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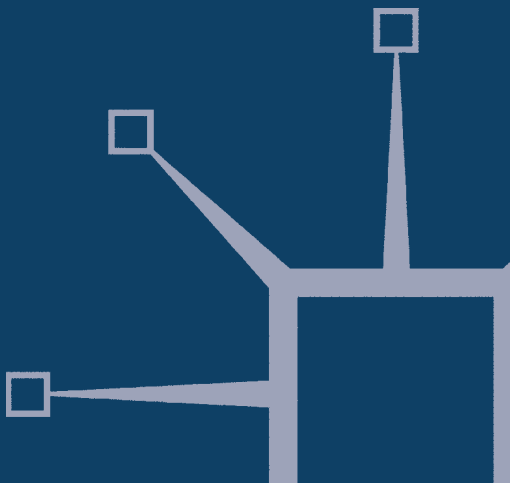
Public Choice Theory and Local Government

A Comparative Analysis of the UK and the USA

George A. Boyne



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Dedicated to my father

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Preface

The contents of this book reflect my academic interests in local government, public choice theory and research methodology. During the last ten years, my work on these topics has developed from political parties, to bureaucrats, to local government structure, to organisational performance, and finally to contracting-out. A common element in all of these areas is the relationship between competition and the behaviour of local authorities. This relationship is at the core of 'empirical' or 'positive' public choice theory which suggests that competition in the public sector is associated with superior performance. This book is an attempt to evaluate the scientific validity of this proposition.

I am grateful to many people who have commented on elements of this work at seminars and conferences. This includes several prominent academics who have tried to persuade me that public choice contains assumptions and arguments that are so odious that the theory should not be studied at all. Such critics have, unwittingly, reinforced my conviction that the empirical claims of public choice theory need to be investigated rigorously.

GEORGE BOYNE

1 Introduction

Research on the public sector has been increasingly influenced by public choice theory during the last forty years (Dunleavy, 1991; Lowi, 1992; Self, 1993). This theoretical perspective is based on the application of economic ideas to political structures and processes. In particular, the public choice approach reflects neo-classical models of economic behaviour (Wohlgemuth, 1995). These assume that producers in economic markets are motivated primarily by selfishness, and that competition can channel self-interested behaviour towards the common good. In the same way, public choice theorists argue, policy-makers in the public sector pursue their own narrow interests, but competition can redirect their attention towards the general welfare of society.

The aim of this book is to assess the empirical validity of the core public choice proposition that competitive pressures lead to superior performance in the public sector. Most critiques of public choice theory focus on the relative merits of service production and resource allocation by markets or government, that is on arguments concerning the appropriate size of the private and public sectors (e.g. Self, 1993; Stretton and Orchard, 1994; Udehn, 1996). By contrast, the theme of this book is the impact of competition on the provision of *public* services. Three distinct forms of competition are analysed: competition between public organisations for a share of tax revenues and service responsibilities; competition between political parties for the power to determine policy choices; and competition between governmental and private organisations for control over the production of public services. All three types of competition, public choice theory suggests, influence levels of expenditure, efficiency and responsiveness to public demands. This book is the first comprehensive assessment of the relevance of these ideas to local government.

A subsidiary aim of the book is to dispel the 'myth in the making' that public choice research is an abstract pursuit with few empirical applications. For example, Stretton and Orchard (1994: 124) argue that 'most public choice theorists stick to their distinctive postulates

about motivation, and spend their time elaborating the deductions which can be derived from them, however untestable these deductions may be'. They add that empirical testing 'has become a minor specialist interest rather than a main concern in the design of theories' (1994: 132; for similar arguments see Dunleavy, 1991; Green and Shapiro, 1994). The main chapters of this book show that public choice propositions on competition in local government are eminently testable, and that there is a lot of empirical evidence around. The quality of this evidence, as will be seen in Chapters 2 to 5, is another matter.

Evidence on local government in the USA and UK has been selected for analysis for three main reasons. First, the public choice model of competition between governmental units was developed explicitly to account for the behaviour of local authorities (Tiebout, 1956; Ostrom et al., 1961). Secondly, local government systems provide a large 'natural laboratory' for the evaluation of theories of policy and performance in the public sector (Boyne, 1996a). The number of multi-purpose local government units is over 500 in the UK and more than 22 000 in the USA. This quantity of local authorities provides extensive scope for variations in competition and performance, and for tests of the relationship between these variables. Indeed, much of the empirical evidence in the 'house journal' of the public choice movement, *Public Choice*, has been derived from analyses of sub-national units of government. Thirdly, public choice ideas have influenced policies on local government in both countries. For example, arguments on the benefits of competition have been used to maintain the fragmentation of local government in the USA, despite numerous attempts to create more consolidated structures (Ostrom et al., 1988). Similarly, the public choice perspective on the dangers of municipal monopoly was reflected strongly in the introduction of compulsory competitive tendering in UK local government. The two local government systems are, therefore, an especially useful context for the evaluation of public choice theory. Moreover, evidence on the impact of competition on the behaviour of local governments can also be used to draw wider conclusions on the validity of public choice theory.

The first part of this chapter outlines the main characteristics of public choice models of the relationship between competition and

performance in local government systems. In the second part, the plan of the main body of the book is outlined and the key questions which the analysis seeks to answer are summarised.

1. PUBLIC CHOICE THEORY, COMPETITION AND PERFORMANCE

(a) The Motives of Policy-Makers

The basis of public choice theory is that 'man is an egoistic, rational utility maximizer' (Mueller, 1979: 1). Just as behaviour in economic markets is driven by the pursuit of private gain, so is activity in political systems. In other words, human nature is uniformly selfish, regardless of whether people are performing roles which are economic or political. Gwartney and Wagner (1988: 7) note that 'economists have used the self-interest postulate to develop theories which enhance our understanding of how markets work. Public choice represents an extension of this postulate to politics . . . since there is no evidence that entrance into a voting booth or participation in the political process causes a personality transformation, there is sound reason to believe that the motivation of participants in the market and political process is similar.' The selfishness of policy-makers is also emphasised by McKean (1965: 498) who argues that politicians and officials 'do not arise each morning and ask "What can I do today for Pareto optimality?" Like the rest of us, they are surely utility maximizers.'

The view that human behaviour consists of 'rational egoistic maximisation' (REM) has been widely challenged. For example, Degregori (1974: 205) dismisses it as 'out of touch with reality', and Kelman (1987: 81) condemns it as a 'terrible caricature of reality' (see also Hoogerwerf, 1992; Lewin, 1991; Quiggin, 1987; Self, 1993; Stretton and Orchard, 1994; Udehn, 1996). The conventional public choice response to such criticisms is that the reality of assumptions is irrelevant to the validity of a scientific theory. All that counts, according to this view, is the empirical accuracy of the hypotheses which are deduced from the assumptions. Thus, if public choice predictions are supported by the evidence, then the

assumptions 'work', regardless of their realism. For example, Buchanan and Tullock (1962: 28) argue that 'the ultimate defence of the economic-individualist behavioural assumption must be empirical. If, through the employment of this assumption, we are able to develop hypotheses about collective choice which will aid in the explanation and subsequent understanding of observable institutions, nothing more need be thrown into the balance . . . The only final test of a model lies in its ability to assist in understanding real phenomena' (see also Downs, 1957: 21; Niskanen, 1971: 10).

This epistemological position is problematic even if public choice propositions are supported empirically. It cannot be argued that the REM premise must be true simply because evidence exists which is consistent with public choice hypotheses. Other theories may also be corroborated by the same evidence (see Toye, 1976). Thus if competition is associated with superior performance in the public sector, this does not directly reinforce the plausibility of the REM assumption. It is possible that the performance of politicians or managers with purely altruistic motives would be improved by competitive pressures. For example, a set of small charitable organisations devoted exclusively to the pursuit of global peace and happiness may perform better than one large monopolistic organisation. The mere existence of several organisations may stimulate the less efficient organisations to emulate the behaviour of the best performers. In this case the public choice hypothesis on competition would be supported even if the basic axioms of the theory were false.

The problems of interpretation are even greater if empirical evidence is inconsistent with public choice predictions. First, the self-interest axiom is purely formal – in itself, it generates no hypotheses on the behaviour of policy-makers (Simon, 1994). In order to breathe life into the REM assumption, it is necessary to add 'auxiliary' assumptions on the motives of policy-makers; for example, that politicians seek to maximise votes or that bureaucrats attempt to maximise their budgets. Therefore, if public choice arguments are not confirmed by the evidence, at least two interpretations are possible: either the auxiliary assumptions concerning specific motives are false, or the more general self-interest axiom is mistaken.

A second and equally serious problem concerning the REM assumption can be identified. It is not one assumption but *three*: the separate elements concern egoism, rationality and maximisation. Selfish policy-makers may behave irrationally and select a course of action which fails to achieve their personal objectives. For example, politicians may choose to campaign on issues that they mistakenly believe to be the most important to the electorate. Furthermore, selfish decision-makers may choose rationally to 'satisfice because they have not the wits to maximise' (Simon, 1961: xxiv). For example, self-interested but lazy bureaucrats may decide to pursue a level of expenditure only marginally above that 'really' required to provide a service. Thus, if public choice hypotheses are contradicted by the evidence, the fault may lie in any or all of the three components of the REM premise.

The implication of these points is that the relationship between public choice theory and empirical evidence is complex. The argument that a simple test of 'correspondence with reality' can be applied to public choice models is naive. Even if the concepts in the theory are operationalised accurately, and if appropriate empirical procedures are followed, problems in the interpretation of the evidence will remain. Empirical tests of the relationship between competition and performance in the public sector can illuminate the strength or weakness of public choice theory, but cannot provide a blinding light. Crisp and clear conclusions on the validity of the public choice perspective cannot be reached without judgements on the plausibility of the auxiliary assumptions concerning the aims of politicians and public officials, and the realism of the three elements of the fundamental REM premise.

In sum, the view of public choice theorists that 'evidence is everything and assumptions are irrelevant' is untenable. Nevertheless, an analysis of the results of tests of the competition hypothesis is a crucial first stage in the evaluation of public choice theory. Evidence that competition is associated with superior performance would provide important support for the public choice 'world view'. By contrast, if competition does not have the hypothesised effects, then the whole public choice edifice is substantially weakened.

(b) Public Choice Models of Competition

Competition between organisations implies a contest for a share of a market, or a struggle to dominate a market (Burke et al., 1991; Hayek, 1949). Competition has also been described as 'the striving of rivals to gain advantages relative to one another' (Stigler, 1957: 3). The neo-classical economic perspective on the value of competition in the private sector is summarised by Reekie (1979: 6) as follows:

> It can be shown, using the assumptions of perfect competition, that welfare is maximized only when price equals marginal cost for all commodities and that this condition only holds in a perfectly competitive equilibrium. It then follows that monopolistic and oligopolistic market structures . . . can be deemed inefficient and undesirable.

Such assumptions on the benefits of competition and the costs of monopoly are reflected in the 'structure–conduct–performance' (SCP) paradigm of industrial economics (Clarke, 1985; Shepherd, 1990). This model suggests that a competitive market structure has a positive influence on the conduct of the owners and managers of private firms, which in turn leads to high levels of industrial performance. Public choice theory is, in essence, the application of the SCP paradigm to the public sector: if the appropriate structure of competition is created, then the behaviour of politicians and officials will be steered towards the interests of the public. As McKean (1965: 500) argues, 'if well designed, the invisible hand can go a long way toward turning private "vice" into public virtue, in government as well as in the private sector'.

