INTRODUCTION

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ACCOUNTABILITY, EFFICIENCY AND FLEXIBILITY IN LOCAL GOVERNMENT BEHAVIOR

The control of local government has in late years been a focal point for public debate in U.S., U.K. and Sweden. Yet it is apparent from the papers assembled in this volume that "local government" stands for rather different things in the three countries and that differences between the countries are even greater when it comes to defining the problems and the instruments of "control". Although there may not be any common policy conclusion to be drawn, the variation of experience can teach us a good deal about i.a. the interaction between institutional structure and public policy.

The Scope and Development of the Local Public Sector

There are marked differences between the countries in regard to the autonomy, scope, size and rate of growth of the local public sector. A rough ordering of the countries in terms of the importance of state and local public spending would have Sweden on top, the U.S. at the bottom, and the U.K. somewhere between. This outcome is of course partly due to the fact that many "local" goods and services, like e.g. health services and various housing services, which in the U.S. are to a large extent privately produced and distributed, are treated as a public responsibility in the other countries -- in Sweden by long-standing tradition, in U.K. often by 20th century reform. In addition there are inherited differences in attitude towards local government between the small country of Sweden and the two big countries, U.S. and U.K. In Sweden a tradition of relatively autonomous local communities preceded historically the emergence of a strong central government, while in the U.K. the rights and limitations of local government have been successively defined and dispensed by an already established central power.

These differences are today reflected in the contrast between the relatively unified and self-financed local authorities in Sweden and the local governments in U.K. and U.S., which tend to be more diverse in structure and more dependent on central government for finance and instruction. While in Sweden the major part of the income tax is levied with a roughly proportionate but independently set rate by each local government, the rate on real estate is still the main source of finance for local authorities in the U.K. and U.S. The pattern of expenditure of local governments is probably also important in determining their public image. The explicitly redistributive transfers of locally administered social welfare e.g. have increased in all countries, but their relative importance in regional government budgets tends to be biggest for the U.S. authorities, with their more limited scope, and smallest for the Swedish authorities, with their broader spectrum of activities. Taken together these diverging traditions and budgetary patterns may go some way to explain, why local government in Sweden, compared to the other countries, tends to be less censored by public opinion for the common evils of tax-distortions and public mismanagement.

Without such background it would be hard to understand the different turns of public debate around local government, as they emerge from the papers in this volume. Various forms of fiscal containment of local governments have during the 70s been suggested and tried in the U.K. and U.S., while the main concern in Sweden has been the local governments' lack of flexibility and their difficulties in adjusting to changing macroeconomic conditions. Yet, the local government expenditure in Sweden has doubled its share of GNP over the preceding two decades and the share is now above 30%. The major part of the expenditure is exhaustive, i.e., it corresponds to claims on real resources. The same share in the U.K. is only about two thirds of that in Sweden, has increased very slowly since 1960 -- declining in fact during the latter part of the 70s -- and less than half are exhaustive expenditures. The U.S. share, finally, is far below the British share and has risen very little in the past twenty years.

However, it is the U.S. public that has been complaining most loudly about the excessive and fast growing local government expenditure, and it is in the U.K. that the blame for the unsatisfactory macroeconomic performance has most often been attributed to local governments, acting as a "black hole" in the economy, fastly swallowing scarce real resources. The key to understanding these puzzling contrasts in voter reactions obviously lies in distinguishing between the various meanings attached in different countries to "control of local governments".

Dimensions of Control

Controlling local government can alternatively be looked upon as a question of accountability, efficiency or macroeconomic flexibility. <u>Accountability</u> means inside control, control by local voters over revenues and expenditures. <u>Efficiency</u> means an absence of administrative resource waste but also denotes a composition of supplied services in accordance with the needs and wishes of the constituency. Finally, flexibility here stands for the capacity of local government to adjust to changes in the economic environment and in the policy directives of central government -- to outside control.

