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Local Government Failure

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Abstract: A substantial public choice literature exists on the generic phenomenon of government failure in advanced western representative democracies. However, much less attention has been focussed on this question in the specific context of local governance, with the important exceptions of Bailey (1999) and Boyne (1998). In this paper we advance the argument that not only is government failure an essential dimension of policy making at all levels of government, but that cogent reasons exist for believing that the problem of government failure may be much more acute in local government than at higher tiers of governance. This argument runs counter to conventional wisdom amongst commentators, including Bailey (1999) and Boyne (1998).

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LOCAL GOVERNMENT FAILURE

The phenomenon of government failure, defined here as the inability of a government agency or agencies in a given tier of government or in a federal system of multi-tiered governments to intervene optimally in a market economy, is now a familiar area in policy analysis. In this article we advance the argument that not only is government failure an essential dimension of policy making at all levels of government, but that cogent reasons exist for believing that the problem of government failure may be much more acute in local government than at higher tiers of governance. This argument runs counter to conventional wisdom amongst commentators on municipal policymaking, most notably the views of authoritative British scholars Bailey (1999) and Boyne (1998). Moreover, we develop a new taxonomy of government failure in support of our thesis.

The application of the public choice approach to the public sector has generated various taxonomic systems of government failure. For example, perhaps the earliest typology of government failure was developed by O'Dowd (1978, p.360) who argued that all forms of government failure fell into a generic tripartite classification containing 'inherent impossibilities', 'political failures' and 'bureaucratic failures'. A somewhat more recent and closely related taxonomy of government failure has been advanced by Dollery and Wallis (1997) who argue that it is possible to identify three main forms of government failure; legislative failure, bureaucratic failure, and rent-seeking. But possibly the most comprehensive typology of government failure has been developed by Weisbrod (1978), who has advanced a fourfold classification which comprises legislative failure, administrative failure, judicial failure and enforcement failure.

The paper itself is divided into three main parts. Section one focuses on the typologies of government failure, which have been especially constructed for local government by Boyne (1998) and Bailey (1999). A new fourfold taxonomy of local government failure is developed in part two, which attempts to highlight the peculiar susceptibility of this tier of governance to government failure. The paper ends with some brief concluding remarks in section three.

TAXONOMIES OF LOCAL GOVERNMENT FAILURE

The literature contains comparatively few instances of the application of public choice theory to a specifically local government context in the sense of developing a taxonomic theoretical system of government failure, with some exceptions, most notably Boyne (1998) and Bailey (1999). In his *Public Choice Theory and Local Government*, Boyne (1998) develops a taxonomy of competitive categories in local government which can influence the degree of government failure at this level of government. He distinguishes between 'three distinct forms of competition' in the local government arena. Firstly, there is 'competition between public organisations for a share of tax revenues and service responsibilities' (p.1). Secondly, political parties should compete for the power to determine policy choices in local government jurisdictions. The final form of competition which can prevail in local government has been described by Boyne (1998, p.1) as 'competition between governmental and private organisations for control over the production of public services'. Boyne argues that for effective Tiebout-style competition to occur in the local government various conditions must be met to ensure that nature of this competition results in efficient outcomes, which are often ignored by public choice theorists. These conditions include 'horizontal fragmentation' or a large number of local governments at a given level of government, 'vertical fragmentation' in which several tiers of government compete, and 'substantial local autonomy', where 'local communities should have the discretion to innovate, experiment and develop distinctive policies' (p.22).

Drawing on the work of Albert Hirschman (1970), Bailey (1999) approaches the question of government failure at the municipal level from a somewhat different perspective. Hirschman (1970) developed the concepts of 'exit' and 'voice' as alternative means by which consumers of public services can influence the provision of these services and thereby decrease the degree of government failure they experience. In generic terms exit refers to the capacity of citizens to choose between alternative producers of some specified service. By contrast, voice refers to the ability of consumers to express their preferences for a different mix or quality of public services through various administrative mechanisms, like electoral voting, complaints to public service managers and customer surveys, without migrating away from their municipal jurisdictions.

