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by

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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). Moreover, we develop a new taxonomy of local government failure in support of our thesis.

Key Words: government failure, local government, public choice

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A TAXONOMIC ANALYSIS OF GOVERNMENT FAILURE IN LOCAL GOVERNANCE

Throughout the developed world the role of local government has become steadily more complex and this has placed increasing pressures on policy makers. It is no longer sufficient for professionals in the local government milieu to simply rely on ‘rules of thumb’ and ‘commonsense’ in the development and refinement of municipal policy. Instead policymakers are now obliged to employ the insights developed in the social sciences in general, and economics in particular, as conceptual tools in policy formulation and implementation. For example, the market failure paradigm has long served as a useful guide to determining the appropriate functions of the state in a market economy. In essence, market failure is defined as the inability of a market or system of markets to provide goods and services in an economically optimal manner and the existence of market failure provides the intellectual basis for government intervention in a market economy. But the theory of market failure rests on an idealistic view of the abilities of governments, including local government, and has led to excessive and inefficient levels of state intervention. A more realistic view of the capacities of government is necessary to broaden the theoretical toolkit of the policy maker. Accordingly, we contend that in addition to the market failure paradigm, local government policy makers must also take the literature on the phenomenon of government failure into account. This will enable policy makers to consider not only the benefits of government intervention, but also its costs. In an analogous fashion to market failure, government failure can be generically defined as the inability of a governmental 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 to achieve allocative and productive efficiency. If we broaden the definition of government failure to include equity as well as efficiency, then the full social consequences of government intervention can be considered. Wolf’s (1989, p.28) definition of market failure can be employed *mutatis mutandis* to read: governments may fail to produce economically optimal (efficient) outcomes or socially desirable (equitable) outcomes.

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 policy making, 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 paper itself is divided into four main parts. In the first section we provide a synoptic outline of the various taxonomies of generic government failure afflicting all levels of government which fall within the broad public choice tradition. Section two 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 three, 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 four.

GENERIC TAXONOMIES OF GOVERNMENT FAILURE

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'. 'Inherent impossibilities' referred to instances where the state '...attempts to do something which simply cannot be done'. By contrast, 'political failures' described cases where the objectives of government intervention are conceptually feasible but '...the political constraints under which the government operates make it impossible in practice that they should follow the necessary policies with the necessary degree of consistency and persistence to achieve their stated aim.' And finally, 'bureaucratic failure' covers examples of state intervention where '...the administrative machinery at their disposal is fundamentally incapable of implementing it in accordance with their intentions'.

A somewhat more recent and closely related taxonomy of government failure has been advanced by Dollery and Wallis (1997). They argue that it is possible to identify three main forms of government failure. In the first place, legislative failure refers to the ‘...allocative efficiency [which] 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). Secondly, ‘...even if socially beneficial were enacted, bureaucratic failure will ensure that these policies are not efficiently implemented ...[since] public servants lack sufficient incentives to carry out policies efficiently’ (p.360). The third form of government failure resides in rent-seeking because government intervention virtually always creates wealth transfers and ‘people thus devote scarce resources which could have been employed in wealth creation towards redistributing existing wealth in their favour’ (p.360).

Perhaps the most comprehensive typology of government failure has been developed by Weisbrod (1978), who has advanced a fourfold classification. ‘Legislative failure’ refers to excessive public expenditure attendant upon the vote maximising behaviour of politicians. Secondly, ‘administrative failure’ derives from the observation that the ‘...administration of any law inevitably requires discretion, and the combination of information and incentives acts to affect the manner in which the discretion is exercised’ (Weisbrod, 1978, p.36). Thirdly, ‘judicial failure’ occurs when the legal system does not yield economically optimal outcomes. And finally, ‘enforcement failure’ is defined as the sub-optimal ‘...enforcement and non-enforcement of judicial, legislative, or administrative directives [which] can thus vitiate the effectiveness of actions of these other stages’ (p.39).

