



**University of New England**

**School of Economics**

**LOCAL GOVERNMENT FAILURE IN AUSTRALIA:  
AN EMPIRICAL ANALYSIS OF NEW SOUTH WALES**

by

J. Byrnes, B. Dollery and J. Wallis

No. 2001-12 – August 2001

**Working Paper Series in Economics**

ISSN 1442 2980

<http://www.une.edu.au/febl/EconStud/wps.htm>

Copyright © 2001 by J. Byrnes, B. Dollery and J. Wallis. All rights reserved. Readers may make verbatim copies of this document for non-commercial purposes by any means, provided this copyright notice appears on all such copies. ISBN 1 86389 7631

## **LOCAL GOVERNMENT FAILURE IN AUSTRALIA: AN EMPIRICAL ANALYSIS OF NEW SOUTH WALES**

J. Byrnes, B. Dollery and J. Wallis\*\*

### **Abstract**

The complexities of contemporary local governance in Australia and other advanced democracies provide social scientists with significant theoretical and empirical challenges. Drawing on rent developments, including public choice theory, economists have sought to develop taxonomic systems of government failure specifically tailored to local government circumstances. This paper seeks to extend the Dollery and Wallis (2001) taxonomy of local government failure by invoking Olson's (1965) concept of political entrepreneurship. The paper then attempts to determine the empirical validity of the augmented taxonomy by examining it in the context of New South Wales local government.

Key Words: Local government failure, public choice, local governance.

---

\*\* Joel Byrnes is a B.Ec. (Honours) student in the School of Economics at the University of New England, Brian Dollery is Professor of Economics and Director of the Centre for Local Government at the University of New England, Armidale, New South Wales, Australia, and Joe Wallis is Senior Lecturer in Economics at Otago University, Dunedin, New Zealand. Contact information: School of Economics, University of New England, Armidale, NSW 2351, Australia.  
Email: bdallery@metz.une.edu.au.

**LOCAL GOVERNMENT FAILURE IN AUSTRALIA:  
AN EMPIRICAL ANALYSIS OF NEW SOUTH WALES**  
**J. Byrnes, B. Dollery and J. Wallis**

## **Introduction**

In contemporary western society, local government finds itself in an increasingly complex milieu. In Australia and elsewhere, the local government community faces escalating demands on its resources whilst simultaneously experiencing diminishing financial capacity. These pressures require a more sophisticated approach by municipal managers, which draws on the analytical frameworks offered by social scientists, including economists.

Economic theory offers a number of useful theoretical approaches that can inform local government policymaking. For example, the market failure paradigm provides conceptual guidance on the best ways in which municipalities can intervene to enhance economic growth and economic efficiency in their local economies. Similarly, new institutional economics can play a significant role in the design and reform of governance structures to meet changing demands. The theory of government failure can also assist in formulating and implementing improved local government policy.

Government failure can be defined 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 achieve their intended outcomes. 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.

In contrast to the substantial public choice literature on the problem of government failure in state and federal governments (Mueller, 1989), comparatively little effort has been expended

on government failure at the municipal level. Nevertheless, economists have developed at least three taxonomic approaches to local government failure. Authoritative British scholars Bailey (1999) and Boyne (1998) have both advanced typologies of local government failure premised on the belief the problem of government failure is less acute at the local government level compared to state and central governments. By contrast, Dollery and Wallis (2001) have argued that the phenomenon of government failure is likely to be more widespread in local governance and have produced a taxonomy of local government failure based on this proposition.

This paper seeks to extend the Dollery and Wallis (2001) taxonomy and apply it to the actual circumstances of contemporary local government in New South Wales. The paper itself comprises four main parts. Section 2 reviews the taxonomic systems developed by Dollery and Wallis (2001). Section 3 attempts to augment the Dollery and Wallis (2001) typology by adding a further dimension based on political entrepreneurship. Section 4 focuses on the empirical application of the expanded Dollery and Wallis (2001) taxonomy to New South Wales local government. The paper ends with some brief concluding remarks in section 5.

### **Taxonomies of Local Government Failure**

The theoretical literature contains relatively few cases of the application of public choice theory to local government in the sense of developing a taxonomic system of government failure, with some exceptions, most notably Boyne (1998) and Bailey (1999). In contrast to Boyne (1998) and Bailey (1999), Dollery and Wallis (2001) 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, Dollery and Wallis (2001) develop a new fourfold typology of government failure in order to sustain this claim. In essence, they 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 are termed “voter apathy”, “asymmetric information and councillor capture”, “iron triangles”, and “fiscal illusion”.