As methods by which citizens can influence the extent of government failure at the local government level, both exit and voice have various limitations. Bailey (1999, pp.47/48) identifies

five main characteristics of local public services which can inhibit the effectiveness of voice in municipal affairs. 'Legal and institutional barriers' in the form of diluted political representation, electoral and procedural irregularities, inadequate public hearings, and so forth, can all serve to impede political attempts aimed at improving public services. 'Information asymmetries' between public bureaucrats and citizens concerning the nature and costs of public service delivery can also constrain the efficacy of voice. Where services are highly differentiated as, say, in the case of the quality of education provided by different schools, voice by some citizens may only influence the behaviour of a particular school rather than the whole school system, in contrast to undifferentiated services where voice will have more general effects. The socioeconomic characteristics of the population in a particular jurisdiction may be a decisive factor, with better-educated, affluent groups more likely to express voice than their poorer, less educated counterparts. Finally, the greater the relative importance of some public service to the perceived welfare of a population, the more important voice will be as a means of addressing government failure.

Exit is also subject to a number of constraints which are spelt out by Bailey (1999, p.48). The non-excludability characteristic of public goods may preclude exit altogether when these are national public goods, and even for some local public goods like poor environmental protection legislation may involve expensive relocation. Natural monopolies similarly preclude exit where they cover large geographical areas. Legislative impediments to entry by alternative suppliers of a service may negate exit possibilities, as in the case of national telecommunication providers. In large countries with uneven concentrations of population, such as Australia, Canada and the United States, large local government jurisdictions with small numbers of people may generate spatial barriers to exit. And lastly, imperfect information available to consumers may mean they are unaware of relatively unattractive service provision they are currently receiving, and thus induce them to underestimate the benefits of exit.

A NEW TAXONOMY OF LOCAL GOVERNMENT FAILURE

The various taxonomic systems of government failure which we have highlighted shed considerable light on the numerous ways in which this phenomenon can manifest itself in market economies characterised by representative democracy. Moreover, it would appear that not only are the generic forms of government failure ubiquitous in the sense that they apply to governance

systems in all advanced countries, but that they also occur at all levels of governance in these countries. Needless to add, the weight of evidence suggests that government failure is much more severe in developing societies than in their developed counterparts (Grindle, 1997), but either the fragility or absence of democratic institutions in these nations would seem to imply that the origins of government failure in the developing world are due to institutional incapacity and dictatorship rather than the functioning of a sophisticated democratic process. Nevertheless, with the significant exceptions of Boyne (1998) and Bailey (1999), the extant taxonomies of government failure discussed earlier are designed to apply to all tiers of governance and contain no explicit suggestion that some levels of government may be more susceptible to government failure than others. Moreover, even though both Boyne (1998) and Bailey (1999) direct their attention exclusively at municipal governance, there is no indication that they believe local governments are especially predisposed towards government failure in comparison with higher levels of government. Indeed, both authors seem to think the relative ease of exit from local government jurisdictions should make municipalities rather less prone to government failure than their more august counterparts.

In contrast to this literature, we contend that cogent reasons exist which suggest that local governments are much more susceptible to government failure than higher levels of government. Furthermore, drawing on the existing taxonomic literature contributed by public choice theorists, we develop a new fourfold typology of government failure in order to sustain this claim. In essence, we argue that at the level of municipal governance, it is possible to identify four main forms of government failure which, although they might also afflict federal and state governments, are nonetheless especially evident in the operations of local government. These kinds of government failure can be termed ‘voter apathy’, ‘asymmetric information and councillor capture’, ‘iron triangles’, and ‘fiscal illusion’. We shall examine each of these proposed taxonomic categories in turn.

Voter Apathy

A fundamental proposition of public choice theory holds that, in general, voting by citizens in political elections is an irrational activity since the process of voting is costly whereas the benefits associated with voting are negligible (Aldrich, 1997). Yet obviously in the real-world people do vote, although in many instances participation rates are low. This so-called ‘paradox of

voting' can be resolved if voting is viewed as a consumption activity. Moreover, in western societies the socialisation process strongly emphasises the civic virtues associated with political participation.

Although the conception of voting as a consumption activity may thus explain why people vote in elections, it cannot predict how voters will choose between alternative options once they are inside the polling booth. The conventional analysis of this question focuses on the economic dimensions of the choice; voters weigh up the costs and benefits of competing policy options and select the policy which maximises their net benefit in terms of outcomes (Mueller, 1989). However, more recent literature on 'expressive voting' seems to indicate that the actual choice of electors depends more on preferences for options rather than outcomes, where options do not consider the costs involved in outcomes (Brennan and Buchanan, 1984; Faith and Tollison, 1993).