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). Of these authors, Boyne is undoubtedly the most ambitious in his approach. In his *Public Choice Theory and Local Government*, Boyne (1998, p.1)

attempts to assess the ‘...empirical validity of the core public choice proposition that competitive pressures lead to superior performance in the public sector’. In this volume, Boyne 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). Following Schneider’s (1989) public choice analysis in which local government is essentially an industry for local services in which buyers, made up of households and businesses, make location decisions and pay local rates and taxes to sellers, comprising municipal politicians and council bureaucrats, who either purchase or produce the requisite services, Boyne argues that public choice theory holds that municipalities engage in two kinds of competition. On the one hand, ‘geographical competition’ occurs between local governments ‘...in different areas for a share of the market in households and businesses’, and on the other hand, there is ‘competition between different tiers of local government for a share of local tax revenues in the same geographical areas’ (p.16). However, in common with many other industries, producers are subject to various regulatory constraints on their behaviour. Accordingly, Boyne argues that for effective Tiebout-style competition to occur in local government, at least three conditions must be met which are often ignored by public choice theorists. Firstly, governmental structures providing local public goods and services must be ‘horizontally fragmented’ in the sense that a large number of local governments at a given level of government must be providing the same kinds of services and competing for the same spatially mobile customers. Moreover, ‘vertical fragmentation’ must also be present in which several tiers of government compete over the finite tax revenue base and consumers can judge the relative efficiency with which each level of government delivers its services and allocate their political support and taxation payments accordingly. Just as consumers of local government must be able to migrate towards more efficient service providers, so too local governments must be legislatively capable of relocating scarce resources between existing local governments and establishing new municipal structures. But fragmentation and flexibility alone are not sufficient to ensure vigorous competition between local governments. Boyne (1998. p.22) argues that ‘substantial local autonomy’

is also an essential prerequisite for intergovernmental competition, which has generally been neglected by exponents of public choice theory. He puts the argument thus:

Local communities should have the discretion to innovate, experiment and develop distinctive policies. In other words, the centre should encourage localities to compete on service and quality. This condition for competition has been ignored in the public choice literature, perhaps because most authors have written from an American perspective...[where] there is a much stronger tradition of local autonomy.

Finally, even if local government is fragmented, flexible and autonomous, vertical fiscal imbalance may nevertheless prevent the emergence of Tiebout-style competition. High levels of central or state government funding to local governments can constrain competition and impede efficiency in various ways which have been overlooked by public choice theorists. For instance, large subsidies allow local governments to 'externalise' their costs by shifting them on to higher levels of government (Dye, 1990). Similarly, when most of the cost of local government services is born by national and state taxpayers, little incentive exists for households and businesses to migrate away from inefficient municipalities and this erodes the nature of competition itself (King, 1984).

The second form of local government competition identified by Boyne (1998, p.1) as a feature of the public choice approach refers to 'competition between political parties for the power to determine policy choice'. Drawing on the theory of contestable markets, Boyne argues that party competition in this context has two basic characteristics. Firstly, where no significant barriers to entry are present, the threat as well as the actual existence of opposition parties which could oust the incumbent party, may be sufficient to induce even a monopoly governing party to behave 'as if' it faced electoral competition. Policy selection, formulation and implementation under these conditions will embrace public preferences and consequently lead to better governance. Secondly, where uncertainty over election results prevails, with the possibility of changes in party control a distinct prospect, electoral competition may result in the adoption popular policy platforms by both incumbent and opposition parties. This should also enhance the performance of governing parties and their competitors as they pursue the 'median voter'.

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’. In many respects this dimension of competition represents the core of the public choice model in so far as it deals with the comparative advantages of markets as opposed to governments in the production of local government services. In essence, public-choice type arguments in favour of competition emphasise ‘bureaucratic failure’ outlined earlier and can be summarised as follows (Boyne, 1998, p.91):

[I]n the absence of competition, officials pursue their own interests and the result is services that are inefficient, oversupplied, and unresponsive to public demands. Moreover, public choice theory predicts that bureaucrats will not voluntarily transfer service responsibilities to private providers, and that where competition is thrust upon them, they will strive to keep production “in-house”.