The view that policy-makers' pursuit of self-interest can be constrained by institutional arrangements is accepted even by strident critics of public choice theory. For example, Self (1993: xii) argues that 'the directions and degrees of self-interest depend very much upon the structure of opportunities within a given political and economic system'; and according to Stretton and Orchard (1994: 20), 'material self interest is strong and pervasive in the motivation of people's public behaviours. But it is open to many institutional transformations.' Public choice theory suggests that competition is

a crucial component of the 'structure of opportunities' which policy-makers confront, and that the replacement of monopoly by competition is an 'institutional transformation' with beneficial effects on public services.

Three main public choice models of competition in the public sector can be identified. The first stems from the work of Tiebout (1956) who argues that a local government structure with many small units can provide a 'market-like' solution to the problem of matching local policies to public preferences. In a 'fragmented' local government system, each unit must compete effectively in order to retain existing households and firms, and to attract new customers in the local government marketplace. The principal 'products' which local authorities can offer the public are low taxes and a high quantity and quality of services. Local policy-makers who provide value for money in local service provision are likely to be rewarded with a higher market share and buoyant local revenues. Those who fail to achieve a good ratio of service benefits to tax costs are likely to lose customers and suffer a decline in the local tax base. By contrast, if a large local unit covers a wide territory then it is less likely that business will be lost to other areas. In such a 'consolidated' local government system, large units have 'spatial monopoly'.

The Tiebout model has subsequently been extended to incorporate 'vertical' as well as 'horizontal' fragmentation. This means that there should be several tiers or layers of local government in each area. A fragmented structure thereby provides two sources of competitive pressure on each local unit: rivalry from other areas for a share of the total local government market, and rivalry between the tiers within each area for a share of the revenues from the existing tax base. In a further development of the initial Tiebout model, public choice theorists have drawn attention to the importance of concentration as well as fragmentation in the local government market. The concept of concentration refers to the distribution of market shares between local units. If there is an even spread between many local authorities then the scope for competition is substantial, but if one unit has a very high market share then the structure of the market is monopolistic rather than competitive. These ideas draw directly on empirical analyses of the SCP paradigm which include extensive tests of the relationship between

'concentration ratios' and economic performance (Clarke, 1985; Davies et al., 1991).

A second public choice model of competition is based on Downs' (1957) work on the role of political parties in a representative democracy. Downs argues that politicians are motivated by power, and in particular seek to maximise their share of the popular vote (note here that at least two auxiliary assumptions are added to the self-interest axiom: first that politicians are 'power hungry', and secondly that the currency of power is votes). Downs argues that if public opinion is distributed on a left–right ideological axis, then party leaders will converge on the middle of this distribution in order to win votes. By assumption, politicians attach little intrinsic value to policies, and are prepared to adopt any platform that will help them to win an election.

The fiercer the competition between the parties, the greater the likelihood that politicians will match their policies to the preferences of the median voter at the centre of the political spectrum. In the absence of effective competition, a governing party can pay less attention to the views of the electorate, safe in the knowledge that it faces no serious rival. Instead, political leaders can seek to maximise power *within* their party, for example by adopting policies that please their activists or financial backers rather than the electorate in general. This may result in policies which are substantially to the left or right of those desired by the median voter. By contrast, if policies reflect the views of median voters then the aggregate distance between public demands and public policies is minimised.

The third public choice model of competition is concerned mainly with the behaviour of public officials rather than politicians. The seminal public choice perspective on bureaucracy was developed by Niskanen (1971), although earlier contributions by Tullock (1965) and Downs (1967) laid the foundations for this work. Niskanen argues that bureaucrats are motivated by a number of selfish objectives (e.g. prestige, material rewards), and that all of these interests are served by higher levels of public expenditure. In short, bureaucrats are budget maximisers. Furthermore, they have the power to achieve this aim because they have a monopoly of information on the true cost of service production, which in turn stems from their position as monopoly providers of public services.

The consequence is that government expenditure is too high, and that services are inefficient and unresponsive to public demands. According to Niskanen, then, the wrong services are provided at the wrong price because of the monopolistic structure of public sector markets.

As with the other public choice models, if the diagnosis is monopoly then the prescribed remedy is competition. In particular, bureaucrats should be exposed to the competitive threat that responsibility for service production may be transferred to an external supplier. If a 'competitive bidding' process is used to allocate the rights to service production, then politicians will be able to observe alternative estimates of service costs. Thus the effect of competition in the market for service production is that power is transferred from bureaucrats to their political 'masters'.

All three public choice models of competition suggest that policy-makers who enjoy monopoly powers are likely to perform poorly. If competitive pressures are present, however, politicians and officials will be constrained to serve the public interest rather than their own interests. Such competitive pressures can take a number of forms: rivalry from other units of government, attempts by opposition parties to replace the governing party, and bids by external agencies to produce public services. Any or all of these 'market forces', public choice theorists believe, will have a disciplining effect on the behaviour of public organisations and lead to better performance.

(c) Dimensions of Performance

Public choice theory lacks a clear exposition of the dimensions of organisational performance in the public sector. Nor has there been much analysis of the theoretical influence of different types of competition on different aspects of performance. It is, however, possible to identify three main concepts of performance that are at least implicit in public choice arguments (for more comprehensive discussions of the performance of local authorities see Boyne, 1997c; Boyne and Law 1991; Jackson, 1995).

The first aspect of performance is simply the level of public expenditure. If monopoly results in excessive spending, then

competition should be associated with lower spending. This proposition follows directly from arguments on bureaucratic power (Niskanen, 1971) and the structure of local government systems (Schneider, 1989b). A second dimension of performance is technical efficiency (also referred to as 'productive efficiency'; see Le Grand and Bartlett, 1993; Walsh, 1996). This concept refers to the ratio of expenditure inputs to service outputs. Technical efficiency is achieved when output is maximised for a given input, or when inputs are minimised for a given output (see Jackson, 1982: ch. 7). The final dimension of performance is responsiveness to public demands. This features most explicitly in the Downs (1957) median voter theorem. According to Beetham (1996: 32), 'the criterion of *responsive* government goes beyond accountability or answerability, to embrace the requirement that governments take note systematically of the full range of public opinion in the formulation and implementation of law and policy'. In the Downs model of party competition, the closer the connection between public policies and median voter preferences, the greater the level of political responsiveness. Party competition may also be associated with levels of expenditure and efficiency. Walsh (1996: 76) argues that 'Democracy can create incentives to technical efficiency through the threat of loss of office. Though there may be little evidence that local voting patterns do depend upon technical service efficiency, politicians may behave as though that is the case.'

These three concepts of performance can serve as yardsticks for measuring the impact of competition in the public sector. If public choice theory is valid, there should be a significant negative relationship between measures of competition and expenditure, and a significant positive relationship between competition and levels of efficiency and responsiveness.

2. PLAN OF THE BOOK

The main chapters of this book consist of an evaluation of the empirical validity of the three public choice models of competition in local government. The analysis of each of these models follows a common format. First the components of the theory of competition

are identified and assessed, and the hypothetical links between competition and performance are explained. Secondly, the extent of competition in the UK and USA is examined. This involves a comparison of average levels of competition, and an analysis of variations in competition across local units within each country. Thirdly, the results of empirical tests of the relationship between competition and performance are reviewed. Fourthly, the quality of this evidence is scrutinised: this includes an evaluation of the measures of competition and performance, and an assessment of whether other relevant variables were taken into account in the empirical tests. Finally, conclusions are drawn on the validity of the public choice model of competition.

In Chapter 2 the public choice perspective on competition between local authorities is analysed. Most discussions of public choice theory and local government focus on arguments concerning fragmentation in general and the Tiebout model in particular (e.g. Dowding, 1996; Keating, 1995). However, as noted above, horizontal fragmentation is only one aspect of structural arrangements. Public choice theory also draws attention to other characteristics of the local government market. These include the number of tiers of local authorities, the horizontal and vertical distribution of market shares, and the presence of barriers to entry. Furthermore, public choice theory suggests that competition is influenced not only by structural arrangements, but also by the degree of local autonomy from central controls, and the level of inter-governmental grants. If local autonomy is low then competition on 'products' is suppressed, and if central funding is high then competition on 'price' is weakened. These arguments on the conditions for effective competition have been developed in separate strands of public choice theory. In the first part of Chapter 2, they are drawn together into a comprehensive public choice model of inter-authority competition.

The second section of the chapter examines the extent to which local government in the UK and USA meets the 'competitive conditions' identified by public choice theory. For example, what is the level of fragmentation? How much autonomy is available to local policy-makers? What is the balance between local revenues and central grants? How have these characteristics changed in recent

years, and which of the two local government systems is more competitive? The third part of Chapter 2 summarises and evaluates the empirical evidence on the relationship between competitive conditions and local authority behaviour. Is there a significant link between competition and performance? Are levels of spending, technical efficiency and responsiveness to public demands influenced by local government structure, autonomy and finance?

The public choice model of competition between political parties is analysed in Chapter 3. The concept of party competition implies that the outcome of elections is uncertain, but not random. In order for competition to constrain the behaviour of the ruling party, politicians must believe that defeat is a realistic possibility but that victory can be obtained by adopting policies which satisfy public demands. A specific hypothesis generated by the Downs (1957) model is that as competition between political rivals becomes closer, so the connection between median voter preferences and public policies becomes stronger. In other words, party competition is a mechanism for ensuring that representative democracies are responsive to the political 'middle ground'.

Several dimensions of party competition are distinguished in the first section of Chapter 3: the presence of at least two party rivals, the relative strength of the parties, and the extent of volatility or turbulence in their power. These measures are applied to local political systems in the UK and USA in order to assess the extent of party competition. The indicators of inter-party competition in empirical studies are then critically reviewed, and evidence on the impact of competition on local authority behaviour is summarised and assessed. Finally, conclusions are drawn on the validity of the public choice hypothesis that rivalry between political parties is positively related to the responsiveness of local political systems.

Arguments and evidence on competition between local authority departments and external agencies are considered in Chapters 4 and 5. Two chapters are devoted to this topic simply because of the large quantity of evidence on the extent and effects of competition in both the UK and USA. In the first part of Chapter 4, public choice arguments on the problems of bureaucratic monopoly are analysed. Different elements of the 'utility functions' of public officials are emphasised by Tullock, Downs and Niskanen. However, they agree

that bureaucrats are fundamentally selfish, and that the result is a public sector which is bloated, inefficient and unresponsive to public needs. This view of the behaviour of bureaucrats is reflected strongly in policies that have promoted contracting-out in the USA (Hilke, 1993), and in reforms that have imposed 'quasi-markets' and 'market testing' in the UK. The second part of Chapter 4 proceeds to examine the extent of competition for local service production, and to analyse the reasons for geographical variations in this form of competition within the UK and USA.

The impact of external competition for the provision of local services is evaluated in Chapter 5. Evidence on the effects of voluntary and compulsory competitive tendering in the UK, and of voluntary contracting-out in the USA, is summarised and assessed. It is shown that empirical studies in the two countries share many of the same methodological weaknesses. Moreover, in both the UK and USA, many of the studies analyse refuse collection. Therefore it is important to consider whether the statistical results for this function can be generalised to other services. Conclusions are drawn on whether competition from external suppliers is associated with lower spending and greater efficiency in local government systems.