Despite the undeniable fact that the right to vote plays a decisive role in democracy, together with related constitutional rights, including free speech and freedom of association, the act of voting in democratic elections is fraught with ambiguities. For instance, the substantial costs of gathering and digesting information on competing candidates, alternative policies, the costs and benefits of policy platforms, and the like, together with the fact the vote of an individual elector cannot realistically influence electoral outcomes, means that most voters choose to remain 'rationally ignorant' on many of the issues involved. Similarly, voters typically play dual roles in the political process, acting both as potential beneficiaries of public policies and as prospective financiers of these policies in their capacities as taxpayers.

Despite the centrality of voting in the democratic process, it is by no means the only element in collective decision making. Numerous other mechanisms exist, some of which we noted earlier in our discussion on Hirschman's (1970) 'voice' concept, which range from formal voting procedures to opinion polls, protest meetings, petitions, 'talkback' radio shows and the like. These alternatives to voting serve to diminish its significance in electors' eyes and contribute towards low political participation rates, ill-informed voters, and the various other problems associated with elections under representative democracy.

Although the difficulties arising from voter apathy undoubtedly afflict both the electoral process and its subsequent 'responsiveness' to the preferences of citizens at all levels of

government, the problem seems to be most acute local government. It is possible to identify several factors that may account for this observation. Firstly, and perhaps most importantly, in many local government systems, voters do not perceive periodic municipal elections as politically significant events because the behaviour of local governments is severely constrained and manipulated by state and national governments. Local governments simply 'don't matter in the scheme of things'. For example, Bailey (1999, p.265) notes that in Britain 'by the early 1990s, central government directly controlled about two-thirds of local government income and also had powers to cap local rates as well as having a significant on other revenue sources such as rents for municipal housing'. It is thus hardly surprising that not only were voter turnouts low in British local government elections, but voters also seemed to view them '...as little more than opinion polls on the popularity of central government' (Boyne, 1998, p.69). Similarly, with respect to New Zealand local government, Kerr (1999, p.4) has observed that 'there is a low turnout at elections, usually no more than 50 percent, despite postal voting'. Even in the United States, where local governments enjoy considerable autonomy, voter apathy is most pronounced at the local level. By comparison, in state and national elections voter participation rates have generally been substantially higher (Loughlin, 1986), except in countries with compulsory voting, like Australia.

A second reason for greater voter apathy in local government elections resides in the fact that in many countries these elections are not contested along party political lines, and even in those nations where political parties do participate, many candidates do not have party affiliation and party affiliations may in any event be much weaker than at the state or federal levels of government. Accordingly, voters do not have the informational benefits of party platforms to assist them in making informed choices. For instance, in the United States, political parties often play little formal role in municipal elections largely because in many jurisdictions they are debarred from participation as a consequence of the earlier 'reform movement' aimed at removing corruption from American urban politics (Hawley, 1973). Along similar lines, in many parts of Australia, including regional and rural New South Wales, longstanding convention usually precludes municipal candidates from adopting explicit partisan platforms.

Media reporting of local government elections is typically much less comprehensive and unquestioning than for comparable federal and state ballots and consequently affords voters much less opportunity to become well-acquainted with the policy platforms of individual candidates

standing for election. Whether this is a cause or simply an effect of voter apathy is a moot point, but it nevertheless surely accounts for a greater degree of ill-informed voting in municipal elections than their counterparts at higher levels of government.

Because of their lower public profiles and complicated interface, governance and management roles in municipal government are often confused in the eyes of many citizens, who cannot readily distinguish between elected representatives and professional public servants. Thus, perceived responsibility for past policy successes and failures is difficult to assign between the councillors and managers. Moreover, the committee systems characteristic of numerous local governments serve to further confuse the question of responsibility (Kerr, 1998).

Finally, the nature of local government activities itself makes any evaluation difficult. Municipalities typically deliver a vast range of services, even where their focus is on the relatively narrow 'services to property' dimension of delivery. Under these circumstances, not only is monitoring of service delivery an onerous task, but accountability is extremely difficult to establish. It is thus little wonder that citizens remain apathetic about the operations of local government.