The Dollery and Wallis (2001) taxonomy of local government failure can be summarised in Table 1 below:

**Table 1: Dollery and Wallis (2001) Taxonomy of Local Government Failure**

Factors that may lead to government failure	Hypothesis
<p><b>Voter Apathy</b></p> <p>Following from Aldrich (1997), voting by citizens in elections can be thought of as an irrational activity since the process of voting is costly whereas the benefits associated with voting are negligible. The outcome of this is a degree of ‘voter apathy’, and whilst this may affect all levels of government, five reasons can be identified to suggest that the degree of voter apathy is higher in local government.</p>	<ul style="list-style-type: none"> <li>(a) In many local government systems, the role and behaviour of councils is severely restricted and manipulated by state and federal governments. As a result, voters do not see municipal elections as significant political events</li> <li>(b) In many countries, municipal elections are not carried out along party political lines, and as a result, voters do not have the informational benefits of party platforms to assist them in making informed choices</li> <li>(c) Media reporting of local government elections can be much less questioning and comprehensive than that afforded state or federal governments. Voters therefore do not have the same opportunities to become aquatinted with the various policy positions of candidates</li> <li>(d) Voters may find it difficult to assign responsibility for previous policy successes and failures between elected representatives and professional public servants, due to their lower public profiles and the complicated interface between the two in the formulation and implementation of policy</li> <li>(e) Due to the vast array of functions carried out by municipalities, any monitoring or evaluation can be an onerous task.</li> </ul>
<p><b>Asymmetric Information and Councillor capture</b></p> <p>Guided by Jensen and Meckling’s (1976) agency theory, in which they identified the generic problem of ensuring that agents maximise the welfare of principals, economists have applied this to the role of bureaucrats. Bureaucrats are said to bear an agent/principal relationship to politicians, who in turn bear an agent/principal relationship to voters. Moe (1984, p 765) observes that “the whole of politics can be seen as a chain of principal agent relationships”. Four factors, based variously on agency theory and the economic theory of bureaucracy, can be identified that may lead to a greater degree of government failure at the local government level.</p>	<ul style="list-style-type: none"> <li>(a) Since councillors typically hold part-time positions and are remunerated accordingly, to provide a means of income and to guard against the possible failure of re-election, elected representatives usually hold full-time employment. As a consequence it is often difficult for them to master the complex and minute detail of the office they hold. They are thus reliant upon professional managers to provide them with advice and information. An agent/principal problem may emerge as a result. There is an incentive for managers to pursue objectives at variance with those espoused by councillors. Furthermore, as it is often not feasible for the principal to monitor the actions of the agent, managers are in a position to exploit this relationship. This is likely to be a much more severe problem at the local government level since federal and state politicians typically hold full-time positions and are thus able to more readily master the detail of their office</li> <li>(b) A related problem arises from the fact the local government representatives generally do not have access to political advisers, who may assist in filtering information received from professional managers</li> <li>(c) Councillors can also be “captured” by professional managers through their ability to control the policy agenda. Bureaucrats can control the outcomes of votes by elected councillors by specifying the alternatives to be voted upon. For example, managers may present a budget proposal that calls for a greater degree of spending. If the proposal receives a majority of votes, then it is accepted. However, if the <i>status quo</i> is selected, the manager succeeds in maintaining the current fiscal setting.</li> <li>(d) Selective behaviour (Breton and Wintrobe, 1982), especially selective inefficiency (Wintrobe, 1997) can be pursued by</li> </ul>

### **Iron Triangles**

Derived from the public choice theory of rent-seeking (Buchanan, Tollison and Tullock, 1980) and Mancur Olson's (1965) pioneering work on distributional coalitions, the theory of iron triangles refers to the formation of tripartite confluent colluding associations – or ‘triangles’ – that seek to influence the share of a municipalities budget devoted to particular local government programs. Following from Olson's (1965) analysis of collective action, such groups can be classified as privileged and are ‘iron’ in nature. Three factors can be identified to suggest that the problem of iron triangles will be felt more acutely at the local government level.

managers due to the inherent asymmetry of information that exists at this level of government. Should a manager not agree with a policy objective, they may impede the implementation with deliberate inefficiencies until the policy is withdrawn.