In the final chapter, the main findings of Chapters 2 to 5 are summarised and integrated. To what extent are the local government systems in the UK and USA competitive rather than monopolistic? How much competition is there between local authorities, between political parties, and between public and private producers of local services? Does competition in local government have the effects that public choice theory predicts? Are there significant relationships between variations in competition and variations in the expenditure, technical efficiency and responsiveness of local political systems? How valid and comprehensive is the empirical evidence on public choice hypotheses? The last part of Chapter 6 outlines a research agenda for further empirical tests of public choice hypotheses.

Public choice theory has generated many vigorous debates in the social science community. Just as there are public choice 'zealots' who are convinced of its validity, so there are equally fervent 'fundamentalists' who regard it as not only wrong but also dangerous. There seem to be at least two reasons for the widespread hostility to

public choice theory. First, public choice has 'colonised' academic territory that was traditionally dominated by political scientists in general and public administration researchers in particular (Boyne, 1996e). Thus the critical response to public choice theory may reflect a wider concern about 'economic imperialism' in the social sciences. A second, and perhaps more important, reason for the negative reaction to the public choice perspective is its resonance with aspects of New Right ideology. It is therefore worth emphasising that the focus of this book is on the empirical validity or 'scientific status' of public choice hypotheses, rather than their normative content or 'ideological status'. It may be argued that it is impossible to separate the scientific and ideological elements of public choice propositions. However, this is to confuse the purely scientific content of a theory with the ways in which it is used to influence policy choices. For example, if competition is found to lead to lower levels of local spending, this cannot in itself help to decide whether spending should be high or low, or whether there should be more or less competition. Such ideological issues are logically separate from questions concerning the academic value of a theoretical perspective. Furthermore, if policy decisions are to be made about the appropriate level of competition in local government systems, then the first step must surely be to establish the empirical relationships between competition and performance. That is the primary purpose of this book.

2 Competition between Local Authorities

The aim of this chapter is to examine whether competition between local governments leads to better performance. Whereas conventional views of local government structure emphasise the benefits of planning across wide geographical areas and co-ordination of services (Young, 1975), public choice theory draws attention to the advantages of markets and competition in local government systems. Put simply, if the structure of local government is such that councils must compete for market share, then they are more likely to be technically efficient and responsive. By contrast, if councils are guaranteed a fixed share of the market, then they are likely to be complacent, profligate and unresponsive to public needs and demands.

The chapter is in three parts. First, the theory of inter-authority competition is explored. This involves an examination of public choice principles concerning institutional structures, market shares, the funding of local government and the level of local autonomy. Secondly, the extent to which the local government systems in the UK and USA display these 'conditions of competition' is analysed. And thirdly, empirical evidence on the relationship between competitive conditions and the behaviour of local governments is evaluated.

1. PUBLIC CHOICE THEORY AND INTER-AUTHORITY COMPETITION

Public choice theory views local government as an industry in which there are buyers and sellers in the market for local services (see Ostrom and Ostrom, 1965). The buyers are households and businesses who choose to locate in specific areas and pay for their choices through local taxes; and the sellers are politicians and bureaucrats who either procure or directly provide services for the

public (Schneider, 1989b). Competition between councils takes two forms: first, geographical competition between authorities in different areas for a share of the market in households and businesses; second, competition between different tiers of local governments for a share of local tax revenues in the same geographical area.

As with many industries, local government is subject to central government constraints on its internal structure, products and prices. Governments can influence the level of competition in any industry through policies on the number of firms and their market shares, the nature and variety of goods and services that are produced, and the prices that are charged to consumers (see Shepherd, 1990; Stigler, 1968). These ideas from the literature on industrial economics can be used to identify three major variables which influence the level of competition between the units in a local government system. First, the *structure* of the system, as measured principally by the number of units and tiers and the distribution of market share between them. Second, the level of local *autonomy*: even if there is a large number of units, strict central curbs on local autonomy will suppress competition on the quantity and quality of products. Third, the *extent of central funding*: even if there are many units and high local autonomy, substantial central funding will suppress competition on price.

(a) Structure

Local government structures may take one of two broad forms (see Boyne, 1992a; Ostrom, 1972). In a 'consolidated' structure all services are provided by a single unit that covers a wide geographical area. In such a single-tier system each authority has a monopoly over all local services and has an extensive spatial monopoly. By contrast, in a fragmented structure, local government is divided into a number of tiers with many units in each tier. The public choice preference for a fragmented structure is a reaction against the 'conventional' view that large, hierarchical, multi-purpose organisations are the best way to organise local public services. According to Ostrom (1989: 30), research in this tradition in the USA:

> gradually articulated several principles of administration. Such concepts as unity of command, span of control, chain of command, departmentalisation by major functions, and direction by single heads of authority…are assumed to have universal applicability in the perfection of administrative arrangements. Strengthening of government is viewed as the equivalent of increasing the authority and powers of a chief executive. General-authority agencies are preferred to limited authority agencies. Large jurisdictions are preferred to small. Centralised solutions are preferred to the disaggregation of authority among diverse decision structures.

The public choice approach does not completely reject arguments for large units of local government which may be necessary for some services in order to internalise externalities and take advantage of economies of scale (see Breton and Scott, 1978). However, it is important to note that scale effects refer to the level of output rather than population size *per se*, and that economies of scale may be present at the level of 'plants' (e.g. a school) rather than at the 'firm' level of a local authority as a whole (see Boyne, 1995). In this case, even small authorities may be able to produce services at minimum cost. Also, as Bish and Warren (1972: 102) argue, a large local authority 'is analogous to a multipoint firm with exclusive rights to products and sales within a specified territory… While a natural monopoly, which (such) governments are implicitly assumed to be, is theoretically able to supply a market at lower average cost than two or more producers, incentives for efficient and responsive performance may be lacking.'

Tiebout (1956) argues that a highly fragmented local government system with many authorities provides a solution to the problem of determining the appropriate level of public services. The more public preferences vary geographically, the greater the degree of fragmentation required for responsiveness to local demands. Fragmentation allows households and businesses to choose between various combinations of taxes and spending. Even if public preferences are geographically homogeneous, fragmentation is required to ensure technical efficiency in service provision. In order to attract and retain mobile residents and businesses each small unit

of local government must ensure value for money in service provision, otherwise customers will 'vote with their feet'. This 'horizontal' fragmentation of the structure of local government provides citizens with information concerning taxes and services in neighbouring areas, thereby increasing the competitive pressure on decision-makers.

Osterfield (1989: 155) argues that governmental responsiveness to public preferences is better secured by geographical 'exit' than by democratic 'voice'. Through exit, individuals can join communities with others who share similar preferences. By contrast:

> the democratic process must ultimately result in the selection of one alternative from an indeterminate number of possible alternatives and adopt it in the name of, and impose it upon, the entire society… Those whose preferences are not incorporated into the government policy cannot, as is generally the situation with the market, satisfy their preferences by taking their business elsewhere. The best the loser can hope for is to exercise enough influence to get the policy changed. But this only means that the old losers are now winners and the old winners losers; it does not change the nature of the game, only the final score.

A competitive structure not only implies horizontal fragmentation (a large number of local units) but also vertical fragmentation (several tiers of local government). This has received less attention than horizontal competition in public choice theory. As Belanger (1987: 136) notes, 'a considerable fraction of economic literature on governmental structure does not touch upon the liberating effects for the citizen of vertical intergovernmental rivalry. Instead, they [sic] insist on the costs of duplication or of overlapping of programs and on the confused policies that are generated by multiple levels of governments.' If one authority is responsible for providing all services it can engage in 'full-line forcing', which means that consumers pay one fee for a whole package of services, regardless of their relative valuation of the parts of the package (Wagner and Weber, 1975). However, if services are divided between several tiers of local government then their relative costs become visible, and consumers can make separate judgements on the performance of each tier and allocate their political support and tax payments

accordingly. Vertical fragmentation within an area forces local authorities to compete for a share of the finite local tax base. Bish and Warren (1975: 105) argue that the number of tiers will be limited by the costs of monitoring and public participation:

> Because of the differences in the nature of goods and services provided by government, demands for them are likely to be efficiently articulated only by political units of different sizes. This does not imply that a separate demand articulating unit with different boundaries is requisite for each good service. The costs to a citizen of participating in a separate political unit for each function – whether through voting directly on issues, voting for a representative, or direct lobbying – would be extremely high. Instead, it is rational to design political units which serve simultaneously for demand articulation for several goods with approximately the same boundaries . . . There are important tradeoffs for the citizen. The more numerous the political units, the more accurately a citizen may indicate his preferences, but the more costly it will be in terms of his own participation. Conversely, the fewer the political units, the more difficult it will be to express preferences on any single good or service, but the less costly will be his own participation.

In addition to fragmentation, a fully competitive local government structure would contain both the flexibility to switch services between existing units and the potential to establish new units. If consumers are unhappy with a service provided by a local authority then they should have the option to transfer the responsibility to another unit. This form of 'consumer power' would pose a permanent competitive threat to existing providers' share of the local government market. Such flexibility is present in the 'Lakewood Plan' in the USA. Under this arrangement, municipalities in the Los Angeles area provide services themselves or negotiate contracts with the county. Warren (1966: 202) argues that the Lakewood Plan 'institutionalises a competitive relationship between a large scale producer of municipal services (the county) and a diverse set of consumer jurisdictions in which the latter have the option of withdrawal and the capacity to bargain over service arrangements'. Consumers should also have the option to establish a new unit to provide a

service, such as the special districts for particular services in the USA (see Ostrom et al., 1988). In other words, there should be no 'barriers to entry' in the local government market. Consumer power to transfer services and create new units allows 'communities of interest' to be defined at different spatial scales, depending on the services to be provided. For example, the geographical size of the relevant community for pollution control is likely to be much bigger than for children's play areas. Also, where services are produced 'in house' a size of unit may be created that minimises costs in relation to circumstances in the local area.

Thus in a fragmented local government system 'business' may be lost to other areas, to other units in the same area or to new 'firms' entering the market. In a horizontally fragmented structure, councils that perform well will gain new households and businesses, whereas councils that perform poorly will suffer a decline in their tax base. In a vertically fragmented structure, local tax revenues will be more easily acquired by an efficient tier of local government than a prodigal tier.

These arguments on structure assume that fragmented institutional arrangements will lead to competitive behaviour and superior performance. However, this conclusion does not follow if a large unit dominates many smaller rivals. In this case, even a fragmented structure may lead to monopolistic behaviour. For this reason, public choice theory emphasises not only fragmentation in the local market, but also the level of concentration. In other words, it is important to consider not only the number of units in the local government market, but also the distribution of power between them. This dimension of market structure can also be measured horizontally and vertically. Horizontal concentration refers to the distribution of market shares within a tier of local governments, and vertical concentration relates to the shares of different tiers that cover the same area.

In vertically concentrated structures, 'economies of scope' may confer advantages from the provision of a range of services by the same organisation. Grosskopf and Yaisawarng (1990: 61) argue that local governments may be analogous to multiproduct firms where 'economies of scope are said to exist if the cost of providing a diversified set of services is less than the cost of specialised firms

providing those same services . . . the traditional source of economies of scope is through the "sharing" of some inputs in the production of related goods or services, where these shared inputs are also often fixed'. In the case of local government, the fixed inputs that can be shared include computing facilities, central administrative staff and decentralised area offices.