The relatively high degree of voter apathy in local government, in comparison with its national and provincial counterparts, provides greater scope for government failure at this level of governance. In general, it can be argued that apathetic voters might not only elect inadequate representatives, but also fail to scrutinise their performance with a sufficient degree of rigour. For example, where voters are comparatively ill informed about the election platforms of councillors they are in a poor position to judge whether subsequently elected candidates have indeed met expectations or carried out their mandates. Similarly, given accountability and monitoring difficulties, citizens may experience difficulties in ascertaining how well municipalities are performing and who is responsible for any noteworthy problems that may arise. This seems to provide local government legislators with greater scope for opportunistic behaviour than their colleagues at higher levels of government and accordingly make local government more prone to what both Dollery and Wallis (1997) and Weisbrod (1978) classify as legislative failure. This may explain why in many real-world jurisdictions, state and federal governments sometimes retain statutory powers to override the decisions of local governments or even suspend local governments and arrange new elections.

Asymmetric Information and Councillor Capture

Given the comparative lack of scrutiny afforded elected local government representatives by apathetic municipal voters, relationships between these councillors and senior professional managers in the local government bureaucracies take on even greater significance than comparable relationships between politicians and public servants at higher levels of government. Ronald Wintrobe (1997, p.430) has posed the central question in this context by asking ‘how much influence does the bureaucracy have over what (and how much) governments do?’ One way of understanding the nature of these relationships is through agency theory.

If we conceive of the public sector in a representative democracy as being constituted by an interlocking series of principal-agent relationships, then the importance of agency failure becomes apparent. For example, Moe (1984, p. 765) observes that ‘the whole of politics can be seen as a chain of principal-agent relationships, from citizen to politician to bureaucratic superior to bureaucratic subordinate and on down the hierarchy of government to the lowest-level bureaucrats who actually deliver services directly to citizens’. This view leads to an approach to public sector reform that seeks to reduce the scope for agency failure in these relationships.

We contend that the agent/principal problems between elected representatives and professional bureaucrats in the local government milieu are likely to be much more acute than in their federal and state counterparts. Various arguments can be advanced in support of this contention. For instance, outside large metropolitan local governments, elected municipal representatives typically hold part-time positions and are remunerated accordingly. In the majority of cases they are thus obliged to have alternative full-time employment not only to sustain themselves economically in the short run, but also as a form of longer-term insurance against the possible failure of re-election in the future. They are thus unable to devote their full attention to the duties of their elected office. One consequence is often an inability to master the complexities and minutiae of local government finances and service delivery. This leads to a strong reliance on the advice and information provided by professional managers. Following the economic theory of bureaucracy, these managers may be motivated to pursue objectives in conflict with those espoused by elected representatives. Moreover, in accordance with agency theory and the lack of capacity for elected representatives to monitor principal/agent relationships with managers adequately, managers are well placed to exploit the resultant agency failure. Put differently, since

the 'hands-on' nature of their jobs means managers are bound to be much better informed than councillors, and since managers are the chief policy advisers to councillors, it seems likely that by manipulating the asymmetry of information to their advantage, managers can 'capture' councillors and thereby the policy outcomes they desire. Although analogous problems clearly exist at higher levels of government, because elected representatives in national and state governments serve in a full-time capacity, they can devote much more time and energy to mastering the complexities of the bureaux they oversee and are thus not as badly disadvantaged by problems of asymmetrical information and attendant capture as their colleagues in local government.

A similar and related argument derives from the fact that elected municipal councillors seldom have access to policy advisers at all, never mind advisers with a detailed knowledge of the workings of local government. By contrast, it is commonplace in state and federal governments for elected representatives to have constant access to professional advisers and researchers well versed in the intricacies of policy formulation and implementation who can assist them in evaluating and 'filtering' information from public service managers. Whilst the presence of such policy advisers and researchers obviously cannot completely nullify the problem of asymmetric behaviour in the interactions between politicians and public sector executives and thus altogether remove capture, it surely goes some way towards overcoming these problems.

Agenda control represents an additional means by which well-informed bureaucrats hold a comparative advantage over their relatively ill-informed political masters and can thus out-manoeuvre them in agent/principal terms. In their 'setter model', Romer and Rosenthal (1978) have shown how bureaucrats can control the outcomes of votes by elected councillors (or actual citizens in referenda) by specifying the alternatives which are voted upon. More specifically, councillors may be called to vote on a particular budget proposal. If a majority favour the proposal, then it is accepted. If a majority reject the proposal, then expenditure is set at a predetermined 'reversionary level'. In essence, 'the lower the reversion level, the higher the budget the bureaucratic setter is able to extract from voters', (Wintrobe, 1997, p.438), and if the reversionary level of expenditure is set higher than the pre-vote expenditure, then this also allows for budget growth.