- (a) Rent-seeking distributional coalitions are to be found at all levels of government. However, due to a number of characteristics of local government, it appears that self-seeking interest groups are likely to be more successful at this level of government than any other. As has already been established, professional managers have a greater degree of autonomy as a result of the acute asymmetry of information between them and their part-time political masters. Combined with the tendency for local governments to rely upon standing committees to oversee their operations, interest groups can readily identify politicians with powers over particular municipal functions, as well as form alliances with municipal managers in charge of the various programs. Interest groups may then use this alliance 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.
- (b) Bailey (1999) argues that distributional coalitions are likely to have a greater deleterious effect on resource allocation in local government. Since a relatively high percentage of tax revenues are fixed, and do not vary significantly with the consumption of local public services, interest groups have an incentive to attempt the redistribution of service provision in their favour.
- (c) As the local tier of government is typically the most horizontally fragmented, iron triangles might be expected to have a more significant impact on policy making, since small local governments will attract less media and voter scrutiny.

### **Fiscal Illusion**

‘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’. Of the five forms that fiscal illusion can take, two are especially applicable to the local government arena. They are the “fly-paper effect” and ‘renter illusion’.

- (a) The ‘fly-paper effect’, so-called since ‘money sticks where it hits’, refers to the hypothesised tendency for categorical lump-sum grants from federal to state or local governments to increase public expenditure by more than an equivalent increase in income from other sources. As Dollery and Wallis (2001, p 16) contend “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”.
- (b) “Renter illusion” relies on the assumption that since the primary revenue of local government is derived from property taxes, only those voters who own property and are thus directly levied will correctly estimate the tax-price of local public goods. It follows then, that an increase in the proportion of renters within a local government will lead to an increase in the level of public expenditures, *ceteris paribus*. Since higher levels of government are less reliant upon property taxes, local government is far more susceptible to this form of fiscal illusion.

---

### **An Extension of the Dollery and Wallis Taxonomy**

It seems possible to extend the Dollery and Wallis (2001) taxonomy by identifying a fifth source of government failure at the local government level. Drawing on the work of Olson

(1965), we argue that the inefficient use of resources by political entrepreneurs to capture the attention of voters may lead to systematic allocative inefficiency in local government.

Continuing in the tradition of Anthony Downs (1957) and many others, Olson (1965) sought to provide a generalised analysis of “...the problem of collective action, 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 the context of group or collective behaviour. In its simplest form, Olson (1965) postulates the logic of collective action as an equation of cost ( $C$ ), gross benefits to individual  $i$  ( $V_i$ ), and net benefits to individual  $I$  ( $A_i$ ) from their contribution to the collective effort of some group in the following form:

$$A_i = V_i - C$$

If  $A_i > 0$  for any  $i$ , then the group in question is termed “privileged”, and will in general succeed in collective action. Alternatively, if  $A_i < 0$  for all  $I$ , then the group is “latent”, and will fail in collective action unless additional individual incentives can be brought to bear. Firstly, selective incentives may exist which induce successful collective action as a by-product of private incentives. In these cases, groups or organisations supplying collective goods simultaneously provide separate negative or positive incentives to group members or intended group members. And secondly, political entrepreneurship may be present where some individual or subset of a group finds it in their larger self-interest to provide collective goods to groups.

Typically, politicians at the higher levels of government have worked their way through the party political ranks, as it were, to attain their level of office. A potted survey of politicians who have recently held high office in Australia provides support for this proposition. For example, Kim Beazley, Peter Costello, Tony Abbott, John Howard and Bob Hawke, to mention a few, all began their political careers in student politics.

The behaviour of local government politicians can be analysed fruitfully using the concept of political entrepreneurship. Councils can be conceived of as breeding grounds for political entrepreneurs to not only capture the attention of political party officials at higher levels of government, but also of prospective voters in federal and state seats.

The actions of political entrepreneurs in themselves cannot necessarily be seen as a cause of government failure. A political entrepreneur, by working toward the collective goals of a

council, may induce the efficient delivery of public services. However, since “allocative inefficiency arises from the excessive provision of public goods as politicians pursue strategies designed to maximise their chances of re-election rather than policies which would further the common good” (Dollery and Wallis, 1997, p. 37), we can hypothesise that if a municipal political entrepreneur seeks to advance her political career at higher levels of governance, her actions regarding public expenditure are likely to be correlated with capturing the attention of voters and party officials rather than the allocatively efficient provision of public goods.