Vertical fragmentation may prevent the realisation of economies of scope and, therefore, lead to higher costs. If services are divided between several tiers of authorities then problems of co-ordination and administrative duplication may exist. Economies of scope may be maximised if closely related services are provided at the same tier in a local government system. If all services share some common overheads then full economies of scope will be attainable only in a single-tier system. However, even in a multi-tier system economies of scope may be gained if services are concentrated at one level rather than dispersed equally between levels. Therefore the potential importance of economies of scope suggests that vertical fragmentation will lead to lower efficiency, and that vertical concentration will lead to higher efficiency.

Any benefits from economies of scope may, however, be counteracted by problems of public scrutiny. If many services are provided by a single organisation, then it is harder to discern the connection between tax costs and the benefits of any specific service. Moreover, if market share is concentrated in a geographically large top tier, any trend towards high spending and low efficiency is reinforced by a loss of competitive pressures from fiscal migration. The threat of fiscal migration is greater if market share is evenly distributed or concentrated in lower-tier units, because the average distance firms or individuals have to move in order to dramatically alter their tax and spending packages is lower. By contrast, if market share is heavily concentrated in large top-tier units the average relocation distance that is required to make a marked difference to the tax and spending ratio is much greater.

Political pressures towards high performance may also be reduced by horizontal concentration. Local authorities with a large market share are in a similar position to large firms: potential dominators of their smaller rivals and beyond the influence of their customers. In contrast, evenly spread market shares mean that local

authorities find it more difficult to exploit their neighbours or customers. According to public choice theory, therefore, performance may be higher where market shares are evenly distributed.

(b) Autonomy

Fragmentation and deconcentration are necessary but not sufficient conditions for competition in local government. In order to foster competition in practice it is necessary for central government to permit substantial local autonomy. 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 quantity and quality. This condition for competition has been neglected in the public choice literature, perhaps because most authors have written from an American perspective. There is a much stronger tradition of local autonomy in the USA than the UK (see Boyne 1993b; Wolman and Goldsmith, 1992). Arguments concerning the benefits of competitive structural arrangements have therefore tended to assume the existence of autonomy, rather than building this explicitly into public choice models.

Local autonomy may be defined as the freedom to exercise choice in local policy-making and the capacity thereby to influence the well-being of local residents (Wolman and Goldsmith, 1990). Autonomy implies local power over the goals of local authority activity (for example, whether to seek to improve local housing conditions) and local power over the method of achieving these goals (for example, to build directly or subsidise the private sector). Clark (1984: 145) refers to these local powers as 'initiative', which is 'the power of localities to legislate and regulate the behaviour of their residents', and 'immunity' which is 'the power of localities to act…however they wish within the limits imposed by their initiative powers'. It follows that local autonomy is reduced by central policies that remove powers of action or impose an obligation to act, and enhanced by policies that bestow new powers or abolish obligations (see Boyne, 1993a).

Central curbs on local autonomy prevent the potential competitive benefits of fragmentation from being realised in practice. If all local units are compelled by the centre to behave in the same way,

then there is no point in migration across areas to secure a different package of services. As Tiebout (1956: 420) argues 'the act of moving or failing to move is crucial. Moving or failing to move replaces the usual market test of willingness to buy a good and reveals the consumer voter's demand for public goods.' In the same way, if all tiers of local government in an area are subject to stringent central controls then there is little point in the public attempting to apply fiscal or electoral sanctions for poor performance; but when local areas are given the discretion to pursue their own interests, competition in the local public economy will encourage appropriate outcomes. Public choice theory assumes that individuals will cluster into homogeneous communities and that consumer preferences will be closely reflected in public policies. By contrast, 'if increased standardisation and regulatory control is shifted up the hierarchy, the ability of lower level governments to offer alternatives (in quantity or quality) will be restricted and local officials will be less accountable to citizens' (Staley and Blair, 1995: 23).

The absence of tight central controls in the public choice model does not imply that councils are completely autonomous. Indeed, if there were perfect competition in the local government market then local policy-makers would have very little discretion – policies would be entirely determined by the demands of households and businesses. Shannon (1991) argues that inter-jurisdictional competition is an 'invisible regulator' that constrains decisions on taxes and services. He suggests that competition between US states has a 'braking' effect on taxes, and an 'accelerating' effect on services:

> Interstate tax and expenditure competition serve jointly as the two 'unseen hands' that set the outer limits on how far any state can push ahead of other states on the tax front or lag behind them in the public service area. The behaviour of our states resembles 50 ships sailing in a great naval convoy… The farther any state moves ahead of the convoy on the tax side, the greater becomes the risks of tax evasion, taxpayer revolts, and the loss of economic development to states pursuing more conservative tax and spending policies. By the same token, the farther any state falls behind the convoy in the public service area, the greater the

> risk that it will lose economic development to states providing a higher quality of life. (Shannon, 1991: 122–3)

Thus the constraint of competition on local autonomy may be as great as the constraint of central controls. However, from a public choice perspective, efficiency and responsiveness in the local government system are more likely to result from local competition than central intervention. Indeed, local competition may not only promote efficiency and responsiveness in the provision of existing services, but also act as a 'discovery procedure' that generates new services and innovative methods of service delivery (Vihanto, 1992).

(c) Finance

Even if local government is fragmented and each unit has substantial autonomy over the pattern of service provision, the full benefits of competition will not be realised if central grants are high. The inverse relationship between central funding and local competition has been overlooked in much of the public choice literature. A rare recognition of the importance of this relationship is provided by Dye (1990: xvi) who argues that local governments cannot 'be truly competitive if the costs of their decisions can be externalised – shifted through federal grants-in-aid to the national government and to taxpayers throughout the nation'.

A high level of central funding can be viewed as a 'public bad': a cost for the performance of the local government system as a whole, but a benefit for individual areas. As Bailey (1994: 755) argues, each local community 'will tend to overemphasise equity (i.e. redistribution in their favour) or their constitutional rights to free (or heavily subsidised) services and underplay any resulting inefficiencies. This is because the gain to themselves of any redistribution in their favour will be greater than any loss they incur due to any inefficiencies at the economy-wide level.'

In a competitive market, inefficiency is reflected in sharp price differences between alternative suppliers. If local services are heavily subsidised by central government, however, the full force of the 'price mechanism' will be blunted. The higher the level of

central funding, the lower the incentive for fiscal migration between areas (Grossman, 1989; McKenzie and Staaf, 1978). If local taxes comprise a low proportion of service costs, then the absolute financial gain from moving is likely to be small. The payment of large central subsidies not only provides inefficient authorities with a buffer against competitive pressures but also distorts the price signals sent to the local population in each area (King, 1984). Grants disguise the real cost of local authority service provision. The local electorate may perceive only the local tax cost of service provision and fail to appreciate the extent of the central subsidy. This 'fiscal illusion' may give the impression that council services are cheap compared with other goods and services, and thereby artificially inflate the demand for local authority provision.

There is, nevertheless, a public choice argument for some central funding in the form of 'equalisation grants' to neutralise local variations in service needs and tax base resources. Equalisation grants put all areas on the same competitive footing: they provide 'equality of opportunity' in the local government market (Breton, 1987). In the absence of equalisation grants, fiscal migration will be caused not only by variations in local authority responsiveness and efficiency, but also by differences in local needs and resources. If there are no central grants, people in high need or low resource areas may receive poorer services and pay higher taxes than people elsewhere. There will then be an incentive to move to another area in order to secure a better 'fiscal residuum' (Buchanan, 1950; Scott, 1964). By contrast, fiscal migration because of variations in needs and resources will be prevented if there is 'horizontal equity' in local government finance, which implies that people with equal incomes (or property values) are treated equally. As Buchanan (1950: 589) argues

> If the fiscal balance for equals is not made equivalent for all areas of the economy, a considerable distortion of resources from the allocation arising as a result of economic criteria alone might result. The whole fiscal structure should be as neutral as is possible in a geographic sense. An individual should have the assurance that wherever he should desire to reside in the nation, the over-all fiscal treatment which he receives will be approximately the same.

Although equalisation grants are required if fiscal migration is to play the role attributed to it by public choice theory, this does not imply that grants should contribute a large proportion of local spending. As Newton (1980) argues, equalisation could have been achieved with far lower grants than prevailed in the 1960s and 1970s in the UK, when central funding comprised around two-thirds of net local spending. In addition, from a public choice perspective, a grant should be truly equalising and not simply paid as a geographically uniform per capita subsidy to local councils. Public choice theory implies that this is the worst form of grant which promotes neither local competition nor horizontal equity.

It has been argued that central grants do not remove competition between local governments, but simply transfer it from economic markets to political markets. In the USA, Kincaid (1991: 91) distinguishes between 'unmediated competition' which is 'direct competition in the open market, as when states compete directly for tourists and firms'; and 'mediated competition' which occurs when 'states compete in the US congress for grant-in-aid funds, and localities compete in the state legislature for highway funds'. This implies that there is no escaping inter-governmental competition. Rather, a choice can be made about the form of competition that is likely to produce superior outcomes. From a public choice perspective, the failures of the political market are likely to be greater than those of the economic market. Whereas economic competition exposes authorities to public demands, political competition places decisions in the hands of self-interested bureaucrats and politicians.

An inverse relationship between economic and political competition has also been identified in Britain. Newton (1980: 112) argues that

> grants have had the effect of converting a good deal of the economic conflict between local authorities into political conflict between local authorities of different types, and between these authorities and central government. Horizontal economic competition between one local authority and its neighbours tends to be transformed into horizontal conflicts between different types of authorities which benefit from different ways of distributing the grant, and into vertical conflict between local authorities

> which combine with one another in order to do political battle with central government over the crucially important question of how big the grant is to be, and how it is to be distributed.

The result of this shift from economic to political competition is that councils pay less attention to local economic prosperity and public preferences, and more attention to the 'rules of the grant game' and central government demands. In this context, Belanger (1987: 142) argues, 'an efficient local administration is not primarily concerned with real responsibility any more but, rather, with "selling" its projects to a government on a higher level. When such a situation prevails, a good administrator in local government is first of all a good salesman.'

An alternative strand in public choice theory suggests that high grants lead not to political competition but collusion. In private markets, companies may be tempted to operate a cartel in order to control prices in an industry. This arrangement allows private firms to create a more stable environment for their activities and, if the collusion is successful, to obtain a market position analogous to a monopolist. Similarly, it has been argued that local bureaucrats may form a cartel with other jurisdictions and central government in order to constrain price variations through the payment of grants. According to Grossman and West (1994: 27):

> In the absence of collusion and under a system of free competition, each separate government will have incentives to cut tax prices in order to attract population and resources . . . One way of hindering this process is to try to establish a more uniform tax price system across all jurisdictions, the higher level of government being the logical body to administer the cartel agreement.

Collusive arrangements in private industries are more likely to be created and sustained when there are fewer participants (Shepherd, 1990). The operation of a cartel in local government is also likely to be easier when there is a lower number of separate local units. In this case the absence of fragmentation in local government may be one cause of higher central funding, which in turn reduces further the scope for competition.

In short, high grant subsidies, and widely different subsidies in different areas, make a nonsense of price competition in local government. High grants also undermine local autonomy, particularly if they are 'specific' rather than 'general'. Specific grants are tied to particular services or programmes in which central government has a special interest, whereas general grants leave local authorities with the freedom to allocate the funds between services according to their own priorities. Thus specific grants bias the pattern of services towards central preferences rather than local preferences. The conventional economic justification for specific grants is that they are required to correct for externalities across local authority boundaries, for example to stimulate the provision of a service which also benefits residents in neighbouring authorities (see Breton and Scott, 1978; King, 1984). However, the existence and extent of such externalities tends to be assumed rather than demonstrated. Breton and Scott (1978: 151) argue that the real rationale for specific grants may be budget-maximising behaviour by central bureaucrats.