Finally, strategies of ‘selective behaviour’ (Breton and Wintrobe, 1982), especially ‘selective efficiency’ (Wintrobe, 1997) can be embarked upon by bureaucrats using their advantage of asymmetric information. Wintrobe (1997, p.431) describes selective efficiency as a means by which ‘...bureaucrats control their masters’ choices by being efficient at the things they want to do, and inefficient at those they do not’. Thus when elected representatives oblige public managers to implement policies against their will, these can be confounded by deliberate inefficiency until they are withdrawn. Conversely, in areas where bureaucrats wish to expand operations, they can ensure efficient delivery and bring this to the attention of politicians. Given the greater degree of asymmetric information in municipal governance, it can be argued that selective efficiency is likely to prove a more potent weapon than at higher levels of government.

Iron Triangles

Whereas some of the earlier taxonomies of government failure we noted made explicit reference to citizens attempting to divert scarce resources from governments to themselves, like Dollery and Wallis’ (1997) rent-seeking category, most of these typologies nevertheless at least implicitly recognised that individuals and interest groups seek to influence both policy formulation and implementation in self-interested ways.

The analysis of interest groups in redistributing wealth and power through the political process has been approached by economists from at least three main theoretical directions. Firstly, and perhaps most importantly, the theory of rent-seeking tries to explain the ways in which citizens as wealth maximisers seek to use government intervention to create economic rents for themselves. The resultant burgeoning literature has provided fascinating insights into the interplay between state intervention and maximising economic agents (Buchanan, Tollison and Tullock, 1980).

A second theoretical perspective on the role of interest groups in the political process derives from Mancur Olson’s (1965) pioneering work on distributional coalitions. Olson sought to provide a generalised analysis of ‘...the problem of collective choice, the prisoner’s dilemma, the free-rider problem and the conditions of common fate, depending on the context (or discipline) in which it arises’ (Barry and Hardin, 1982, p.19) by invoking the economic paradigm of rational choice in group or collective behaviour.

Finally, endogenous policy theory, first developed by Magee, Brock and Young (1989), can also shed light on the manner in which interest groups can manipulate the political process to

secure their desired distributional outcomes. In essence, this theoretical perspective investigates the nature of economic and social policy formulation and tries to explain why welfare-reducing policy distortions exist since they are not rational from the point of view of society as a whole. Magee, Brock and Young (1989) distinguish between the concepts of economic efficiency and political efficiency. They argue that 'economically efficient policies create greater gains than losses whereas inefficient policies do the reverse' (Magee, Brock and Young, 1989, p.1). By contrast, politically efficient policies are those which increase the probability of election of parties and candidates. Moreover, a trade-off generally exists between economic efficiency and political efficiency.

Although policy formulation and implementation at all levels of government will be characterised by rent-seeking distributional coalitions maximising self interest in a process of endogenous policy development, it seems likely that powerful interest groups may be particularly successful in the local government sphere. We have argued earlier that municipal politicians generally without strong party affiliations are often elected on ill-defined policy platforms by apathetic and ill-informed voters and their activities are typically not subject to the same degree of media and other scrutiny as their colleagues at higher levels of government. Similarly, professional bureaucrats enjoy far greater discretion as a consequence of the acute asymmetry of information between them and their part-time political masters. Moreover, outside of the American political system, with its strong emphasis on congressional committees and other delegated powers, and in contrast to Westminster style parliamentary democracy, local government relies much more on standing committees to oversee its operations. For instance, municipal councils usually have 'parks and gardens' committees to run its public open spaces programs, 'roads and maintenance' committees to direct its public thoroughfare operations, and so forth. Interest groups can thus readily identify specific politicians with powers over particular aspects of municipal activity and target these individuals accordingly. They can also form alliances with municipal managers in charge of the various programs and attempt to influence the advice these bureaucrats give to committee members. In this way 'iron triangles' made up of elected committee councillors, professional managers and interest groups can arise which dominate policy making in specific areas. Often these interest groups will be made up of sub-contractors who undertake operations for municipalities, suppliers who provide goods and services to councils, property developers who build and renovate residential and other areas, and

businesses that enjoy preferential zoning arrangements and licensing agreements. The tripartite composition of these confluent colluding associations - or 'triangles'- and the difficulty of penetrating into them - or their 'iron' nature - mean that these iron triangles will tend not only to be dominant for considerable periods, but also stable through time.