It is clear from the discussion in the papers that there is a marked difference as to the control dimensions emphasized in the three countries. The fiscal limitation movement in the U.S. has tried to safeguard efficiency in local governments -- or at least set bounds to waste -- by establishing fiscal limits, obviously distrusting the existing forms of accountability to perform the monitoring task. Apart from administrative waste, the increasing share of redistributive measures of social welfare often appears to have been a major source of malcontent.

The U.K. discussion has been focused on the problem of macroeconomic flexibility, the risk of local governments slowing up recovery and structural change in the private sector by crowding out private resource claims in the factor markets. Behind this anxiety about local government expenditures outrunning the available resources lies a consciousness of an insufficient accountability, which may allow local bureaucracy to operate outside constituency control as well as to be rather impervious to central government policy and directives.

The Swedish discussion can be said to represent the other extreme, compared to the U.S. debate. There are few doubts expressed about the accountability of local governments and the distrust of bureaucratic efficiency, although certainly existing, is much less marked than in U.K. and U.S. The emphasis is instead on the need to make the autonomous local governments more sensitive and responsive to the cyclical and medium-term economic policies of central government in order to avoid that the local authorities get out of step with the rest of the economy. Since there is no accusation of irresponsible behavior towards the constituencies, like in the U.K., there is also less pressure for tough direct controls and consequently less risk for political polarization.

Instruments of Control

The instruments available for controlling local government can be divided into means of voter control, of central control or of market control, respectively.

There are various ways in which local voter control can be strengthened. A sufficient degree of self-financing and of freedom from central regulation is probably needed to give substance to claims of self-government. A heightened sensitivity to local voter opinion may be achieved e.g. by decentralizing the decision-making, by broadening the base of direct participation, or by making more frequent use of local referenda.

The means of central control can take the form of legislation, limiting revenues and/or expenditures, or regulation determining form and extent of the local government activities. Financial control instruments used in most countries are grants and credit restrictions. Central control can also sometimes be achieved in an indirect way, by general policy means like incomes policy, tax policy or credit market policy.

There are, finally, various ways in which local government activities can be brought under market control. The most obvious one is privatization, by which the responsibility for producing and/or distributing local government goods is handed over entirely to private agencies or at least is left open for private competition. There are also many intermediate ways of making use of market mechanisms without relinquishing local government control. By an extended use of user fees, public pricing, and voucher systems, local government may try to achieve an efficient resource allocation while retaining overall control. Another important area, where a strengthened market control may be attempted, is the limitation of wages for local government employees. This can take the form of trying to equalize the negotiating position of private and public employers as well as strengthening the employer responsibility of the individual local authority.

As exemplified by the papers in this volume, the choice between these major types of control instruments will depend on the control problem encountered, the historical experience, institutional framework, and political tradition of the country concerned.

In the U.K., where accountability is regarded as a major problem, the trend seems to go in the direction of limiting the effects of the problem by central control, rather than trying to achieve increased accountability by reforming the structure of local government. In the U.S. the means most often employed for this purpose are fiscal limitations in state constitutions.

Political parties and representatives doubting the efficiency of government bureaucracies, have always and everywhere tended to support the idea of privatization. In the 70s these ideas were sometimes translated into action, particularly in the U.S. Experiments were conducted not only with complete privatization of local government activities but also with various forms of voucher systems and extended public pricing. Privatization has become a fashionable political topic also in Europe, but so far the actions taken in this direction have been very limited. The major instrument employed in order to force local governments to become more efficient has up till now been a budget squeeze, accomplished by central financial controls. In both the British and Swedish debate, however, the inefficiencies of local governments have often been blamed on the rigidities of central regulations and the price distortions of central grants and suggestions have been made to increase efficiency by deregulation and a decrease and generalization of grant support.

There seems to be a corresponding division of opinion as to the best choice of means for improving the flexibility of local governments, which is looked upon as the major problem both in the U.K. and Sweden. So far the actions taken in both countries have taken the form of tightened financial control by central government -- relatively harsh and individualized in the U.K., milder and more general in the case of Sweden. Again, however, there is a school of thought in both countries that contends that only by making the local authorities more independent of central government and strengthening constituency control, can you hope for a more flexible response to changes in income and resource growth and make the governing bodies more sensitive to changes in general economic policy.