2. THE EXTENT OF INTER-AUTHORITY COMPETITION

(a) Britain

The structure of local government in Britain was, before the twentieth century, in many ways consistent with the public choice model. There was substantial horizontal fragmentation – for example, 15 000 parishes were responsible for poor relief before the Poor Law Amendment Act of 1834 consolidated these units into 700 Poor Law Unions. A variety of single-purpose units also existed in the nineteenth century with responsibility for services such as health, highways and education. The level of vertical fragmentation was especially high in London, where twelve separate local government tiers existed in the middle of the nineteenth century (see Boyne and Cole, 1998). Local autonomy was also high at this time, with few mandatory service responsibilities imposed by central government. Keith-Lucas (1980: 14) argues that the centre 'left the local communities very much to themselves, allowing them to

regulate their affairs by local custom or by private and local acts, rather than in accordance with any general national pattern'. Finally, there was no central funding of local services until the early part of the nineteenth century. By the 1840s grants were still as low as 6% of net local expenditure (Foster et al., 1980; Bennett, 1982).

Since the late nineteenth century, however, the local government system has become much less consistent with the competitive conditions stipulated by public choice theory. Structural reforms between the 1880s and 1970s greatly reduced the number of separate local government units (Boyne and Cole, 1996). For example, the 1902 Education Act abolished 2500 local school boards and transferred their powers to a much smaller number of multi-purpose councils; and local government reorganisation in England in 1974 cut the number of local authorities by almost 70% (see Boyne, 1993b). The autonomy of local units also declined as councils lost control over some functions (e.g. hospitals, gas, water) and found their remaining powers increasingly circumscribed by legislation (see Stoker, 1991). Finally, the share of net local spending borne by local taxation declined from 85% at the start of the twentieth century to one-third by the mid-1970s. General and specific grants were used to purchase local co-operation in the implementation of national policies (see Foster et al., 1980). These trends away from competitive conditions have largely continued since the 1970s.

Structure

The Conservative government which was elected in 1979 inherited a two-tier local government system in England, Wales and the mainland of Scotland. In the mid-1980s, steps were taken to consolidate local units into a single-tier system in the major urban areas of England, by abolishing the Greater London Council (GLC) and the six Metropolitan Counties. After the abolition of these authorities in 1986 the thirty-two London Boroughs and thirty-six Metropolitan Districts acquired a spatial monopoly over local authority services in their areas. These councils obtained either full control of former GLC and Metropolitan County services, or partial control through a complex pattern of joint boards which are not directly

accountable to the electorate (Leach et al., 1991). A further vertical consolidation occurred in London in 1990 when the Inner London Education Authority was abolished and its responsibilities transferred to twelve London boroughs. In Scotland and Wales in 1996 the regions, counties and districts established in the 1970s were replaced by a single tier of 'all purpose' authorities. Most county and district services have been consolidated in 'unitary authorities'; other services are run jointly by neighbouring unitary councils through joint boards or less formal collaborative arrangements. These reforms, which have also been extended to parts of non-metropolitan England, effectively abolish vertical fragmentation in directly elected local government in the affected areas (Boyne et al., 1995).

The structural reforms have two contradictory implications for competition in local government. First, the abolition of upper-tier councils removes vertical competition. The remaining tier of directly elected councils has a monopoly on the local tax base, need not compete for a share of tax revenue, and has responsibility for all local services. In addition, whereas the public previously voted separately for upper-tier and lower-tier councils, they have only one vote with which to signal their preferences in a unitary system. The second effect of structural reform is to introduce more horizontal competition into former upper-tier services which are more geographically fragmented in the new arrangements. The disaggregation of county services could lead to greater variety, choice and responsiveness in services such as education and social work which were previously provided by these authorities. On the other hand, this effect is partly offset by lower fragmentation in former district services such as housing and planning.

Thus the net effect of structural change depends on the relative size of the effects of vertical and horizontal competition. Neither the public choice literature nor empirical tests of structural effects offer much insight on this question (see Boyne, 1992a, 1997a). However, it may be that the geographical areas covered by the new unitary authorities remain too large to allow fiscal migration to impose a serious constraint on the behaviour of councils. In this case the loss of vertical competition may not be offset by the extra horizontal competition.

Autonomy

It is common for new governments in the UK to make statements about reviving local democracy and restoring local autonomy. It is also normal for such statements to be quickly forgotten in the centre's quest to turn national decisions into local policy outcomes. The Conservative governments between 1979 and 1997 were no exception to this pattern – central policies showed little tolerance of local diversity. There is a wide academic consensus that curbs on local discretion during the Thatcher years in particular were unprecedented (see, for example, Crouch and Marquand, 1989; Travers, 1989). In part, this may confuse intentions and achievements, but there is little doubt that the local government system was moved in some of the directions that the centre desired (Boyne, 1993a). For example, in education the centre imposed a 'national curriculum' on local schools, and removed higher and further education from local control. Curbs on local autonomy are indicated 'not only in the volume of legislation, circulars, advice and in some cases abuse directed at local government, but also in the willingness of the centre to interfere with particular authorities' (Stoker, 1991: 149). Previous governments had attempted to influence the level of spending in the local government system as a whole, but the Conservatives sought to control the spending of individual authorities through manipulating grants, specifying the expenditure required to meet service needs in each local area and capping councils' spending. The impact of these controls is illustrated in Table 2.1 which shows the statistical relationship between local expenditure and central spending guidelines in the various groups of councils in England and Wales. The figures show the average percentage of the variation in local spending explained statistically by central guidelines in each of the periods of office of the four Conservative governments since 1979. In the early years of the new financial regime many authorities 'strayed' considerably from their guideline, as indicated by r^2s of little more than 50% in some groups. However, the relationship between central objectives and local behaviour gradually became much tighter, so that by the beginning of the 1990s local expenditure variation was very closely related to the spending guidelines. Indeed, in two groups of authorities, local spending was

almost entirely predictable on the basis of the centre's assessment of the expenditure required in each area, as indicated by r^2s as high as 99%.

Table 2.1: Relationship (r^2) between Local Spending and Central Spending Guidelines in England and Wales

	1981/2–1983/4	*1984/5–1987/8*	*1988/9–1991/2*	*1992/3–1993/4*
Inner London Boroughs	54	56	73	93
Outer London Boroughs	91	92	85	99
Metropolitan Districts	59	70	88	99
Non-Metropolitan Districts	53	59	69	74
Welsh Districts	51	80	79	94
English and Welsh Counties	84	85	84	96

Notes
1. Figures are the mean for the time period indicated.
2. 1981/2 was the first year for which spending guidelines were published for each local council.
3. There are too few Welsh counties (8) for a separate analysis.
4. Data source: *Finance and General Statistics* (London CIPFA, annual).

Further pressures towards a uniform pattern of local policies have resulted from the 'citizen's charter'. The provision of information to consumers on the cost and quality of products is an essential element of a competitive market (Stigler, 1968). However, the citizen's charter indicators are of limited use because they focus largely on cost rather than quality. In addition, local authorities are required to publish a standard set of performance indicators, thereby directing their attention to a common set of objectives (Boyne, 1997c). In attempting to dictate local choices, central government has acted as a 'substitute' for market forces. Public choice theory implies that all of the 'good things' which the centre desired would have been produced in a properly competitive local government system. However, the failure to establish the necessary condition of a competitive institutional structure left the Conservatives with little choice but to attempt through central planning to manufacture the outcomes that market forces might otherwise have produced.

Finance

During the late 1970s the Labour government restrained public expenditure and central grants declined from 66% to 61% of net current spending by local authorities. This trend was reinforced by the first two Thatcher governments. However, there was a sharp reversal of policy in the late 1980s, and by 1991 grants represented a higher percentage of council spending than at any time in the history of local government in the UK.

The Conservatives used two main methods to make local authorities in general more financially self-reliant, and to curb the supposed 'extravagance' or 'inefficiency' of high spending councils in particular. First, the share of local expenditure borne by grants was reduced in successive years. This was facilitated by legislation in 1980 which introduced a new grant system and enabled central government to penalise 'big spenders' by withdrawing part or all of their grant. In 1980 grants covered 59% of local current expenditure in England and Wales, but this figure fell to 50% in 1984 and to 40% by 1989. These grant cuts were a significant constraint on local spending decisions (Boyne, 1990). Second, when local authorities sought to replace grant losses with local tax revenue, central government introduced two new controls: in 1982 councils were debarred from levying 'supplementary rates' in the middle of the financial year, and in 1984 councils deemed to be overspending were 'rate capped'.

The decline in the level of grants enabled some competitive pressures in local public economies to be restored: price differences between areas became sharper and incentives to fiscal migration increased. For example, the difference between the highest and lowest local tax payment in England increased by almost 25% between 1980 and 1986. The competitive benefits from the decline in grants were partly offset, however, by an increase in the proportion of specific grants. Between 1980 and 1989, grants tied to particular purposes increased from 18% to 31% of total central funding.

The pattern of local government finance changed sharply with the introduction of the poll tax in England and Wales in 1990. The new local tax was broadly consistent with public choice theory. According to Hepple (1989: 398), 'the poll tax itself cannot be

unequivocally deduced and mandated from public choice theory. But one can argue that it was the appropriate interpretation and application of public choice theory for Britain in the late 1980s.' By contrast, the grant changes which accompanied the poll tax were problematic from a public choice perspective. The government stressed the important role of grants at the margin in the new financial regime: any increase in expenditure beyond the (supposedly 'objective') level required to fund a standard level of services was to be borne by local taxpayers. However, the most significant change from a public choice perspective concerned the increase in the level of grant as a result of the 'nationalisation' of non-domestic rates. Since 1989 in Scotland and 1990 in England and Wales 'local' business taxes have been set by central government and the money has been redistributed to local authorities as a standard sum per adult. This had three adverse consequences for local competition. First, the competitive benefits of the previous cuts in grant support were lost: grants soared to over 70% of local spending. Secondly, the new grant not only undermined efficiency but also failed to promote horizontal equity because it was not related to variations in needs and resources. And thirdly, the central imposition of a geographically uniform business rate weakened the threat of fiscal migration by businesses as a competitive constraint on local authorities. It may be argued that this constraint was never strong because local authorities were compensated for a loss of tax base by an increase in the 'resource' element of central grants. However, resource equalisation in the 1980s was imperfect (Boyne, 1989). In addition, there was no direct compensation for the secondary effects of business migration, for example the loss of local employment and the extra pressure on local services such as social work.

The poll tax itself also had 'unintended consequences' which further raised grant funding. The public protests which contributed to Margaret Thatcher's loss of office led the new Conservative leadership to introduce a local government finance 'rescue package' consisting of a £140 per taxpayer reduction in local bills. The money was found by raising central government taxes and redistributing the funds as yet another grant to local authorities. Again the money was provided as a general subsidy which did nothing to stimulate efficiency or horizontal equity. The net result of the introduction of

the poll tax is that less than 20% of net service costs are borne locally and incentives to fiscal migration by residents have declined. Local authorities may still compete on service standards, but competition on service costs has been greatly suppressed by central funding.