Rent-seeking in this situation will aim at the formation and protection of iron triangles and countervailing rent-seeking by individuals and groups outside of triangles will consist of attempts to join existing triangles or replace extant triangles with new ones. Olson's (1965) categorisation of interest groups as either potentially successful ('privileged') or inherently unsuccessful ('latent') will determine the outcome of rent-seeking activity. Resultant policy formulation and implementation can be characterised as endogenous in the sense that it represents the interplay of the interests of the politicians, bureaucrats and interest groups who form the iron triangle in question.

Bailey (1999) argues that distributional coalitions are likely to have a greater deleterious effect on resource allocation in local government than at higher levels of government in a federation. He contends that a high proportion of local tax payments are fixed by various rules, not least property taxes which depend on land value, and do not vary significantly with the consumption of local government services. Under these circumstances, distributional coalitions have an incentive to attempt to change the level of service provision in their favour or to modify the distribution of service provision with a given and largely exogenously determined fixed total municipal budget. Accordingly, the activities of interest groups will focus heavily '...on the distribution of incremental expenditures and much attention is paid to annual budget changes which are small in relation to the overall budget' (Bailey, 1999, p.97). No distributional coalition will be willing to accept a fall in the services it receives because no corresponding change in its tax liability could occur, given the structure of municipal finances. Since opposing interest groups may tend to neutralise each other's influence, existing expenditure regimes would tend to remain fixed. This means inter alia that local governments experience great difficulties in meeting 'changed socioeconomic conditions', with the result that allocative inefficiencies would inevitably intensify.

Boyne (1998) believes that the degree of 'fragmentation' or decentralisation of local government might affect the demand for 'spatially divisible' public goods as opposed to

‘spatially indivisible’ public goods. Spatially divisible goods benefit particular localities rather than encompassing neighbouring zones whereas spatially indivisible goods benefit much greater areas. Thus residents of a given jurisdiction will prefer relatively more spatially divisible goods on grounds that the benefits of these goods will fall exclusively on them and adjacent jurisdictions will not be able to ‘free ride’ on the fruits of their rates and taxes. A similar argument can be advanced with respect to the power and enduring nature of iron triangles. We would expect that the greater the degree of fragmentation, the more significant would be the impact of iron triangles on policy making. After all, small local governments will attract less voter interest, enjoy minimal oversight by elected politicians, and draw little media attention in comparison to larger municipal entities where the ‘stakes are higher’. Accordingly, iron triangles are probably easier to form in fragmented systems.

The possibility of corruption within iron triangles also appears to be greater at the local government level than at higher tiers of governance. For example, Rodden and Rose-Ackerman (1997) point out that the ‘smallness’ and ‘intimacy’ of municipal jurisdictions makes them especially susceptible to corruption. Similarly, after reviewing the evidence, Susan Rose-Ackerman (1999, p.149) observes that ‘the most corrupt and patronage-ridden governments seem to be at the local level in most countries, including developed countries such as the United States and Germany’.

Fiscal Illusion

In advanced modern economies governments undertake a bewildering array of expenditure and regulatory functions and finance these activities through a myriad taxes and charges on their citizens. Measuring the size and cost of government has thus proved both conceptually and empirically difficult even for professional economists (see, for example, Dollery and Singh, 1998), let alone participants in the political process, especially voters. One consequence of the size and complexity of contemporary government in industrialised societies resides in the phenomenon of fiscal illusion. In essence, the concept of fiscal illusion revolves around the proposition that the actual costs and benefits of government may be consistently misconstrued by the citizenry of a given fiscal jurisdiction. Five specific forms of fiscal illusion can be identified (Dollery and Worthington, 1996), two of which are especially important in the context of local government.

Firstly, the ‘flypaper effect’, so-called since ‘money sticks where it hits’, refers to the hypothesised tendency for categorical lump-sum grants from federal to state and local governments to increase public expenditure by more than an equivalent increase in income from other sources. This proposition contravenes the ‘equivalence theorem’, a central proposition of the traditional theory of inter-governmental grants (Oates, 1972), which holds that a lump-sum grant to a fiscal jurisdiction will stimulate the same increase in expenditure that would flow from an equivalent increase in the private incomes of people who comprise the population of the jurisdiction. It would seem that voters misperceive grants as ‘gifts’ to their jurisdictions and overlook the fact that their tax liability rises at higher levels of government. Despite some reservations about the methodologies employed to investigate the real-world prevalence of the flypaper effect in local government, it appears that empirical evidence exists in support of the model, although this conclusion should be qualified by noting that institutional structures underlying the grants process in any country (or the problem of ‘endogeneity’) obviously play a major role in determining the strength of the flypaper effect (Worthington and Dollery, 1999).