Is Local Government Too Big? - The U.S. Case

The four papers dealing with local government in the U.S., are all concerned with the risk of excessive government and the means of containing any immoderate public resource claims.

Edward Gramlich, University of Michigan, gives a critical survey of various theories and arguments put forward to explain how and why levels and growth rates of public spending tend to be excessive, viewed from a median-voter's standpoint. He first uses available data and estimates from other studies to examine the claims that the growth rate of public spending has been excessive during the last decades. The data do not seem to support these claims, which is not unexpected, since public spending shares have now been declining for a decade.

Gramlich then goes on to examine the empirical evidence for three different theories that try to explain excessive levels of public spending in terms of a voting bias: for public employees, for welfare transfer recipients, and for public workers receiving monopolistic wage differentials. He finds some evidence in favor of all these theories but concludes that the quantitative magnitude of the possible effects seems to be too small to make a compelling case for the view that government spending has grown to excessive proportions in the U.S.

Saul Hymans, University of Michigan, also deals with the question of excessive public spending and, like Gramlich, he bases his discussion on a median voter model. Contrary to Gramlich, however, Hymans focuses exclusively on the redistributive aspects of public spending. The public spending he models is aimed at a target group of recipients and its value to the median voter will depend on the voter's empathy for this target group. Hymans shows that with usual empirical assumptions this way of analyzing public spending leads to the following general result: "The median voter desires a declining trend in the provision of real government services relative to real GNP, but is willing to devote a growing share of society's output to providing those services." He is also able to show that this median voter model implies a trade-off between quantity and quality in the provision of government services. "If the target group is allowed to increase in relative size, the tax price rises too rapidly to prevent a decrease in the relative real income of the target group."

Wallace Oates, University of Maryland, devotes his paper to a critical assessment of the U.S. experience of fiscal containment measures in the form of legislation and constitutional amendments curtailing the fiscal activities of state and local government. His examination of the results so far leads him to express some doubts both as to the efficiency and the desirability of these fiscal containment measures.

The efficiency of the legislative measures may be endangered by the fact that partial curtailment of revenue can be compensated for by increased financing -- and control -- by higher levels of government and by increased use of alternative revenue sources of local government or sidestepped by various forms of "creative finance". The consequent change in financial structure and in the degree of centralized control may be both unintended, inefficient and undesired.

What is also undesired are the potential losses of welfare that will occur if the limitations become binding and prevent a desired increase in the public spending share from being realized. What may or may not be desired are the redistributive effects of the fiscal limitations, which seem likely to be regressive.

George Peterson, Urban Institute - Washington, tries to evaluate the U.S. experience of privatization and public pricing of local government activities.

For some services -- most conspicuously, trash collection and hospital management -- privatization appears to give clear cost reductions, primarily from better labor management and the lowering of excessive compensation levels.

Apart from these specific examples, however, the potential efficiency gains seem to be very limited and privatization by way of private contracting appears often to be primarily valued as a way of cutting down services, without taking direct political responsibility. Of greater potential impact is the admission of competition among private providers into "public" services by way of e.g. voucher systems for schools.

Public pricing has enjoyed a surge of political attention in the U.S. lately. Peterson concludes though, that pricing has so far mainly been used as a revenue device and not explicitly as a way of rationing demand for public services. The use of pricing for limiting demand is, however, likely to intensify.

Is Local Government Out of Control? - The U.K. Case

The two British papers have as a common theme the evaluation of the attempts of central government since the middle of the 70s to contain and control local government expenditures by financial means. While the first paper mainly reviews the macroeconomic motivations of control, the second gives a critical account and assessment of the mechanisms of control.

Peter Jackson, Leicester University, takes as starting point the official government position that: "public spending is at the heart of Britain's present economic problem", because "high government borrowing has fuelled inflation, complicated the task of controlling the money supply and thus denied the wealth creating sectors some of the external finance they need for expansion". He then scrutinizes the theoretical and empirical basis for these views.

