

# Soft budgets and local borrowing regulation in a dynamic decentralized leadership model with saving and free mobility<sup>\*</sup>

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## Abstract

This paper considers a simple dynamic decentralized leadership model with local borrowing and regional productivity enhancing investment. The central government is benevolent but cannot commit. The local governments strategically act while accounting for the ex post motive of the central government. We then investigate inefficiency in the subgame perfect equilibrium. We analyze the effect of central control on local borrowings. It is revealed that the central control is of no use. The model is extended to the case with residential mobility which gives different policy implications. .

**Key Words:** soft budget, local borrowing, local investment.

JEL:H71,H72,H73,H77

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