The import of this argument from a policy perspective is that where alternative suppliers of some good or service are available, policymakers can compare relative prices and make rational decisions on this basis. Although Boyne (1998) does not raise the point, a key distinction should be drawn here between the provision and production of local government services. Given the public good characteristics of many local public services, government provision is often unavoidable. However, with public funding there are seldom strong arguments for avoiding private production if it is demonstrably more efficient than public production.

Drawing on the work of Albert Hirschman (1970; 1974; 1976), 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. In a market mechanism the existence of many competing firms makes exit a simple method of changing suppliers in the absence of prohibitive transaction costs, whereas in a local government context exit deals with the

ability of consumers to move from a municipal jurisdiction to another to experience a more desirable form of public service provision. 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. Hirschman (1970) saw exit as falling primarily within the economic sphere of activity whereas voice was manifest most often in the political realm.

The exit-voice taxonomic approach to the problem of government failure in local government provides an extremely useful conceptual framework for policymakers, especially in so far as it implicitly subsumes many of the other analytical perspectives which have been developed. Bailey (1999, p. 60) has described the strengths of this approach as follows:

Although developed separately from fiscal federalism theory, and from the other areas covered by local government economics, in effect it underpins them. Voice is implicit in Oates's decentralization theorems and exit in Tiebout's "voting with the feet" hypothesis. The differing financing arrangements for local government, reform of its internal structure, privatization of its activities, and other reforms, can all be analysed by making use of the exit-voice typology to a greater or lesser extent.

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.

Hirschman (1970) considered various public policy options for improving the efficacy of both exit and voice. From the perspective of local government, Bailey (1999) argues that two distinct approaches can be adopted: 'piecemeal measures' or a more drastic 'radical reorganisation of local government'. We will briefly review these strategies.

In general, Bailey (1999, p.56) contends that '...exit can be made easier by measures which serve to liberalize the supply-side of public service provision, enabling service users to choose between alternative suppliers'. He identifies six different strategies which can facilitate exit. Fragmenting existing large local governments into smaller units can reduce the costs of migration and thus enhance the mobility of the citizenry. Financing local public service provision through user charges rather than compulsory local rates and taxes allows individual consumers to 'opt out' of specific services they do not want to avail themselves even if they remain within the same municipal jurisdiction. Vouchers

exchangeable both within and without the jurisdiction, like school vouchers, enable citizens to select the public service in question from a range of alternatives. Competitive tendering of particular local public services for specified contract periods to different private producers will allow consumers to choose between alternative providers of the same service within the same jurisdiction. Deregulation of public service provision away from single statutory service providers may also increase consumer choice. Finally, privatization may result in the introduction of several new public service producers, provided it is designed to avoid the transformation of public monopolies into private monopolies.

Similarly, Bailey (1999, p.57) argues that ‘voice can be made easier by measures which amplify the demand side’, apart voters from simply electing local government politicians at periodic elections. For example, institutional changes can be introduced to give consumers of local public services a greater opportunity to participate directly in decision making concerning the quantity and quality of such services, including the use of referenda and the appointment of citizens to management boards. Moreover, municipal managers can also encourage public consultation through opinion surveys, public hearings, and other consultative practices. ‘Complaints procedures’, like legally prescribed minimum service standards and ombudsmen, can be instituted to garner further information on public perceptions of service provision. Lastly, scope should be created for citizens to launch legal challenges on grounds of inadequate service provision.

