable asymmetries and non-desirable asymmetries (misallocations). The discussion goes beyond the purpose of this section. Therefore, we adhere to the widely applied definition provided by Boadway et al. (1998).

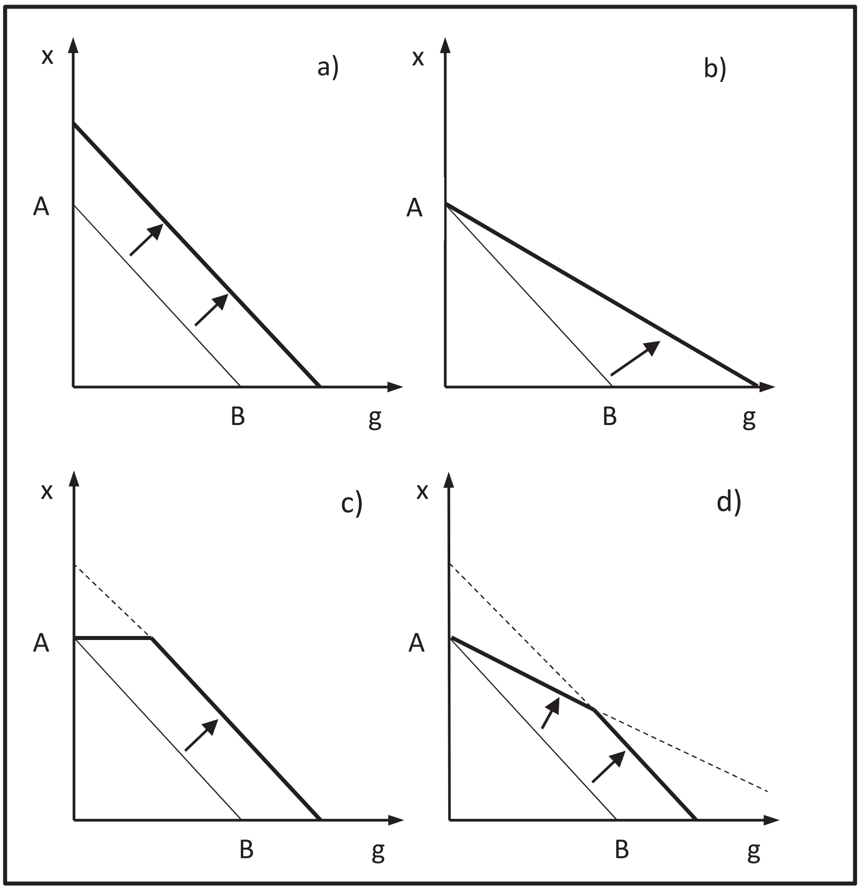

Figure 2.1: Budget effects of intergovernmental grants
The figure shows the budgetary effects of intergovernmental grants at the recipient level. AB is the budget line without grants spent for two types of public goods. *g* represents the amount of expenditures on assisted public goods. *x* represents the amount of expenditures on other public goods. Figure a) Unconditional nonmatching grant. Figure b) Conditional matching grant, open-ended. Figure c) Conditional nonmatching grant. Figure d) Conditional matching grant, closed-ended. Source: Author's illustration based on the figures by Boadway and Shah (2009: 308–313).

There are two basic types of grants:[7] unconditional (general purpose) grants and conditional (specific purpose) transfers. Unconditional grants typically represent an income effect for the recipient unit (see Figure 2.1a). Conditional grants can only be spent on a defined purpose or project to promote objectives desired by the grantor. There are important distinctions with regard to the type of conditionality (input-based or output-based) and the design of matching provisions. Matching grants require that the recipient uses a certain amount of own resources. They follow the basic economic logic of a subsidy as they alter the relative price in favor of the assisted public service. Hence, they invoke income as well as substitution effects. Matching requirements can be open-ended (see Figure 2.1b) or closed-ended (see Figure 2.1d). Any euro of an open-ended conditional grant

[7] The paragraph draws on Boadway and Shah (2009: 307–312).

spent on an assisted public good will be subsidized by the grantor. In case of a closed-ended grant, the total amount of transfer is limited. Nonmatching grants can be seen as the extreme case of a 100% subsidy (see Figure 2.1c). A related, but vaguely defined, category is block grants, which apply only to a predefined area of public expenditures but can be spent freely in this area (Boadway and Shah, 2009: 307). Boadway and Shah (2009: 314) point to the parallels between output-based conditionality grants and the more general concept of performance-oriented transfers. The logic of this latter type of conditional grants will be relevant to chapter 3. There are strong parallels with the logic of performance budgeting and managerialism (see section 2.3.2). Output- and performance-oriented conditioning aim to improve the recipients' results-based accountability, that is, local governments maintain their freedom in deciding over the input allocation to provide the assisted public good and can be held accountable for the output.