It can be argued that the problem of political entrepreneurship is likely to be felt more acutely at the local government level for at least three reasons. Firstly, since local government is typically the lowest level of government in a federation, with a large number of elected representatives, the proportion of political entrepreneurs is likely to be higher at this level than any other. Secondly, due to the high degree of voter apathy, and comparative lack of interest by the media in local government, a politician will need to embark on grandiose and eye-catching projects to become known by voters. Similarly, a local government political entrepreneur may find it expedient to deliver “change” even if the current policy stance is efficient. Finally, since state and federal jurisdictions are typically larger in area and population than local government wards, political entrepreneurs may need to provide public goods that have a benefit region much larger than that of the local government they represent.

### **Empirical Application To NSW Local Government**

We can now apply the expanded Dollery and Wallis (2001) taxonomy to contemporary local governance in the Australian state of New South Wales.

#### **Voter apathy**

The Australian electoral system is unique in that it is compulsory for citizens to vote at elections for all levels of government. This presents difficulties in gauging the degree of voter apathy in comparison with countries that do not force citizens to vote.

Nevertheless, one way of measuring voter apathy in local government is to compare the proportion of voter turn-out and the percentage of informal votes cast at federal and local government elections. In the recent past, a federal election was held in Australia in 1998, and local government elections were held in New South Wales in 1999. Data from these two

elections has been collected for the purpose of making such comparisons. The data is summarised in Table 2 below:

**Table 2: A Comparison of Voting at Local and Federal Elections**

	<b>1998 Federal Election*</b>	<b>1999 NSW Local Government Elections #</b>
Voter turn-out	94.99%	84.22%
Informal votes cast	3.78%	5.47%

Source: \*Australian Electoral Commission (1998a) and (1998b). #NSW Electoral Commission (2001). Notes: Voter turn-out is expressed as a percentage of the population enrolled to vote, whilst informal votes cast is expressed as a percentage of votes cast.

Local government typically consists of one chamber, whereas the federal government consists of two chambers, the House of Representatives and the Senate. In order to make valid comparisons between the two tiers of government in Table 2, data for the federal level was taken from the House of Representatives only.

The data suggest that a greater degree of voter apathy may exist at the local government level in the Australian federation. Voters are 11 per cent more likely not to vote in local government elections, and when electors do vote, they are 30 percent more likely to cast an informal vote. Given this information, it is reasonable to suggest that voter apathy is a valid source of government failure within NSW local government.

### **Asymmetric information and councillor capture**

Instances of the generic problem of asymmetric information and councillor capture in the operations of local government in NSW may be gleaned from official inquiries into local government behaviour conducted by the NSW Department of Local Government (DLG) (see, for instance DLG, 1997, 1999, 2000b). In the present context, we provide two specific case studies which convey much of the flavour of these inquiries. They are occurred in Woollahra Municipal Council and Ku-ring-gai Council. Each will be dealt with in turn.

The Woollahra case study is taken from a post implementation review report concerning Woollahra Municipal Council (DLG, 1998). By way of background, on 13 November 1995, Woollahra Municipal Council adopted a Plan of Management for Woollahra Park. The post implementation review report found that since the adoption of the management plan, it had been amended in an unauthorised manner and that the amended version had apparently been circulated and used as if it were the adopted Plan of Management. Councillors were thus left

under the impression that the original Plan of Management, as adopted on 13 November, was still the policy document under which decisions about Woollahra Park were made.

Among other matters, the DLG sought to determine how the plan of management was amended without Council's knowledge, who amended it, and whether the amendments were of any material significance as defined by the Local Government Act (1993). The Department found that the document was amended sometime between its adoption and June 1996. It was noted that the Plan of Management was, by virtue of its existence on the Council's computer network, open to alteration by any person having access to the network. Accordingly, the Department was unable to determine who amended the document, but nevertheless concluded that responsibility for the document was held by the Director (of) Technical Services at the time.

The amendments made were of considerable significance. In effect, the addition of two clauses to the plan meant that the Council, or, more importantly, its employees, could enter into lease agreements regarding the area covered by the management plan. It would be reasonable to assume that the management plan was amended by a member of staff at the Council who considered the plan to be restrictive, yet did not want to go through the appropriate channels to have the document amended. Relying on the fact that Councillors did not have an intimate knowledge of Council operations, the employee simply amended the document as s/he saw fit, without advising Councillors of his or her actions. This would appear to be an example of councillor capture brought about by asymmetric information.

The Ku-ring-gai Council example (DLG, 2000a) is centred on the commissioning of a report by the General Manager into the success or otherwise of the contracting out of waste collection services by the Council. The report was commissioned some months before a local government election was held. A number of operational concerns came to light as a result of the report and the General Manager arranged for a confidential briefing between herself, the then Mayor and Deputy Mayor and the author of the report. It was decided that this report should not go to the full Council.