The idea of high grants being used to run a price-fixing cartel may appear implausible in the context of recent events in British local government. For example, counties and districts have been at loggerheads over local government reorganisation (Boyne and Law, 1993; Wilson, 1996); and central–local relations often seem more like a boxing match than a cosy conspiracy against the taxpayer. Nevertheless, there are signs that greater opportunities for collusion are associated with higher grants and thereby with the suppression of price competition. Grants tend to be higher in Scotland and Wales than in England, possibly because there are far fewer councils and it is therefore easier to establish a price-fixing cartel. Higher grants in Scotland and Wales are partly explained on the basis of lower tax base resources and higher service needs. However, it has been shown that grants in Wales are around 10% higher than would be expected when needs and resources are taken into account (Boyne et al., 1991). Further evidence of collusive behaviour by the existing firms in the local government industry is provided by the rigid enforcement of complete barriers to entry against the formation of new local units.

(b) USA

Public choice principles are more closely reflected in local government in the USA than the UK. The structure has been far more fragmented, both vertically and horizontally; national controls on local autonomy have been weaker; and the level of grant support for local expenditure has been lower. Nevertheless, during the twentieth century there has been some movement away from the public choice model. For example, between the 1930s and the 1970s the total number of local governments declined by over 50% from 156000 to 80000. This was largely attributable to the consolidation of small school districts with their neighbours (see Strang, 1987). Local autonomy has also been undermined by federal intervention.

Graves (1964: 655) notes that 'as late as 1932 . . . the American delegation at the International Congress of Cities in London was the only one of more than 40 countries having no direct administrative relationships between the central or national government and its cities'. Subsequently, central constraints increased to the point where Lowi (1978) argued that the United States had become a 'united state'. To some extent, the greater federal role in local affairs was a result of local pleas for financial assistance. At the turn of the century, central grants represented only 1% of state-local revenues, but increased to 10% in 1940 and 15% by 1960. By the end of the 1970s there were 530 federal programmes which provided financial aid to cities, and grants constituted 27% of state-local revenues (Judd and Kopel, 1978). In contrast to the UK, the trend away from public choice principles has been reversed since the 1970s. The number of local governments has grown, central constraints on local autonomy have been relaxed and central funding has fallen.

Structure

During the 1980s the total number of multi-purpose units and special districts increased while the number of separate school districts continued to decline (see Table 2.2). The net result was the biggest rise in the total of local units since before the Second World War. Although national governments in the USA are precluded constitutionally from a direct effect on local government structure, there may have been indirect effects from the Reagan administration's general ideological stance and from the president's support for the view that local communities should solve their own problems (Heclo, 1986). In addition, during the Reagan era, public choice principles gained ground politically.

One indication of the political progress of the public choice approach is the changing policy prescriptions of the Advisory Commission on Inter-governmental Relations (ACIR). This body was established by President Eisenhower in 1953 to make recommendations on, *inter alia*, the structural problems of local government. The prevailing academic consensus at the time was that bigger, multi-purpose authorities were required to deal effectively with local problems, and the initial ACIR reports reflected this

view. The ACIR gradually developed a more mixed approach to structural change, and by the 1980s supported local choice, diversity and fragmentation. The shift in the outlook of the ACIR is illustrated by its report on local government in St Louis (Oakerson and Parks, 1988; Phares, 1989). The number of local governments per 1000 population in St Louis County is the second highest of all major metropolitan areas in the USA. In 1988 the ACIR published a report which praised the performance of the St Louis local government system. It has been argued that the ACIR report conveys 'the overpowering sense that (1) this is the way that local government should operate; (2) smaller, and implicitly more, is better; and (3) the free market in governmental organisation should be allowed to operate absent any concern for the overall collective impact' (Phares, 1989: 11).

Table 2.2: Number of Local Governments in USA, 1992

Type	*1977*	*1992*	*Change 1977–1992*	
			Absolute	*Percentage*
Counties	3 042	3 043	+1	0
Municipalities	18 862	19 279	+417	+2.2
Townships	16 822	16 665	–157	–0.9
Special Districts	25 962	31 555	+5 593	+21.5
School Districts	15 174	14 422	–752	–5.0
Total	79 862	84 995	+5 133	+6.4

Source: US Department of Commerce, *Statistical Abstract of the United States*, 1996, Washington, DC, US Bureau of the Census.

Autonomy

Ronald Reagan entered office with a long-standing commitment to get the federal government 'off the backs' of states and localities. As governor of California, and as a candidate for the Republican presidential nomination in 1976, Reagan advocated the devolution of authority from the centre. Thus in 1981, 'the Reagan administration set out to work a fundamental redistribution of responsibilities

between the local, state and federal governments' (Benda and Levine, 1988: 120–1).

However, Reagan's major attempt to restructure inter-governmental relations, the 'New Federalism' initiative in 1982, failed to win political support. Reagan's plan had two elements: first, the federal government would take over responsibility for medical care for low-income groups and the states would take responsibility for Aid for Families with Dependent Children; second, by 1991 the federal government would withdraw completely from selected programmes in education, community development, transport and social services. The plan was rejected by Congress partly because the proposals to reduce federal support coincided with an economic recession. Thereafter, 'the Reagan administration seemed to have lost much of its enthusiasm for far-reaching proposals to "de-bureaucratize" the federal government through the devolution of functions back to the states' (Benda and Levine, 1988: 123).

Nevertheless, a more incremental and piecemeal approach produced some reduction in federal controls on state and local governments in the early 1980s. Responsibility for the distribution of a number of grants to local governments was transferred to the states, thereby removing a direct federal–local link. Procedures and institutions associated with the approval and audit of grants were weakened or eliminated. Local government perceived the new grant arrangements as less complex and more flexible (Lovell, 1985). States and localities were also given more freedom to make their own decisions on regulating the private sector, for example on environmental issues. Furthermore, regulations on civil rights and procedures used in purchasing goods and services with federal money were enforced less vigorously.

Although some new regulations were imposed on state and local governments in the mid-1980s, the net effect of the Reagan administration was to staunch the upward flow of authority to the federal government (Liner, 1989). Some of the controls on local government that the centre relinquished have been replaced by state controls. In extreme cases, states have intervened to administer the affairs of financially stressed municipalities and school districts (Berman, 1995). However, separate patterns of control in each of

the fifty states leave more scope for local competition than if uniform policies are imposed nationwide.

Finance

President Reagan embarked on a 'budgetary blitzkrieg' at the start of his first administration (Conlan, 1988). The Omnibus Budget Reconciliation Act (OBRA) cut federal grants from US $94.8 billion in 1981 to US $88.2 billion in 1982. In addition, sixty grants were eliminated completely and many matching grants were converted from 'open' to 'closed', thereby fixing a ceiling on the federal contribution to state and local spending. The cuts were concentrated on programmes in education, training and social services. In subsequent years some new grants were introduced by Congress, for example, funding for highways in 1982 and for job creation in 1983. Nevertheless, grants declined substantially between 1981 and 1988. Federal aid to state and local governments declined from 3.4% of GNP to 2.4%, and the grant share of net state-local expenditure fell from 27% in 1980 to 21% in 1988, although grants grew again to 24% by 1994 (Walker, 1996). In addition, *direct* federal grants to local governments were cut from 11.2% to 5% of local budgets. Thus the financial intrusion of the federal government into local fiscal decisions was reduced markedly.

The Reagan administration also sought to loosen federal restrictions on the use of grants. All of the president's first-term budgets contained proposals for the amalgamation of categorical grants into block grants, including the amalgamation of thirty-seven education grants into one block grant and twenty-one health grants into four block grants. The switch to block grants 'was intended to help the federal government disengage itself from what were considered to be traditional state and local functional responsibilities' (Conlan, 1988: 51). The changing balance between general and specific grants was reversed to some extent in 1986 when General Revenue Sharing (GRS) was abolished. Nevertheless, the termination of GRS had substantial benefits from a public choice perspective: between 1986 and 1987 the level of federal funding fell by 6% and the number of local governments in receipt of grants was cut from 60 000 to 30 000 units (Wright, 1988).

3. EVIDENCE ON THE IMPACT OF INTER-AUTHORITY COMPETITION

(a) USA

Theoretical arguments on inter-authority competition concern the responsiveness and technical efficiency of service provision. However, most empirical studies in the USA examine the relationship between fragmentation or concentration and *spending* by local governments. Inferences on efficiency can be drawn directly from evidence on expenditure only if it is assumed that variations in output quantity and quality are not related to variations in spending. In other words the 'heroic' (or villainous) assumption is that high spending indicates inefficiency, and that low spending reflects efficiency. It is worth noting that there is some evidence that the relationship between the quantity of service outputs and spending levels is generally weak (for example, Sharkansky 1967; Hinkley and Marquette 1983). In addition, Christenson and Sachs (1980) show that expenditure is not a significant influence on service quality. Thus it may be argued that the inferential gap between structural effects on spending and structural effects on efficiency is tolerably small, particularly when account is taken of the effect of other expenditure 'determinants'. A multitude of studies in the USA and UK have established that local spending decisions are influenced by variables such as service needs, local resources, intergovernmental grants and local political ideology (Boyne, 1996a). It is important, therefore, to take account of such variables when estimating structural effects. All of the studies summarised below control for at least some of these other influences on spending. The empirical analyses are prone to a number of methodological problems that are common in cross-sectional studies of expenditure variation (Boyne, 1985). However, the effect of the structural variables is sufficiently consistent to warrant reasonable confidence in the broad features of the evidence.

The results of the empirical analyses of structural variations are summarised in Tables 2.3–2.9. Where studies present results for different services or time periods the general pattern of the evidence is indicated in the tables. Most of the empirical analyses are cross-

sectional and estimate the statistical relationship between variations in structure and variations in spending per capita or per client, or spending as a percentage of local incomes. The analyses are usually conducted across states, Standard Metropolitan Statistical Areas (SMSA) or counties within a state. The dependent variables are either spending by all local units within an area (for example, a state or a country) or spending by individual units (for example, municipalities or special districts).

Horizontal fragmentation

The results of analyses of this dimension of structure are summarised in Table 2.3. The most common measures of horizontal fragmentation are the absolute number of units in a tier of local government and the number of units per capita. Of the twenty-five tests conducted, eleven indicate that the relationship between horizontal fragmentation and spending is negative, seven indicate that it is positive and five indicate that it is insignificant. The remaining two tests by Zax (1988) suggest that the relationship is non-linear.

The variation in the evidence across studies largely reflects the type of local government units that are analysed. Results for multi-purpose governments generally show a negative relationship between fragmentation and spending. This may indicate greater efficiency because, as Martin and Wagner (1978: 411) argue, 'state governments generally permit the creation of new municipalities only if the provision of public services in the proposed city would equal or exceed that which is being provided by the country. To reduce the provision of public services is not generally considered an appropriate ground for incorporation.' Studies which do not find a negative relationship between spending and the fragmentation of multi-purpose units tend to display methodological problems. For example, Baird and Langdon (1972) find that the number of municipalities per county is not related to spending, but the evidence is suspect because the analysis omits the effect of cross-county competition in a SMSA (Sjoquist, 1982). Similarly, Zax finds that the effect on spending of jurisdictions per county is non-linear: spending is minimised at 290 jurisdictions but then grows. However, only five counties in the USA contain more than 290 jurisdictions, so the

impact of fragmentation is negative across virtually the whole range of existing structures.