Notwithstanding theoretical difficulties in explaining the flypaper effect (Bailey, 1999), it seems clear that the stimulatory effects of inter-governmental grants on local government expenditure might prove to be a major source of government failure at this level of government. After all, around 35 percent of American and 30 percent of Australian local government revenues derive from grants from higher levels of government (Worthington and Dollery, 1999, p.4/5), whereas in the United Kingdom the corresponding figure is almost 80 percent (Bailey, 1999, p.87). Gramlich (1977) has estimated that in the United States, lump sum grants from the federal government appeared to generate a fourfold increase in public expenditure in comparison to an equivalent increase in the income of local residents. Although the framework within which the intergovernmental grant process occurs differs in other advanced countries, and will obviously influence the expansionary effects of these grants accordingly, the resulting allocative inefficiencies are also likely to be substantial.

Secondly, ‘renter illusion’ has quintessential significance in the local government milieu. This form of fiscal illusion holds that an increase in the proportion of property renters in a given municipal jurisdiction will increase the level of public expenditures *ceteris paribus*. The presumption is that since the primary revenue of local government derives from property taxes, only those voters who own property and are thus directly levied will correctly estimate the tax-

price of local public goods. Although we could expect that higher property taxes will be passed on to renters through higher rents, the renters illusion hypothesis contends that a disjunction exists between a rental voter's perception of the level of municipal services and the value of rents paid. Accordingly, renters will vote for higher levels of local public good expenditure than property owners.

A considerable body of empirical evidence has been amassed on the renters illusion hypothesis and the weight of this evidence appears to support the hypothesis (see, for example, Dollery and Worthington, 1996, Table 4). However, several scholars have argued that 'renter rationality' might better explain the ostensible propensity of renters to support higher levels of local expenditure. According to this view, in the short-run property rentals are not affected by property taxes and so increases in taxes will not be passed on to renters (Barr and Davis, 1996). From the perspective of local government policymakers, whether or not renter rationality explains some or all of renter illusion seems less important than the putative fact that a greater proportion of renters in a jurisdiction will tend to bias expenditure upwards.

Renter illusion makes local government especially susceptible to government failure for the obvious reason that higher levels of government are much less reliant on property taxes as a source of revenue. Moreover, rate-capping, rent controls and other factors which influence the nexus between rentals, property taxes and municipal income are typically exogenously imposed on local jurisdictions by state and federal governments. This means that allocative inefficiencies stemming from this source cannot easily be remedied by municipal policies themselves without the assistance of higher tiers of government.

CONCLUDING REMARKS

We have presented a taxonomic view of government failure in local government which draws strongly on the generic typologies which have been developed by theorists operating in the broad public choice tradition. Moreover, we have sought to argue that cogent reasons exist which suggest that government failure in general, and agency failure in particular, are likely to be more acute in municipal government than its counterparts at higher tiers in a federalism. This conclusion is in contrast to views of both Bailey (1999) and Boyne (1999) who seem to believe that since inter-governmental competition is greater at the local government level it may be less susceptible to government failure.

If local government failure is indeed more pronounced, then we should inquire as to whether it can be differentiated in kind from government failure at federal and state levels; that is, does it consist of a different mix of allocative inefficiency, productive inefficiency and distributional inequity. Without a detailed empirical examination of this problem, it is difficult to speculate with any degree of precision. However, it does seem likely that allocative inefficiencies may well be more evident since the relatively small size of municipal budgets makes trade-offs between alternative bundles of local public goods more acute.

If local government is indeed more prone to government failure than state and federal governments, then this also raises interesting questions about the design of appropriate governance mechanisms for municipalities. For example, the amalgamation of small local government structures into larger units could moderate the extent of local government failure. Similarly, the case for competitive tendering and ‘out-sourcing’ may be stronger at the municipal level of government than its higher counterparts. Moreover, uniform national standards of service delivery could be imposed on local governments to oblige them to provide minimal levels of local public goods.

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