A short time later, Council elections were held and the composition of the Council was substantially changed. Moreover, a new Mayor was in place. At the first meeting of the Council, it was resolved that the Council commission an independent report into the out-

sourcing issue. At no point did the General Manager inform the Council that she had in fact commissioned a report herself, and had been fully briefed as to the findings of that report.

As a result of the General Manger not furnishing Councillors with all the details relating to the contracting-out of the waste management service, Council commissioned two identical reports from separate consultants. This too would appear to be a clear instance of the economic inefficiency caused by asymmetric information and council capture.

### **Iron triangles**

Empirical evidence in support of iron triangles is, by its nature, difficult to determine statistically. Owing to their very nature, they are likely to be well hidden by the participants, and often give the impression of legality. Consequently, oversight bodies, like the NSW Department of Local Government may find it difficult to assemble a body of evidence to prove that an iron triangle is illegal and/or allocatively inefficient. Accordingly, a case study approach suggests itself. We will rely here on two specific examples. Firstly, an Independent Commission Against Corruption (ICAC, 1999) report into the operations of the Liverpool City Council and in particular the actions of the Council's Purchasing Manager, and secondly, a DLG inquiry into the Ku-ring-gai Council (DLG, 2000a)

The case of Liverpool City Council is a fascinating one. Here we are presented with a picture of a Council administration blatantly favouring third parties in the awarding of public works contracts. It is a tale of well-planned deceit and corruption, centred on the Purchasing Manager and a number of contractors in the field of public works.

To place this case study in context, it useful to summarise the procedures the council follows in awarding public works contracts. In essence, the prescribed procedure states that for works in excess of \$100,000, the contract should go to open tender, whereas for amounts under \$100,000, the Purchasing Manager should obtain various kinds of quotations. In addition, provision is made in the procedure for the wavering of these requirements in emergency situations. Once quotes are received, the Purchasing Manager recommends a contractor for the job. The contractor submitting the lowest quote usually wins the contract. However, the procedure does not dictate that this should always be the case. The Council also has in place a code of conduct relating to the acceptance of gifts and benefits. In essence, the code states that council employees should not accept such gifts if a compromise is seen to be likely.

The Liverpool City Council Purchasing Manager was responsible for collecting quotes or calling for tenders on work to be carried out on behalf of the council. He maintained an informal list of contractors who were known to council through previous work carried out on behalf of the Council. ICAC (1999) found that the Purchasing Manager engaged in corrupt conduct with five contractors on the list in a variety of ways.

The point must be made that this case study is a clear and proven case of corruption within local government. It is not a requirement of the Dollery and Wallis (2001) model that corruption must be present. Indeed, it may be more likely that iron triangles will be perfectly legal agreements made between a manager, councillor and contractor. However, this case study does accommodate a number of the characteristics of iron triangle arrangements. Firstly, the Purchasing Manager kept an informal list of preferred contractors to be contacted when a job was to be awarded. Secondly, and with particular reference to the submitting of dummy quotes, redistributional coalitions were in existence. In order for the dummy quote arrangement to be successful, it was necessary for three parties to be involved; that is, two contractors and the Purchasing Manager. Thirdly, due to the iron nature of the arrangements, competition for the contract was non-existent. The Purchasing Manager in effect named an amount for which the work should be carried out, rather than allowing the restricted tendering process to deliver a competitive price. Finally, the payments made to the Purchasing Manager can be thought of as an example of rent seeking.

Further evidence of iron triangles is to be found in a DLG (2000a) inquiry into the Ku-ring-gai Council in Sydney's northern suburbs. It was discovered during the investigation that consultants were being hired unnecessarily by the Council to perform tasks that professional staff were able and willing to perform. Furthermore, some consultants were found to be engaged in a way and in circumstances that raised a number of concerns, especially with reference to the Council's Residential Housing Strategy.