Following Hirschman (1970), Bailey (1999) urges caution in redesigning local government institutions to facilitate greater exit and voice since tradeoffs may exist. For instance, if exit is easy, then this may undermine any incentives consumers have to engage in voice. Conversely, should exit be costly, this could weaken voice, in so far as self-interested local government policy elites may realise that disgruntled citizens cannot back voice initiatives with the ultimate threat of exit. Accordingly, some optimal ‘mix’ of exit and voice should be sought by policymakers. But Bailey (1999, p. 56) argues that in a changing world it is unlikely that such a mix would be static: ‘even if an optimal (in terms of public interest) mix of exit and voice could be specified for a particular organisation at any point in time, that mix is not forever fixed, since forces will be instigated which, by design or default, change the scope for exit and/or voice’.

On the other hand, exit and voice may be complementary rather than competing mechanisms under plausible circumstances. For example, Bailey (1999, p.60) notes that 'in particular, the ultimate sanction of exit can increase the effectiveness of voice – provided always that the providers of public services lose revenue as a consequence of exit and that appropriate structures of hierarchical control are in place'. Thus threats of exit may strengthen rather than weaken voice and policy measures which facilitate exit can enhance the credibility of these threats.

A NEW TAXONOMY OF LOCAL GOVERNMENT FAILURE

The various taxonomic systems of government failure which we have examined 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). After all, the act of voting involves various expenses in terms of both time and money while the vote of a single individual has virtually no effect on the outcome of elections. Accordingly, if voting is perceived as an investment activity, then it is irrational to vote since the costs of voting clearly outweigh its benefits, even if the costs of voting are low in absolute terms. On the basis of this kind of hedonistic calculation no one would vote. 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. Stiglitz (2000, p.178) has put this argument as follows:

This paradox is resolved, in a somewhat tautological manner, simply by assuming that individuals get utility out of voting, or more generally, out of participation in the political process. More to the point, considerable time and energy are devoted to inculcating into our children notions of civic responsibility, and among these civic responsibilities the responsibility to be an informed voter.

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. The phenomenon of 'decoupling' has been identified by Wolf (1989, p.41) as a further complicating ingredient of these ambiguities. Decoupling refers to the '... decoupling between those who receive the benefits, and those who pay the costs, of government programmes'. Wolf argues that decoupling occurs in two different forms. On the one hand, 'microdecoupling' arises when the benefits of collective action accrue to a particular group, whereas the costs of such action are dispersed amongst all groups. On the other hand, 'macrodecoupling' occurs where the benefits of collective action are shared by all groups, but the costs of this action are concentrated on some specific group. Accordingly, a consequence of this dual role voting takes on some of the characteristics of a Prisoner's Dilemma game. Mitchell and Simmons (1994, p. 47) have summarised the problem as follows:

As a taxpayer, the citizen is interested in the aggregate size of the budget and supports reduced spending, reduced taxation, and increased economic growth. As a beneficiary of governmental spending, the same citizen supports an increase in subsidies or favours for his company or employer and governmental regulation of his profession: he or she has little interest in the size of the budget. Predictably, these latter interests are generally apt to be more intensely felt than taxpayer commitments.

Moreover, additional factors further complicate the voting process. Electors are usually faced with policy platforms combining widely disparate elements and must choose candidates who espouse policies both favourable and unfavourable to them. Thus, a voter may be obliged to stomach a range of social policies he does not like in order to support economic policies he does like.

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, which we examined 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’. 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.

The literature on agency theory is primarily concerned with the ways in which one economic agent (the principal) can design and implement a contractual system to motivate another economic agent (the agent) to act in the principal’s interests. Accordingly, agency theory is chiefly focussed on the problem of economic incentives. By contrast, conventional neoclassical economics, with its reductionist construct of the organisation as simply a production function converting inputs into outputs in the most productively efficient manner, assumed away principal-agent problems and the associated question of incentives. In the orthodox tradition, principals were perfectly informed on the nature of the tasks agents were hired to perform and their subsequent actions could be costlessly monitored. Agency theory can thus be viewed as the extension of the neoclassical theory of the firm to embrace ‘the problems posed by limited information and goal conflict within organisations’ (Levinthal, 1988, p. 154).