In his discussion of the theoretical framework Jackson concludes that the claim of monetarists that a budget deficit will tend to reduce the level of economic ativity through the impact on money supply, inflation and expectations, are not supported by available British data. Equally weak is the empirical evidence for the disincentive effects of taxation and the crowding out effects of public factor demand.

Jackson then goes on to examine the postwar record of local governments in the U.K. He finds the official anxiety to be largely unfounded, since the public sector's absorption of real resources has been steady and, in recent years, declining. One possible rationalization of the official "over-reaction" may be that it is caused by difficulties in interpreting government expenditure ratios, and particularly the question of whether transfer payments (that do not use resources directly but do need tax-finance) should be counted as expenditures.

Jackson ends by concluding that the main problem with the British local governments is not the macroeconomic one of flexibility and overexpansion but the microeconomic one of efficiency. The solution should therefore not be sought in increased central control but rather in strengthening the control of local voters.

Noel Hepworth, The Chartered Institute of Public Finance and Accountancy, London, gives a careful account of the new financial controls -- in particular cash limits and volume targets in the grant system -- successively introduced by the British government in order to contain local government spending and tax rates. He stresses the insufficient accountability of the local governments as being the core problem of control.

From his critical review of the new financial control measures he concludes that cash limits have only a limited effect on current expenditure but have led to a dramatic -- and probably highly undesirable -- decline of local government investments. The attempt to control expenditure levels of individual local governments bureaucratically may very well lead to an increased political polarization and confrontation. Increasingly exacting central demands could result in a breakdown in local services and administration.

Hepworth ends by stressing that central policy ought to avoid confrontation and instead try to make local government more responsive and responsible. To achieve this, however, requires a strengthening of local government accountability by fundamental reforms of local revenues and local rights and responsibilities.

Is Local Government Too Inflexible? - The Swedish Case

The two Swedish papers both focus on the problem of macroeconomic flexibility and the means available to central government to ensure sufficient flexibility. While the first paper is mainly concerned with evaluating the experience of central controls, the second tries to explore and evaluate the potential control alternatives by way of simulation experiments with a macromodel of the Swedish economy.

Richard Murray, The Swedish Agency for Administrative Development, Stockholm, starts out by describing the very fast postwar expansion of the Swedish local government sector. He then evaluates in turn the attempts made to control this expansion -- or achieve short-run stabilization goals -- by credit policy, investment policy, regulation, indicative planning and grant policy. He finds that local governments have shown little sensitivity in regard to credit and investment policies, while indicative planning and centrally negotiated agreements have had no appreciable effect at all.

Regulation, on the other hand, seems to be a rather effective means for equalizing standards between local governments. At the same time regulations tend to neutralize the effects of grant policy on local government resource allocation. Only recently has grant policy been used to influence aggregate spending and tax rates. The results so far of these attempts seem promising. Another recent development is the endeavor to use liquidity control as a way of ensuring a better timing of local government expenditures over the business cycle. The timing was particularly bad, from a stabilization point of view, during the 70s.

Murray ends by concluding that the overall experience seems to indicate that the possibilities for central control looks most promising in a medium-term perspective.

Bengt-Christer Ysander, University of Uppsala and IUI, Stockholm, and Tomas Nordström, IUI, use a macromodel of the Swedish economy, incorporating a submodel of local government spending and taxing behavior, to study the efficiency of alternative forms of central control policies.

The dynamics of local government spending is measured in terms of elasticities and multiplier effects and its interaction with the rest of the economy is studied by simulations, which reveal i.a. a tendency for local government spending, through interactions in the labor market, to develop according to a cyclical pattern.

Special attention is devoted to comparing the efficiency of various policy instruments in ensuring balance in the labor market and in external payments. The authors i.a. stress the difference in overall effects on domestic consumption. While grant cuts first and foremost hold back total consumption, only marginally affecting the distribution between private and public, tax limits can be viewed as an imperfect expenditure control, mainly shifting resources from local governments to households.