### **Fiscal illusion**

As we saw in Table 1, two forms of fiscal illusion are especially relevant to local government, namely, the renter illusion and the flypaper effect. Unfortunately, few empirical studies into the flypaper effect and renter illusion in local governance have been conducted in Australia, with most work focussed on North America. Nevertheless, some idea of the kind of results obtained for renter illusion are summarised in Table 3:

**Table 3: The Empirical Analysis of Renter Illusion**

Author	Data	Major findings
Barr and Davis (1966)	64 Pennsylvanian municipal areas	Property holding an important determinant of expenditure decisions
Bergstrom and Goodman (1973)	826 US municipal areas	Negative and significant coefficient between percentage owner occupied and the level of general expenditures
Hanushek (1975)	140 Cleveland precincts	Homeowners tend to vote more readily against increases in public expenditure
Peterson (1975)	Selection of US school districts	The rental population is associated with the demand for higher public service levels
Lovell (1978)	136 Connecticut towns	Proportion of owner occupied negatively related to level of expenditures
Gronberg (1980)	83 Chicago localities	Proportion of owner occupied negatively related to level of expenditures
Martinez-Vazquez (1983)	Sundry St Louis precincts	Higher proportion of 'yes' votes regarding increased local expenditures attributable to high rates of renter occupation
Brazer and McCarty (1987)	600 Connecticut, New Jersey and Virginia districts	School expenditure per pupil and municipal expenditure per capita negatively associated with proportion of owner-occupiers
Schwab and Zampelli (1987)	73 Maryland cities and counties	No relationship between percentage of homeowners and police expenditure
Moomau and Morton (1992)	428 New Orleans precincts	The higher the value of rent the more likely renters will perceive the tax burden
Heyndels and Smolder (1994)	302 Flemish municipal areas	No relationship between occupancy status and expenditure outcomes
Carrol and Yinger (1994)	174 Boston towns	Property tax increases are exactly offset by increases in rents. Provides support for renter rationality
Worthington (1994)	46 Australian local gvn't areas	Proportion owner-occupied and expenditure negatively related

Source: Adapted from Dollery and Worthington (1996)

In a specifically Australian context, Worthington (1994) found a negative relationship between the proportion of owner-occupiers within an Australian local government area and expenditure, suggesting that renter illusion is significant within local government in Australia.

A similar empirical situation is apparent for the flypaper effect. Evidence on local government is summarised in Table 4:

**Table 4: The Empirical Analysis of the Flypaper Effect**

Author	Data	Major Findings
DiLorenzo (1982b)	116 New York municipalities	Internal subsidisation increases the level of expenditure
Grossman (1990)	136 Virginian localities	Unconditional grants are positive and significant in increasing the level of expenditure
Stewart (1993)	Australian state and local governments	Increase in grants associated with fall in own-purpose expenditures
Heyndels and Smolders (1994)	302 Flemish municipalities	Positive and significant impact of grants on expenditure

Source: Adapted from Dollery and Worthington (1996).

Of the four studies presented in Table 4, three support the flypaper effect hypothesis as it relates to local government. The only Australian study, conducted by Stewart (1993), found no evidence to support the flypaper effect in Australian local government.

### **Political entrepreneurship**

As a test for the extent of political entrepreneurship in NSW local government, a survey of the political history of the members sitting in both houses of the federal and NSW parliaments has been conducted. Table 5 contains the outcome of this process:

**Table 5: Evidence on Political Entrepreneurship**

Level of government	Percentage having served in local government
Federal House of Representatives*	24%
NSW Legislative Council #	39%

Source: #<http://www.parliament.nsw.gov.au/prod/web/PHWeb.nsf/Members?OpenFrameSet>

- <http://www.aph.gov.au/house/members/mi-alpha.asp>

The data in Table 5 lends support to the argument that some councillors may use local government as a means of furthering their political careers, particularly those seeking a seat in the NSW Parliament. However, a much more comprehensive study would be required to support the argument that this translates into the inefficient provision of public goods.

### **Concluding Remarks**

This paper has sought to augment the Dollery and Wallis (2001) taxonomy of local government failure by adding Olson's (1965) political entrepreneurship category to their

typology. Moreover, we have attempted to subject the expanded taxonomy to empirical scrutiny in the context of contemporary local government in NSW.

At least four observations arise from the empirical analysis. Firstly, on balance the empirical evidence appears to support the proposition that government failure is more pronounced at the local government level. Secondly, the addition of political entrepreneurship to the Dollery and Wallis (2001) taxonomy appears warranted on both conceptual and empirical grounds. Thirdly, the empirical tests which we have applied can perhaps best be described as *ad hoc* in the sense that they are not derived on *a priori* theoretical grounds, but rather drawn from the somewhat scanty available evidence. It follows that these tests should be viewed with caution and the results treated as a preliminary rather than a definitive test of the augmented Dollery and Wallis (2001) taxonomy. Finally, it should be stressed that the expanded taxonomy itself contains categories not readily amenable to rigorous empirical analysis. Accordingly, as an analytical tool for the evaluation of local government behaviour, the enlarged Dollery and Wallis (2001) taxonomy is perhaps best seen as a useful way of conceptualising local government failure and not necessarily as an empirical tool for measuring the degree of failure.