A principal-agent relationship comes into being whenever a principal delegates authority to an agent whose behaviour has an impact on the principal’s welfare. Numerous principal-agent relationships exist across virtually the entire spectrum of human endeavour. For example, principal-agent relationships include voters and their elected representatives, governing politicians and the bureaucrats hired to implement policies, patients and physicians, employers and employees, shareholders and corporate managers, and so forth. The essence of all these principal-agent relationships involves a trade-off for the principal. By delegating authority to an agent, the principal economises on scarce resources by adopting an informed and able agent, but simultaneously takes on the risk that since the interests of the principal and agent will never be identical, the agent may fail to carry out the wishes of the principal. For instance, despite being paid a proportionate commission, real estate agents may wish to sell a property quickly at a lower price than could otherwise be obtained for the owner of the property. Since the interests of principals and agents are likely to diverge in most real-world relationships, agency theory focuses on the costs attached to such relationships and the efforts that both

principals and agents will take to economise on these costs. In their seminal contribution, Jensen and Meckling (1976) identified three categories of agency costs. Firstly, monitoring costs arise from the resources principals invest in monitoring the behaviour of agents and creating incentives for desirable behaviour. Secondly, bonding costs will derive from resources invested by agents to guarantee successful outcomes to their principals. And thirdly, residual loss costs consist in the losses to their wellbeing suffered by principals due to a divergence between their interests and those of their agents. According to Jensen and Meckling (1976), total agency costs are thus comprised of the aggregate of monitoring costs, bonding costs and residual loss costs.

The extent of total agency costs are postulated as dependent on the characteristics of particular principal-agent relationships. For example, in a typical agency relationship agents almost always possess more information about both the task assigned and the relative efficacy of their own performance. Agents often take advantage of this asymmetry of information by engaging in shirking or opportunistic behaviour antipathetic to the interests of principals, and clearly the greater the extent of this behaviour the higher will be the level of total agency costs.

Although in its initial stages agency theory was applied exclusively to the firm, and especially the modern corporation with its characteristic separation of ownership from control characteristic of a principal-agent relationship, it was soon used more widely once its explanatory powers were recognised. Jensen and Meckling (1976, p. 309) recognised the generality of agency theory:

The problem of inducing an 'agent' to behave as if he [or she] were maximizing the "principal's" welfare is quite general. It exists in all organizations and in all cooperative efforts - at every level of management in firms, in universities, in mutual companies, in co-operatives, in governmental authorities and bureaus, in unions, and in relationships normally classified as agency relationships such as are common in the performing arts and the market for real estate.

Although the problems identified by agency theory are thus endemic to all human organisations, they nevertheless manifest themselves in different ways in divergent institutional settings. Economists have approached the question of principal-agent

relationships in bureaucracies formally controlled by elected politicians by seeking model their behaviour. The first rigorous economic model of bureaucracy was developed by Niskanen (1971), whose work provoked much subsequent modelling activity (see, for example, Bendor 1990), and Niskanen's budge-maximising model still represents the mainstream position of American public choice theorists (Mueller, 1989).

In his classic analysis, William Niskanen (1971) argued that bureaucrats sought to maximise the size of their budgets, since larger budgets implied increased salaries, power and prestige. Bureaucrats can increase the size of their budgets by oversupplying output, or by inefficiently supplying output, or both. Bureaucrats are said to bear an agent/principal relationship to politicians who in turn bear an agent/political relationship to voters. Bureaucrats benefit directly from large governmental budgets and thus have intense preferences for high levels of expenditure. By contrast, taxpayers typically only benefit indirectly from government expenditure, and have preferences for low taxation levels. The objectives of agents and principals thus diverge. But because bureaucrats have greater per capita incentives to increase expenditure than the corresponding incentives of taxpayers to decrease taxes, public sector expenditure may be higher than desired.

