Political Fragmentation and Local Fiscal Policies: a New Instrumental Variable Approach

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This paper studies the effect of political fragmentation on local fiscal policies, such as public expenditure and tax revenues. The work exploits three peculiar features of the Italian municipal electoral system; the majority bonus system for mayors, that ensures them always a stable majority in the city council, the possibility to vote separately for parties and mayors, and the position on the ballot paper, which in Italy is randomly determined by State officials. Exploiting these features, and using the ballot order effect as instrument for political fragmentation, the paper identifies the causal effect of parties fragmentation of the winning coalition on local fiscal policy. Evidence shows, in contrast to what shown by the previous literature, that a more fragmented majority performs less public spending and collects less revenues. Moreover, the negative effect of political fragmentation on public spending is stronger when the mayor is elected at the run-off election with respect to mayors that win in the first round.