Although we have deliberately avoided discussing the policy implications of the preceding analysis, not least for reasons of brevity, obviously important policy issues naturally arise. For example, if government failure is indeed more acute at the local government level, then this raises interesting questions as to the optimal structure of municipal governance. For instance, it may be desirable to amalgamate small local government areas so that they more closely resemble their state and federal counterparts. Similarly, it also suggests that the current close degree of supervision of Australian local government by the state and Commonwealth governments, as exemplified by rate capping and other regulatory measures, may be justified.

## References

- Aldrich, J.H. (1997), “When Is It Rational to Vote?” in D.C. Mueller (ed.), *Perspectives on Public Choice*, Cambridge, Cambridge University Press, pp.373-390.
- Australian Electoral Commission (1998a), *Informality Statistics (%) 1998 House of Representatives and Senate*, <http://www.aec.gov.au/voting/inform1998.htm>, accessed 30 May, 2001
- Australian Electoral Commission (1998b), *Voter turnout 1901 – 1998 (total votes as a % of enrolment)*, <http://www.aec.gov.au/voting/turnout.htm>, accessed 30 May, 2001
- Bailey, S.J. (1999), *Local Government Economics*, Macmillian, Basingstoke.
- Barr, J.L. and Davis, O.A. (1966), “An Elementary Political and Economic Theory of the Expenditures of Local Governments”, *The Southern Economic Journal*, Vol.33, pp149-65.
- Barry, B.M. and Hardin, R. (1982), *Rational Man and Irrational Society*, London: Sage Publications.
- Bergstrom, T.C. and Goodman, R.P. (1973), “Private Demands for Public Goods”, *American Economic Review*, Vol63, pp.280-96.
- Boyne, G.A. (1998), *Public Choice Theory and Local Government*, Macmillan, Basingstoke.
- Brazer, H.E. and McCarty, T.A. (1987), “Interaction Between Demand for Education and for Municipal Services”, *National Tax Journal*, Vol.40, pp.555-66.
- Bretton, A. and Wintrobe, R. (1982), *The Logic of Bureaucratic Conduct*, Cambridge University Press, New York.
- Buchanan, J.M. (1978), “From Private Preferences to Public Philosophy: The Development of Public Choice”, in Institute of Economic Affairs, *The Economics of Politics*, London.
- Buchanan, J.M., Tollison R.D. and Tullock, G. (eds.), *Towards a Theory of a Rent-Seeking Society*, Texas University Press, College Station, pp. 3-15.
- Carroll, R.J. and Yinger, J. (1994), “Is the Property Tax a Benefit Tax? The Case of Rental Housing”, *National Tax Journal*, Vol. 47, pp.295-316.
- DiLorenzo, T.J. (1992), “Utility Profits, Fiscal Illusion and Local Public Expenditure”, *Public Choice*, Vol.38, pp243-52.
- Dollery , B.E. and Wallis, J.L. (1997), “Market Failure, Government Failure, Leadership and Public Policy”, *Journal of Interdisciplinary Economics*, Vol. 8 (2), pp. 113-126.

Dollery, B.E. and Wallis, J.L. (2001), "Local Government Failure", *UNE Working Paper Series in Economics*, Working Paper 2001/11, School of Economics, University of New England, Armidale.

Dollery, B.E. and Wallis, J.L. (2001), *The Political Economy of Local Government*, Cheltenham, Edward Elgar.

Dollery, B.E. and Worthington, A.C. (1995), "Federal Expenditure and Fiscal Illusion: an Australian Test of the Flypaper Hypothesis", *Publius: The Journal of Federalism*, Vol. 25, pp23-34.

Dollery, B.E. and Worthington, A.C. (1996), "The Empirical Analysis of Fiscal Illusion", *Journal of Economic Surveys*, Vol.10, No.3, pp.261-297.

Downs, A. (1957), *An Economic Theory of Democracy*, New York: Harper Row.

Gronberg, T.J. (1980), "The Interaction of Markets in Housing and Local Public Goods: A Simultaneous Equation Approach", *Southern Economic Journal*, Vol. 46, 445-55.

Grossman, P.J. (1990), "The Impact of Federal and State Grants on Local Government Spending: a Test of the Fiscal Illusion Hypothesis", *Public Finance Quarterly*, Vol.18, pp.313-27.