Chang and Rowthorn (1995, p. 9) have outlined the general significance of the arguments underlying bureaucratic failure as follows:

These models saw the root of many problems of the contemporary capitalist countries - for example, the over-extension of the bureaucracy, the waste of resources in government administration, the inefficiency of the public enterprises - in the inability of the principals (the public) to monitor the self-seeking behaviour of their agents in public affairs (the bureaucrats). These models were usually presented as neutral efficiency arguments, but have had much deeper political impacts. By arguing that the same assumption of self-centred behaviour should be applied both to the private sector agents and the public sector agents, they not only questioned the public's trust in the benign paternalism of the welfare state but also undermined the self-confidence of government officials and their commitment to a public service ethos.

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 have examined 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. Mitchell and Simmons (1994, p.62) provide an intuitively appealing description of the rationale behind the formation of interest groups in politics:

Rational citizens in pursuit of private desires quickly learn the superiority of organized groups over individual pursuit of welfare through the ballot box. By organizing into an interest group, voters can pursue their goals with greater efficiency. The interest group provides a division of labour, specialisation, and the power of concentrated passion and incentives.

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). In orthodox economic theory the concept of economic rent has traditionally been defined in terms of opportunity cost. Thus rent is simply that part of the reward accruing to the owner of a resource over and above the payment the resource would receive in any alternative employment. Given the customary assumption of maximising behaviour on the part of economic agents, and an absence of constraints on resource mobility, in the stylised world of neoclassical theory competitive forces will ensure the dissipation of rent in a

manner which produces socially desirable outcomes. The existence of positive rent in a competitive market will attract resources in the same way as the existence of potential profits, and consequently result in the erosion of such rent through a socially desirable reallocation of resources. However, once we adjust the social mechanisms in which this process occurs, the consequence of maximising behaviour motivated by the possibility of economic rent may be quite different viewed from the perspective of society at large. Buchanan (1980, p. 4) has neatly summarised the nature of rent-seeking in this alternative setting:

The term rent-seeking is designed to describe behaviour in institutional settings where individual efforts to maximise value generate social waste rather than social surplus...The unintended consequences of individual value maximisation shift from those that may be classified as “good” to those that seem clearly to be 'bad' not because individuals become different moral beings and modify their actions accordingly, but because institutional structure changes. The setting within which individual choices are made is transformed. As institutions have moved away from ordered markets toward the near chaos of direct political allocation rent-seeking has emerged as a significant social phenomenon.

The theory of rent-seeking is thus appropriate for the analysis of the origins of, and competition for artificially created rent, and not for short-lived rents (or quasi-rents) which characterise dynamic market processes. The existence of contrived rent implies the possibility of wealth transfers between individuals and groups in society, and rent-seeking behaviour encompasses attempts by economic actors at creating and competing for these wealth transfers. Given the massive extension of state intervention in modern times, and its ability to affect the redistribution of property rights and hence generate wealth transfers, the primary source and focus of rent-seeking activity has, not surprisingly, been the political process.

In addition to rent-seeking aimed at capturing the benefits generated by existing state intervention, in a society where severe constitutional limitations on state involvement are absent, rent-seeking by interest groups (and individuals) will also occur with the object of attaining intervention and its attendant advantages. It is thus possible to identify at least

two further forms of rent-seeking behaviour. Firstly, rent-seeking directed at securing initial state intervention which will induce contrived rent through the artificial limitation of market processes thus allowing for wealth transfers to occur. And secondly, rent-seeking aimed at capturing the resultant rent and maintaining a position of capture.

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. Distributional coalitions comprise single or multiple interest groups that seek to further the material interests of their members. Olson (1965) distinguished between successful or 'privileged' and unsuccessful or 'latent' interest groups, where the former were capable of overcoming the ubiquitous problem of free-riding whereas the latter were not. In broad terms, Olson (1982) argues that group interaction in complex, stable societies over time leads to socially inferior outcomes given the asymmetric organisational capacities of different interest groups, their group-specific maximands and their attendant ability to affect distributional outcomes.