The debate on conditional grants has highlighted the benefits and the costs of this instrument. Generally speaking, the instrument of conditional grants is meant to influence the fiscal decisions of recipient units to achieve the objectives of the federal government (Boadway and Shah, 2009: 333). An important application of matching grants is public goods with interstate spillovers. Here, conditional grants can be applied to counteract underprovision. Moreover, conditional grants can be applied to achieve specified national standards in public services that have been delegated to state governments. Examples of this are schooling, health, and welfare expenditures. The federalism literature views conditional grants as a tool to tackle problems that cannot be solved by fiscal equalization. Finally, conditional grants are a strategic tool for addressing agency problems between different tiers of government as discussed by the second-generation theories of federalism and public choice theory. These problems are caused by divergent objectives and information asymmetries between state and federal governments (e.g. Ferris and Winkler, 1990). To minimize the loss resulting from the inefficiency caused by subordinate units, the principal (national) government can devise incentives to achieve goal congruence (Prendergast, 1999). This argument applies when the federal government is relatively more benevolent than subordinate governments. The local government literature has discussed a number of reasons why local governments are more prone to government failure (e.g., Dollery and Wallis, 2001).

One of the costs of conditioning funds for subordinate tiers of government is that power is transferred into the hands of the federal government, i.e., the instrument undercuts one of the key advantages of decentralization, namely the responsibility and accountability of lower governments for their own decisions (Boadway and Shah, 2009: 337). This problem becomes more severe if the federal government is not benevolent, and uses grants to exert power and impose its own priorities on the recipients. Another drawback, which applies to all types of grants, becomes evident when the strategic behavior of potential recipients is taken into account. An established body of literature has shown that grant money is treated differently from tax revenues. An important and robust observation is that a grant-induced budget increase leads to a higher increase in public spending than an equivalent increase in taxes due to additional citizen income. This phenomenon is referred to as the "flypaper effect" (see Filimon et al., 1982; Hines and Thaler, 1995; Inman, 2008). Moreover, grants may be subject to bureaucratic manipulation (e.g., Dahlberg et al., 2008) and extend organizational slack (e.g., Kalb, 2010). In chapter 3, we discuss another effect that arises for competitive conditional grant programs. To obtain additional funds, potential recipients will devote resources to the application process and may engage in socially wasteful "influence activities," especially if the amount of funds to be distributed is limited. The result will be a trade-off between efficiency gains and wasteful influence activities or window-dressing. The core logic of this last argument has so far not been discussed extensively or modelled in the context of vertical transfers. However, it has been present in other contextual frameworks such as employer–employee relationships in private sector organizations.

The pioneering works of Milgrom (1988) and Milgrom and Roberts (1988) discuss this issue under the term "influence costs." Their focus is on employment contracts. The analysis by Milgrom (1988) and Milgrom and Roberts (1988) rests on the key assumption that there is an informational asymmetry between super- and subordinate units. Specifically, wasteful influence activities and productive efforts cannot be observed separately, which makes it impossible to punish wasteful activities and promote productive activities. The focus of the analysis is on identifying strategies to limit influence activities. Milgrom (1988) shows that under certain conditions, it is optimal to eliminate managerial discretion rather than relying on wage incentive schemes. A further strategy is to close communication channels to the decision makers and reduce transparency (Milgrom and Roberts, 1988). Although Milgrom's arguments relate to the private sector, they can be applied to similar problems in the public sector, such as conditional transfers and performance budgeting. In his introduction, Milgrom (1988) even provides the motivation for his work using the core problems of federalism: centralization and decentralization. Hence, it seems only rational to apply the logic of influence activities to the public sector.

Here, chapter 3 of this thesis makes an important contribution. However, there is a structural difference: Discretion in fund distribution based on output or performance cannot be ruled out fully as discretion is a result of the exogenous imperfection of performance indicators (see section 2.3.2). This means that equivalents of the above-mentioned strategies for limiting influence activities are not applicable to the problem of conditional grants. Moreover, the role of distributional goals and the presence of interregional spillovers in the public sector have additional implications. Finally, we choose a different modelling approach from Milgrom (1988) and Milgrom and Roberts (1988) as we build on the theory of rent-seeking contests and optimal contest design.

2.3 Local Government Reforms

So far, we considered federal structures as given. Now we turn to the possibility of local government reform. Local government borders as well as the way local administration pursues its tasks can be politically reorganized. First, let us turn to a classification of multiorder governance. Hooghe and Marks (2003) introduce a dyadic conceptualization of multi-level governance that integrates separate strands of theory on federal structures and flexible governance forms. Type I governance forms are characterized by a static dispersion of authority to general purpose, non-intersecting, and durable jurisdictions. Type II forms are flexible jurisdictions that can more easily be rearranged and can overlap. These are designed for specific purposes. Type II forms represent the idea of adjusting jurisdictional borders and correcting for inappropriate territorial configuration. Bottom-up cooperation from local governments, such as jointly run special-purpose associations or intergovernmental agreements, can be seen as one instance of such flexible type II forms. From a normative perspective, the choice of the optimal governance form can be characterized as a quest for efficiency. The centralization or decentralization of service production can be considered macro governance forms. At the local level, governance also encompasses the outer and inside organization of local units. This section discusses reforms related to both of these dimensions.

