Loss of capital status: does it matter for a city's development?
Work-in-progress

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Introduction

In 1999, the number of first-level administrative regions in Poland (*voivodeships*) was reduced from 49 to 16. As a result, 31 cities lost the status of capital ("ex-capitals", Figure 1).[1]

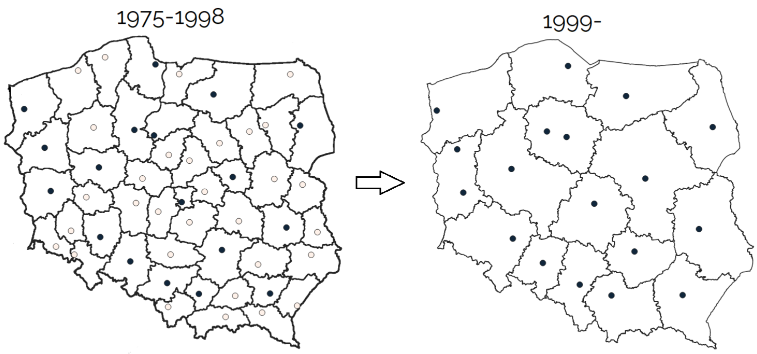


Figure 1: First-level administrative regions (*voivodeships*) before and after 1999. Dark dots represent the capitals from 1975 until now, and gray dots represent the capitals of regions from 1975 to 1998.

Losing the status of capital of *voivodeship* was followed by, inter alia, the decline in employment in local public administration, lower transfers from the central government, and, since 2004, lack of opportunity to manage EU funds. Moreover, the reform also changed a two-tier system of administrative division (communes, *voivodeships*) into three-tier (communes, *poviats*, *voivodeships*). All "ex-capitals" became capitals of points, together with other 35 municipalities.[2] While the reform improved the overall efficiency of public administration, its impact on the "losing" municipalities has not been explored in the economics literature. The optimal (de)centralization design is at the heart of every government organization. Still, as few "natural experiments" exist, there is little evidence on how the loss of capital status can affect a

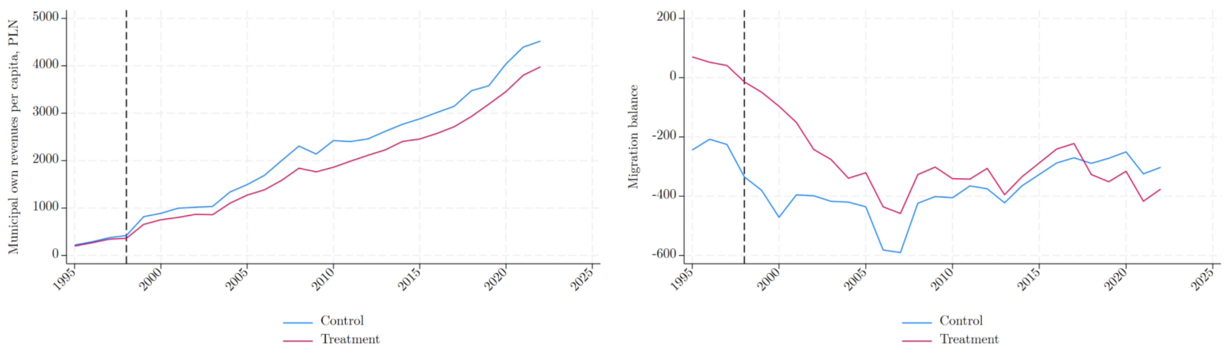
[1]As you can see in Figure 1, there are two regions, each with two municipalities holding the capital status.
[2]Municipalities with a population of at least 100 thousand persons.

city's development.[3] Given the sunk cost of building government capacity, it is plausible to argue that it is not symmetrical to the gain. The latter has been studied by, e.g., Chambru et al., 2022 and Becker et al., 2021. Also, the evidence concentrates on relatively narrow outcomes, mainly concerning the labor market. The related literature also studies the effects of public employment reforms (Faggio et al., 2018, Guillouzouic et al., 2021, Faggio, 2019). This paper contributes to the literature with a causal analysis of the impact of the loss of capital status on a wide range of socioeconomic outcomes.

Data and Empirical Strategy

The dataset used is a panel where a unit of observation is a municipality from 1990-2015. The source is the Main Statistical Office in Poland. The part covering 1990-2000 is novel, digitized from the Office's archives. This dataset covers around 100 variables describing the labor market, living conditions, real estate market, healthcare, education, culture, and demographics. Moreover, I use stenograms from Parliamentary discussions and leading newspapers' archives to describe the public and political debate before the reform. This reform started to be discussed in the Parliament only in 1998 and was a subject of grand dispute between the main parties. In addition, the number of regions in a new administrative landscape was highly disputed. In the paper, I show that the municipalities could not anticipate the outcome of these discussions well in advance.

In the preliminary analysis, in a standard diff-in-diff framework, I compare "ex-capitals" to municipalities that gained the status of capital of *poviat*. I find that the municipalities that lost the status of capital of a *voivodeship* collect, on average, less revenue and have a worse migration balance.



(a) Ex-capital municipalities collect on average 333 PLN per capita less than never-capitals (approx. 80 EUR).

(b) On average, migration balance worsened for ex-capitals by 220 persons compared to never-capitals.

Figure 2: Preliminary results

[3] Dascher, 2000, analyses the reform in West Germany in the 1960's when a number of cities lost the status of a county seat. However, he focuses on the outcomes for municipalities that remained capital.

As of January 2025, I finished cleaning the digitized dataset, allowing me to extend the analysis with a synthetic diff-in-diff (Arkhangelsky et al., 2021):

$$\left(\hat{\tau}^{\text{sdid}}, \hat{\mu}, \hat{\alpha}, \hat{\beta}\right) = \underset{\tau,\mu,\alpha,\beta}{\arg\min} \left\{ \sum_{i=1}^{N} \sum_{t=1}^{T} \left(Y_{it} - \mu - \alpha_i - \beta_t - W_{it}\tau\right)^2 \hat{\omega}_i^{\text{sdid}} \hat{\lambda}_t^{\text{sdid}} \right\}.$$

With weights $\hat{\omega}_i$ estimated using the outcomes of "never-capitals" (not treated units). Given the large set of variables, I aim to complement the analysis with multiple hypotheses testing. Moreover, the empirical analysis would be guided by a simple spatial equilibrium model with public and private goods (Redding and Rossi-Hansberg, 2017).

Mechanisms

The decline in public employment in the "ex-capitals" following the reform was a negative shock for the local labor market. However, an increase in highly educated labor supply could have contributed to the local economy, which now has a relatively larger private sector. Additionally, given the enlarged size of regions, public spending on large infrastructure projects (public transportation or construction of roads) might have been more efficient and benefited "ex-capitals". On the other hand, an increase in local unemployment could have contributed to the emigration of skilled workers. Also, as "ex-capitals" do not longer receive transfers from central government as large as before, local healthcare, education and culture could have become under-financed.
Given the large scope of variables in my analysis, I plan to test more hypotheses. I aim to finish the first draft of the paper in February/March 2025.

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