

Prof Zhaotian LUO (University of Chicago)

Dec 11 Wed 9-10:30am

Title:

Governing Local Bureaucracy in a Centralized State

Abstract:

We develop a model of dynamic moral hazard to study the local governance in a centralized state. In each period, a principal chooses a mode of governance, deciding whether to delegate local affairs to an agent with better expertise, whether to supervise the agent, or to take over local affairs; while the agent chooses whether to exert effort or slack in carefully managing local affairs. A trilemma arises as the principal cannot overcome the three inefficiencies at the same time: loss of local expertise, rent-seeking behavior, and slacking.

The relationship eventually evolves into recurrent centralization, or recurrent unsupervised delegation, or perpetuated slacking.

Albeit inefficient ex post, the equilibrium is consistent with ex ante optimal administration. The underpinning of these results is moral hazard in local agency and a centralized state's lack of commitment in how to govern its local affairs. Our theory sheds light on broader scenarios of agency problems in a centralized state.