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. Magee, Brock and Young (1989, p.51) put the argument as follows:

Economic agents take all actions that increase their welfare; political parties take all actions that increase their electoral welfare. It is obvious that a movement toward political efficiency involving an increase in redistributive policies usually lowers economic welfare. At the same time, a movement toward economic efficiency that dismantles economically inefficient redistributive policies would lower political efficiency (because their reinstatement would enhance the electoral success of one or more parties).

Magee, Brock and Young (1989) argue that in politics policies play much the same role as prices in an economy: That is, both are equilibrating variables that adjust until opposing forces are in balance. In the determination of redistributive economic and social policies, competing demands for and against a particular policy will determine the ultimate nature of the policy. For instance, in the case of tariff protection, if strong groups favour tariffs and comparatively weak groups oppose tariffs, then we would anticipate the outcome to be relatively high tariffs. Policies are thus entirely 'endogenously' determined in the sense that no single individual or group can determine their shape. Even politicians cannot control policy formulation since their vote-maximising behaviour makes them dependent on interest groups – a phenomenon termed the 'powerless politician effect'. The upshot of this model of policy determination is a bleak view of the potential for policy reform; namely, '...there is no solution to the economic waste caused by competitive redistribution' (Magee, Brock and Young, 1989, p.2) since any remedial policies will themselves be endogenously determined in the political process.

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 as 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.

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). Firstly, the revenue-complexity hypothesis holds that the more complex the public revenue-raising system, the higher will be the level of the public sector expenditure *ceteris paribus*, since voters will be unaware of how much taxes they pay. Buchanan (1967, p.135) has argued that '...to the extent that the total tax load on an individual can be fragmented so that he confronts numerous small levies rather than a few significant ones, illusionary effects may be created'. While empirical investigation of the revenue-complexity hypothesis has found substantial support for this model at the local government level (see, Dollery and Worthington, 1996, Table 1), it would nevertheless seem intuitively plausible that since higher tiers of government typically have much

wider taxing powers, its effects would be more pronounced in state and national governments.

A second form of fiscal illusion springs from the income elasticity of the revenue system. The revenue-elasticity approach holds that when increases in national or jurisdictional income 'automatically' translate into even greater proportionate increases in tax revenues, then these additional funds will tend to boost public expenditure rather than decrease tax rates, as in the well-known case of 'fiscal drag' and income taxes. Local governments would appear to be particular beneficiaries of revenue elasticity in respect of property taxes under inflationary conditions, since the appreciation of property values converts into higher tax yields with given tax rates and a given number of rateable properties. But because *ad valorem* or proportionate taxation is much more frequent in federal and state governments the phenomenon is likely to be much more widespread at these levels of government. Nonetheless, municipalities may benefit more in relative terms since property taxes often represent their major source of revenue.

A third kind of fiscal illusion has been identified as 'debt illusion'. Debt illusion refers to the proposition that voters are more aware of the costs of public sector programs if they are financed through current taxation rather than public-sector borrowing. It is argued that this results from the imperfect information available to individuals on the time path of the future benefits and costs of government activity. From the perspective of local government, the significance of debt illusion is problematic. In general, since assets and not individuals are taxed at the local level, the empirical question thus becomes one of the degrees to which community debt is capitalised into individual asset values. Oates (1988, p.77) has observed that '...other things being equal, we should find, that if there is debt illusion, that the future tax liabilities associated with the debt are not fully capitalised into local property values'. Actual empirical evidence on the issue of debt capitalisation is both limited and mixed (see, Dollery and Worthington, 1996, Table 5).

A fourth dimension of fiscal illusion, known as the 'flypaper effect', has a much greater direct relevance to local government. 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 grants 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.

Finally, ‘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 is indeed more prone to government failure than state and federal governments, then this raises interesting questions about the design of appropriate governance mechanisms for municipalities.

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