Table 2.3: Results of Tests of Horizontal Fragmentation in US Local Government

Study	*Dependent variable and local government units*	*Measure of horizontal fragmentation*	*Effect of fragmentation on spending*
Baird & Langdon, 1972	Spending by school districts and municipalities in the central county of 89 SMSAs	(a) School Districts per county (b) Municipalities per county	Higher Insignificant
Wagner & Weber, 1975	Spending by all units in 164 counties in 16 southern states	Absolute number of municipalities	Lower
Mehay, 1981	Spending by 159 cities in California	Extent of annexation of neighbouring areas	Lower
Chicoine and Walzer, 1985	Spending by school districts and special districts in 101 Illinois counties	(a) School District per capita (b) Library Districts per capita (c) Park Districts per capita	Higher Higher Insignificant
Nelson, 1986	Combined taxes of state and localities, 49 states	Counties per capita	Lower
Mehay and Gonzalez, 1986	Municipal wages in 445 municipalities, 24 southern states	Ratio of municipalities to county land area	Higher
Schneider, 1986	Spending by 747 suburban municipalities in 46 SMSAs	Suburban municipalities per capita in the SMSA	Lower
Bell, 1988	Total education spending per pupil, 48 states	School districts per square mile	Lower

Zax, 1988	(a) Ratio of spending to income, all units in 3129 counties	(a) Absolute number of school districts	Insignificant
		(b) School districts per capita	Higher
	(b) Spending by municipalities in 3129 counties	(c) School districts per $m. of spending	Lower
		(a) Absolute number of cities per county	Lower
		(b) Cities per capita in each county	Non-Linear: Higher, Lower
		(c) Cities per $m. of spending in each county	Non-Linear: Lower, Higher
Schneider, 1989b	Spending by 839 suburban municipalities in 39 SMSAs	(a) Absolute number of suburban municipalities in the SMSA	Lower
		(b) Number of other municipalities bordering the municipality	Lower
		(c) Dispersion of tax prices across suburban municipalities	Lower
Forbes and Zampelli, 1989	Taxing and spending by 345 counties in 157 SMSAs	Absolute number of counties in the SMSA	Higher
Eberts and Gronberg, 1990	Ratio of Municipality spending to income, 218 SMSAs	Municipalities per capita in the SMSA	Lower
Burnell, 1991	Average per pupil spending by school districts in 280 counties	School districts per county	Higher
Liner, 1994	Spending by municipalities in 43 states	(a) Municipalities per county	Insignificant
		(b) Ease of annexation of neighbouring areas	Insignificant

The results for single-purpose units of local government show little sign that horizontal fragmentation reduces spending. For example, Chicoine and Walzer (1985) find that the number of independent special districts is associated with higher library district spending and has no significant effect on park district spending. Zax (1988) finds three different results using three different measures of school district fragmentation (see Table 2.3). There are at least two reasons why horizontal fragmentation reduces the spending of multi-purpose units but not single-purpose units. First, the services provided by special districts may be more capital intensive than those provided by multi-purpose units, and therefore horizontal fragmentation may be associated with the loss of economies of scale. This would not explain, however, why spending on the labour intensive services provided by school districts generally shows either a positive or insignificant relationship with fragmentation. Second, fiscal migration may occur across multi-purpose units but not single-purpose units. A move across the boundaries of a special district or school district may yield an improvement in only one service, which may be insufficient to trigger fiscal migration. Thus it is possible that single-purpose units are less susceptible than multi-purpose units to the competitive pressures of fragmentation.

Vertical fragmentation

There is little empirical evidence on the consequences of this aspect of structure (see Table 2.4). An 'ideal' test of vertical fragmentation would examine the effect of variations in the number of local government tiers. Controlling for the functions performed by local government, does it make any difference whether services are dispersed across a large number of separate tiers or consolidated in one or two tiers? The two empirical studies of vertical fragmentation provide only a 'partial' test because they focus on the separate provision of specific services rather than the whole range of services in an area. Wagner and Weber (1975) suggest that the provision of education by separate school boards (rather than multi-purpose local governments) is associated with lower spending in large counties, but higher spending in small counties. They argue that in small counties economies of scope are sacrificed if education is provided

separately, but that in large counties the loss of economies of scope is outweighed by the gain from greater public scrutiny. Mehay (1984) finds that vertical fragmentation is associated with lower spending on fire and parks services. He argues that greater efficiency in independent special districts results from greater public scrutiny. By contrast, 'considerably more bureaucratic discretion is exercised by managers of districts that are adjuncts of large, general purpose governments' (Mehay 1984: 346).

Table 2.4: Results of Tests of Vertical Fragmentation in US Local Government

Study	*Dependent variable and local government units*	*Measure of vertical fragmentation*	*Effect of fragmentation on spending*
Wagner and Weber, 1975	Spending by all units in 164 counties in 16 southern states	Whether education provided by the municipality or a school district	Higher in small counties. Lower in large counties
Mehay, 1984	Spending by 300 fire agencies and 82 park agencies in California	Whether fire and park services are provided by independent districts	Lower

General fragmentation

Many tests of structural effects combine the horizontal and vertical dimensions of fragmentation by measuring the total number of local government units in a county, SMSA or state. Other studies measure the total number of either multi-purpose or single-purpose governments. The results of these studies are difficult to interpret because the net effect of general fragmentation is the sum of horizontal and vertical effects.

Table 2.5 shows that the twenty-seven tests of the relationship between general fragmentation and spending produce mixed results: eight show a negative effect, six a positive effect, ten are insignificant and three are non-linear. However, as in the case of

horizontal fragmentation, the results are strongly linked to the type of units analysed. Thus the majority of tests of the fragmentation of multi-purpose units find a negative relationship with spending; almost all of the tests of the fragmentation of special districts find a positive or insignificant relationship with spending; and the twelve tests which examine the fragmentation of all types of local units are

Table 2.5: Results of Tests of General Fragmentation in US Local Government

Study	*Dependent variable and local government units*	*Measure of general fragmentation*	*Effect on general fragmentation on spending*
Adams, 1965	Spending by all units in 478 counties in 45 states	Absolute number of municipalities and townships per county	Lower
Baird and Langdon, 1972	Taxes of all units in the central county of 89 SMSAs	Absolute number of units per county	Higher
Isserman, 1976	Spending by all units in 21 New Jersey counties	Absolute number of units per county	Lower
Sjoquist, 1982	Spending by 47 central cities in southern SMSAs	Absolute number of units in the SMSA	Lower
Chicoine and Walzer, 1985	Spending by all units in 101 Illinois counties	Units per capita in each county	Higher
Oates, 1985	Combined spending of state and localities, 50 states	Absolute number of units per state	Insignificant
Nelson, 1986	Combined taxes of states and localities, 49 states	Special districts per capita	Insignificant
Nelson, 1987	Spending by all units, 50 states	(a) Multi-purpose units per capita (b) Special districts per capita	Lower Insignificant

Eberts and Gronberg, 1988	Spending by all units in 2900 counties in 280 SMSAs in 50 states	(a) Multi-purpose units; absolute number, number per capita, per square mile (b) Single-purpose units; absolute number, number per capita, per square mile	Insignificant at state level; lower at SMSA, county level Insignificant at state level; higher at SMSA, county level
Zax, 1988	Ratio of spending to income, all units in 3129 counties	(a) Absolute number of units (b) Units per $m. spending (c) Units per square mile (d) Units per capita	Non-linear: lower, higher Non-linear: lower, higher Insignificant Non-linear: higher, lower
Zax, 1989	Ratio of revenues to income, all units in 3022 counties	(a) Units per capita: multi-purpose, special purpose (b) Units per square mile: multi-purpose, special purpose	Higher Insignificant
Dolan, 1990	'Cost' of all units in 102 Illinois counties	(a) Absolute number of units (b) Units per capita	Higher Lower
Eberts and Gronberg, 1990	Ratio of spending to income, all units in 218 SMSAs	Non-municipal units per capita	Insignificant
Joulfaian and Marlow, 1991	Combined state and local spending	Absolute number of units	Insignificant
Park, 1995	Local government spending in 159 SMSAs (a) all units (b) special districts only	Special districts per capita	(a) negative (b) insignificant

equally divided between positive, negative, insignificant and non-linear results. The underlying pattern in the evidence can be seen most clearly in studies which examine the fragmentation of both multi-purpose and single-purpose units (for example, Nelson, 1987; Eberts and Gronberg, 1988).

Another pattern in the evidence is that six of the seven studies which conduct tests of fragmentation at the state level find that the effect on spending is insignificant (see Table 2.5). This raises the interesting but neglected issue of the definition of a geographical 'market' in local services. Zax (1989: 561) argues that 'citizens who are dissatisfied with local services are typically unwilling to change their jobs and social circles in order to change their service consumption. The mobility which disciplines monopolizing local public officials will therefore occur largely among nearby communities.' Thus the competitive forces associated with fragmentation may be strong at the county and SMSA levels but weak over an area as wide as a state.

Horizontal concentration

There is little discussion of the appropriate measurement of 'concentration' in the empirical studies. Most analyses focus on the distribution of spending and revenues, but other measures of market share include population, land area and housing stock (see Fischel, 1981). The theoretical effect of horizontal concentration is less public scrutiny of local government performance and therefore lower efficiency and higher spending. Only three studies have tested this hypothesis (see Table 2.6) and the only significant results suggest that horizontal concentration is associated with lower spending. However, Eberts and Gronberg's (1990) evidence relates to the effect of central city population on spending by suburban municipalities. Thus the result probably reflects the savings to suburbs from central city service provision, and does not imply that horizontal concentration is associated with lower spending across all local units in a SMSA. Hall and Vanderporten (1977) find a negative relationship between concentration and police wages, and argue that this is a product of the purchasing power of large local governments. However, this study also provides only a partial perspective

on the impact of concentration: the market power of a large unit may be offset by the market weakness of the surrounding small units.

Table 2.6: Results of Tests of Horizontal Concentration in US Local Government

Study	*Dependent variable and local government units*	*Measure of horizontal concentration*	*Effect of concentration on spending*
Hall and Vanderporten, 1977	Police wages in 141 cities	City share of SMSA population	Lower
Schneider, 1989b	Spending by 839 suburban municipalities in 39 SMSAs	Coefficient of variation of suburban municipality spending in each SMSA	Insignificant
Eberts and Gronberg, 1990	Ratio of municipality spending to income, 218 SMSAs	(a) Largest four suburbs' share of total population	Insignificant
		(b) Central city share of SMSA population	Lower

Thus tests of concentration should focus not on the expenditures of single units but on all local governments within the relevant geographical market. The absence of such evidence means that no clear conclusions are possible on the effects of this dimension of structure.

Vertical concentration

A 'pure' measure of vertical concentration would consider the distribution of the share of total local services among the tiers which cover a given geographical area. However, this measure is virtually impossible to apply in the USA because the various layers of local government are not geographically coterminous. Therefore it is difficult to isolate the various theoretical effects of vertical

concentration, for example, scope economies and problems of public scrutiny.

Most studies of vertical concentration analyse the relationship between the state's share of the state-local market and the combined spending of state and local units. These empirical studies thereby conflate vertical concentration effects with economies of scale, and with disincentives towards fiscal migration which arise from the high market share of the geographically large upper tier. Even the studies that focus on the county share of the local market suffer from the same problem: counties are larger than their constituent local units, and therefore a measure of vertical concentration based on the county market share picks up pressures towards lower spending (economies of scope and scale) and higher spending (scrutiny problems and disincentives to fiscal migration).