Hanushek, E.A. (1975), "The Demand for Local Public Services: An Exploratory Analysis", Chapter in J.E. Jackson (ed.) *Public Needs and Private Behaviour in Metropolitan Areas*, Cambridge, (Mass): Ballinger.

Hardin, R (1982), *Collective Action*, Resources for the Future, Inc., Washington.

Heyndels, B. and Smolders, C. (1994), "Fiscal Illusion at the Local Level: Empirical Evidence for the Flemish Municipalities", *Public Choice*, Vol.80, pp.325-38.

Hirshman, A.O. (1970), *Exit, Voice and Loyalty*, Cambridge University Press, Cambridge.

Independent Commission Against Corruption (1999), *Report on conduct of Mr Sam Masri, former Purchasing Officer, Liverpool City Council*,  
[http://www.icac.nsw.gov.au/pub/public/pub2\\_67i.pdf](http://www.icac.nsw.gov.au/pub/public/pub2_67i.pdf), accessed 6 June, 2001

Jensen, M.C. and Meckling, W.H. (1976), "The Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure", *Journal of Financial Economics*, Vol 3 (3), pp.305-360.

Lovell, M.C. (1978), "Spending for Education: the Exercise of Public Choice", *The Review of Economics and Statistics*, Vol. 60, pp.487-95.

Martinez-Vazquez, J. (1983), "Renter's Illusion or Savvy?" *Public Finance Quarterly*, Vol.11, pp.237-47.

Moe, T.M. (1984), "The New Economics of Organisation", *American Journal of Political Science*, Vol. 28(4), pp. 739-777.

- Moomau, P.H. and Morton, R.B. (1992) “Revealed Preferences For Property Taxes: An Empirical Study of Perceived Tax Incidence”, *The Review of Economics and Statistics*, Vol.74, pp176-79
- Mueller, D.C. (1989), *Public Choice II*, Cambridge University Press, Cambridge.
- Niskanen, W.A. (1971), *Bureaucracy and Representative Government*, Aldine – Atherton, Chicago.
- NSW Department of Local Government (1997), *Maitland City Council Public Inquiry*, <http://www.dlg.nsw.gov.au/report.pdf>, accessed 8 June, 2001.
- NSW Department of Local Government (1998), *Woollahra Municipal Council: Post Implementation Review Report*, <http://www.dlg.nsw.gov.au/wreport.pdf>, accessed 8 June, 2001.
- NSW Department of Local Government (1999), *Bega Valley Shire Council Public Inquiry*, <http://www.dlg.nsw.gov.au/begarep.pdf>, accessed 8 June, 2001.
- NSW Department of Local Government (2000a), *Report of an Investigation Under Section 430 of the Local Government Act 1993 Re: Ku-ring-gai Council*, <http://www.dlg.nsw.gov.au/ku-ring.pdf>, accessed 8 June, 2001.
- NSW Department of Local Government (2000b), *Windouran Shire Council Public Inquiry*, <http://www.dlg.nsw.gov.au/windour.pdf>, accessed 8 June, 2001.
- NSW Electoral Commission (2001), *General Statistics – 1999 Local Government Elections – Part B*, unpublished data.
- O'Dowd, M.C. (1978), ‘“The Problem of “Government Failure” in Mixed Economies’, *South African Journal of Economics*, Vol.46 No.3, pp. 360-370.
- Olson, M. (1965), *The Logic of Collective Action*, Harvard University Press, Cambridge.
- Peterson, G. (1975), “Voter Demand for Public School Expenditures”, Chapter in J.E. Jackson (ed.) *Public Needs and Private Behaviour in Metropolitan Areas*, Cambridge (Mass), Ballinger.
- Schwab, R.M. and Zampelli, E.M. (1987), “Disentangling the Demand Function From the Production Function for Local Public Services: The Case of Public Safety”, *Journal of Urban Economics*, Vol.33, pp.245-60.
- Stewart, M.F. (1993) *Fiscal Illusion (The Flypaper Effect) and Government Spending in Australia*, Paper presented at November 1993 PhD Conference in Economics and Business, University of Western Australia.
- Wintrobe, R. (1997), “Modern Bureaucratic Theory”, in D.C. Mueller (ed.), *Perspectives on Public Choice*, Cambridge University Press, Cambridge, pp. 429-454.

Worthington, A.C. (1994) "The Nature and Extent of Fiscal Illusion in Australia", M.Ec  
Dissertation – University of New England.