2.3.1 Structural Reforms

To address inefficiencies and challenges in the local public sector, the literature on local government reforms[8] identifies different political approaches. Two im-

[8] In a general sense, the term reform describes a “concious attempt by a specific actor to transform local reality” (Dente and Kjellberg, 1988: 8, cited by Dollery et al., 2008: 15).

portant developments are territorial and functional reforms and the professionalization of administration following the NPM paradigm, which applies the principles of private sector management to the public sector (see Junkernheinrich and Lohrig, 2013a: 25–26; Wollmann, 2000).

Real-world federal systems have not been planned and designed in accordance with the principles of normative economics of federalism (see Dollery and Robotti, 2008a: 27). Rather, territorial borders and task assignment have evolved over time. Consequently, today's jurisdictional borders are not necessarily suited to ensuring the efficient production and provision of public services. Territorial and functional reforms have been applied as a top-down measure to correct for inadequate or obsolete borders or task assignments. In general, the direction of structural reform has pursued the creation of larger units and the reduction of the total number of decentralized governments. Functional reforms and territorial reforms are mostly applied in conjunction. Such structural reforms have been on the policy agenda in most developed countries throughout the world (see Reingewertz, 2012).

Proponents of territorial reforms primarily refer to gains in scale efficiency (economies of scale and scope), cost savings, or the improvement of financial sustainability. A significant body of empirical research has dealt with the outcomes of territorial reforms, such as amalgamations and mergers at the local level. The evidence for efficiency gains, cost savings, and the fiscal sustainability of territorial reorganization has been mixed: Reingewertz (2012) finds that the 2003 amalgamation reforms in Israel have led to a decrease in public expenditures, whereas the service levels have largely stayed the same. Blume and Blume (2007) use the West German territorial reforms in the 1960s and 1970s as a natural experiment to test for the economic effects of local authority mergers in core cities and suburban towns in monocentric regions. They find that merged municipalities experience a higher level of economic growth in the post-merger period than municipalities that have not been merged. Blesse and Baskaran (2013) find substantial and robust cost reductions for compulsory municipal mergers and smaller cost reductions for voluntary municipal mergers in East-German merger reforms in the state of Brandenburg. For local amalgamations in England and Wales, Andrews (2013) finds that the disruptive effects of structural change outweigh the cost savings at the administrative level. Slack and Bird (2013) show that Canadian amalgamations in Toronto have not achieved the aim of reducing local government expenditure levels; moreover, they point to an additional negative effect in that amalgamations have led to a reduction in citizens' access to and participation in local democracy. Similarly, Moisio and Uusitalo (2013) find that municipal mergers in Finland (1970–1981) have not led to lower per capita spending, even from a long-term perspective. The positive effects derived from cost savings in general administration have largely been outweighed by spending increases in other fields of public expenditures. Dollery et al. (2008) present a comparative overview and assessment of municipal reforms in developed Anglo-American countries. Again, there is no unified evidence for or against the efficiency-enhancing effects of territorial reforms.

Turning next to the fact that the existence and size of these gains is still questionable on empirical grounds (see Dollery and Robotti, 2008: 31–35), there are further downsides: Any of these reforms will interfere with local autonomy and lead to conflicts of interest. This is especially true if the reform is initiated and imposed in a top-down fashion by state or federal governments.[9] Blume and Blume (2007), for example, acknowledge that the mergers in Germany have come at considerable political costs, with long-lasting political consequences and citizen resistance. In the short term, structural reforms therefore cause transitional costs (Moisio and Uusitalo, 2013). This raises the question of whether the presumed efficiency might as well be achieved by alternative means of provision or production, such as privatization and intermunicipal cooperation. These come at lower transitional costs and are more flexible in adapting to changing circumstances. In contrast to territorial reorganization, however, these forms have higher coordination and agency costs as they extend the cascades of internal hierarchy and control (see Dafflon, 2012).

2.3.2 Administrative Reforms

Whereas the debates concerning fiscal federalism and territorial reforms reflect the attempt to make the public sector more efficient by designing its outer structure, the NPM movement focuses on the inner structures by improving the efficiency of administrative organization and procedures (Kersting, 2013: 129–130).

[9] Most large-scale territorial reforms are imposed in a top-down fashion. However, this is not exclusively so: Some national governments try to foster voluntary mergers and consolidations in local government (e.g., Sørensen, 2006; Steiner, 2003). In several German states, there has been a two-step procedure in which municipalities were given time to agree on voluntary amalgamations. Those that were still too small afterwards were merged by compulsory top-down rule (e.g., Blesse and Baskaran, 2103). Sørensen (2006) argues that political transaction costs and the lack of well-defined property rights are key factors that inhibit voluntary mergers. Due to the conflicting interests of the associated municipalities, many feasible mergers would not have taken place at all (Hanes et al., 2012). High-income municipalities tend to oppose amalgamation with less wealthy municipalities and equally sized municipalities are less open to amalgamation.