The empirical results in Table 2.7 suggest that vertical concentration is associated with higher spending: five of the nine tests indicate a positive relationship between concentration and expenditure, and only two tests indicate a negative relationship. In addition, Forbes and Zampelli's (1989) evidence that state market share has a negative effect on county spending may be discounted. If the expenditures of the two levels of government are substitutes then there is an inherent negative relationship between the measure of concentration and spending.

General concentration

Studies which measure general concentration focus on the distribution of market shares across all units in a local government system. The three empirical tests of the effect of this aspect of structure analyse fiscal concentration within counties (see Table 2.8). As noted above, horizontal concentration may have little net effect on local spending. Thus the impact of general concentration should reflect the vertical effects of gains from economies of scope and losses from lower public scrutiny. The tests of general concentration take all units into account, unlike the tests of vertical concentration which focus on the market share of the top tier. Therefore the evidence on general concentration may not be contaminated by the effects of scale and fiscal migration.

Table 2.7: Results of Tests of Vertical Concentration in US Local Government

Study	*Dependent variable and local government units*	*Measure of vertical concentration*	*Effect of concentration on spending*
Gustley, 1977	Spending by 25 municipalities in Florida	Extent of service transfers to metro-wide unit	Higher
Giertz, 1981	Combined spending of state and localities, 50 states	State share of state-local taxes and spending	Higher
Oates, 1985	Combined spending of state and localities, 50 states	State share of state-local revenues and spending	Insignificant
Nelson, 1986	Combined taxes of state and localities, 49 states	State share of state-local taxes	Lower
Wallis and Oates, 1988	Combined tax and spending of state and localities, various samples	State share of state-local revenues and spending	Higher
Forbes and Zampelli, 1989	Taxes and spending by 345 counties in 157 SMSAs	State share of state-local revenues and taxes	Lower
Zax, 1989	Ratio of revenues to income, all units in 3022 counties	County share of total local government revenues	Higher
Joulfaian and Marlow, 1991	Combined spending of state and localities, 50 states	(a) State share of state-local spending	Insignificant
		(b) State-local share of federal, state and local spending	Higher

Table 2.8: Results of Tests of General Concentration in US Local Government

Study	*Dependent variable and local government units*	*Measure of general concentration*	*Effect of concentration on spending*
Dilorenzo, 1983	Taxes and spending of all units in 65 counties	4 largest units' share of taxes and spending	Higher
Chicoine and Walzer, 1985	Spending by all units in 101 Illinois counties	Fiscal concentration across all units	Lower
Dolan, 1990	'Cost' of all units in 102 Illinois counties	Standard deviation of spending across all units	Lower

The results of two of the three studies suggest that vertical concentration is associated with lower spending, and therefore imply that scope effects outweigh scrutiny effects. However, Dolan's measure of the dispersion of market shares, the standard deviation of expenditures, is tautologically correlated with the level of expenditure (see Boyne, 1992c). Thus the remaining valid evidence is equally balanced between positive and negative effects.

Barriers to entry

All of the empirical evidence on the effect of barriers to entry supports the hypothesis that an 'uncontestable' local government market is associated with higher spending. There are two explanations for this effect. First, the absence of a competitive threat from potential new units may reduce the efficiency pressures on existing units. Second, the actual formation of new units may reduce costs because of the increase in horizontal fragmentation. However, the fragmentation of only multi-purpose units is associated with lower spending, whereas barriers to entry influence spending by both multi-purpose and single-purpose units (see Table 2.9). Therefore it may be concluded that it is the effect of barriers to entry

on the behaviour of existing units which explains the positive relationship with spending.

Table 2.9: Results of Tests of Barriers to Entry in US Local Government

Study	*Dependent variable and local government units*	*Measure of barriers to entry*	*Effect of barriers on spending*
Martin and Wagner, 1978	Spending by all units in counties in 4 states	Barriers against new municipalities	Higher
Dilorenzo, 1981	Spending by all units in counties in 5 states	Barriers against new special districts	Higher
Mehay and Gonzalez, 1986	Municipal wages in 445 cities in 24 southern states	Barriers against new municipalities	Higher
Kenny and Schmidt, 1994	Education spending per pupil, all US states	State/county restrictions on number of school districts	Higher

Summary and discussion

Four main points emerge from evidence on the effect of variations in local government structure in the USA. First, the horizontal fragmentation of multi-purpose governments leads to lower spending. Second, local government units compete in a market that is geographically limited: competition between units is present at a relatively small spatial scale, but not across wide areas. Third, the vertical concentration of market share in large 'top tier' units is associated with higher spending. And finally, the establishment of barriers to entry is positively related to expenditures by the local government units that are protected by the barriers.

In sum, the broad pattern of the evidence suggests that lower spending is a feature of fragmented and deconcentrated local government systems. By contrast, consolidated and concentrated structures tend to be associated with higher spending. This implies that

the technical benefits of large units with big market shares, such as economies of scale and scope, are outweighted by competitive and political costs, such as disincentives towards fiscal migration and problems of public scrutiny.

The evidence is consistent with the argument that a competitive structure is associated with lower spending and, by extension, greater efficiency; but there are other interpretations. In particular, the negative relationship between horizontal fragmentation and the spending of multi-purpose local governments may reflect the level of service demands rather than efficiency. Different structures may either enhance or suppress public demands for service provision, and thereby lead to higher or lower expenditure. Here it is important to distinguish between two types of public services. First, 'spatially divisible' goods that benefit specific localities. These include public sector housing and schools, which primarily benefit people living within local boundaries rather than residents of neighbouring authorities or commuters. Secondly, 'spatially indivisible' functions that provide benefits over a wide area, for example planning and transportation.

In a consolidated system, services will be provided over a wide area that contains many local communities with varying preferences. Local residents may have little confidence that their neighbourhood will receive a fair share of spatially divisible services in return for taxes paid, or that the services provided will suit their specific needs. Thus consolidation may suppress the demand for such services. By contrast, in a fragmented system voters may demand more services and be prepared to pay higher taxes, safe in the knowledge that the appropriate services will be provided. According to Baird and Langdon (1972) this positive effect of horizontal fragmentation on service provision is especially likely to occur under two circumstances: first, when preferences vary widely across local areas; and second, when such services are financed by earmarked taxes which maximise public confidence that money will be allocated as intended.

An additional reason why fragmentation may lead to higher service demands is that there will be less pressure towards 'exit' from public provision to private suppliers. Thus Sjoquist (1982: 79) argues that:

> In areas with a single jurisdiction, and hence no public sector alternatives, an individual who desires more of a government good may seek a private sector alternative, for example a private school. As the number of public sector options increases, that same individual may find a jurisdiction with a desirable level of the government good and hence give up the private sector alternative, thus increasing the level of public expenditures.

Whereas fragmentation may boost demand for spatially divisible services, it may have the opposite effect on spatially indivisible services. For example, in a horizontally fragmented system the provision of services such as public libraries by an urban authority has positive externalities for neighbouring communities. Thus fragmentation may restrain service provision below an 'optimal' level because 'suburban resources are not made available to help finance the public services . . . (and) there is no mechanism for including the preferences of suburbanities in the public sector decisions of central cities' (Cowing and Holtmann, 1976: 24). The higher the degree of fragmentation, the more boundaries there are between authorities and the more the demand for spatially indivisible services is suppressed. As Adams (1965: 403) argues 'the balkanisation of a county area leads to an undervaluation of social benefits by each political unit because of benefit spillovers and thus to an underallocation of resources'. Some services may hardly be provided at all unless small units are consolidated into a geographically large authority. For example, Gustley (1977: 353) argues that 'the existence of substantial benefit spillovers from air pollution control programmes usually results in minimal expenditures for this service under a fragmented system'. In addition, the provision of redistributive services may be suppressed in a fragmented system, particularly if prosperous and deprived residents are geographically segregated. In a consolidated structure, the rich may redistribute to the poor within a different part of the same local authority. By contrast, if high-income and low-income groups reside in different local governments, then this mechanism of redistribution is blocked. In this case expenditure may be lower in a fragmented system because the quantity of redistributive services is lower, not because of greater efficiency.

Thus horizontal fragmentation may influence public demands for services, and thereby be associated with the quantity of provision and the level of spending. If fragmentation suppresses demands for indivisible services to a greater extent than it enhances demand for divisible services, then the evidence of greater efficiency is at least partly undermined. In order to investigate this issue it would be necessary to separate services into the two relevant types, and analyse how the level of public demands varies with fragmentation. However, there is, as yet, no direct evidence on this issue.

Another interpretation of the negative relationship between fragmentation and spending is that more fragmented structures lead to lower service quality. Christensen and Sachs (1980) test the relationship between general fragmentation (units per capita in 100 North Carolina counties) and local service quality (as measured by consumer surveys). They find that public perceptions of service standards are higher in counties with fewer units of local government. As Christensen and Sachs rightly point out, it would be dangerous to generalise about the relationship between structure and quality from this single study. Suppose, however, that their results are valid and generally applicable. In this case, the evidence suggests that a more fragmented structure reduces spending *and* quality. This need not imply that competition produces lower value for money. In order to draw this conclusion it would be necessary for the quality/expenditure ratio to deteriorate as structure becomes more fragmented. However, there is no evidence on how structure influences the cost per unit of constant quality.

(b) UK

The previous section showed that a large number of empirical tests have been conducted on the relationship between local government structure and spending in the USA. By contrast, no empirical analyses have been undertaken in the UK. It would, in principle, be possible to conduct such tests. For example, multi-purpose local government is consolidated into one tier in London, the six metropolitan areas and some parts of non-metropolitan England; elsewhere functions are divided between two tiers of multi-purpose units. The impact of this structural variation on responsiveness and

efficiency could be tested. The level of concentration also varies, both horizontally and vertically. In some regions there are large authorities which dominate their neighbours (for example, Birmingham in the West Midlands, Manchester in the former county of Greater Manchester, Bristol in the west of England); but elsewhere market shares are more evenly spread. Similarly, the division of taxes and spending between counties and districts is geographically variable. To what extent are such variations in concentration related to performance? There is simply no systematic empirical evidence on such questions.

However, some evidence exists that the British local government system has 'market-like' properties. In particular, the distribution of businesses and households is related to local authority tax and spending levels. The relevance of the Tiebout hypothesis to British local government has been questioned. For example, Sharpe and Newton (1984: 64) argue that councils cover geographical areas which are too large for fiscal migration to operate: 'the Tiebout effect in Britain is likely to be weak and restricted to a small number of metropolitan areas, and special cases such as the south coast and retirement areas'. However, even at the time Sharpe and Newton were writing, there was evidence in support of fiscal migration by households and businesses in the UK. For example, Twomey (1987) measures local fiscal migration flows between local authority districts in Merseyside, Cheshire, Greater Manchester and Lancashire. He finds that fiscal packages have a significant impact on migration in three out of the four counties. Similarly, in their study of London boroughs, Cuthbertson et al. (1982) conclude that local authority spending has a positive impact on population levels and that taxes have a negative effect. Aronson (1974) studies population movements in Leeds and Manchester and concludes that local fiscal variables affect population distribution. Using an adjusted version of Aronson's model, Davies (1982) finds that there is a significant relationship between population movement within the London metropolitan area and local fiscal variables. More recently, John et al. (1995) tested the relationship between household movements and local taxes and services in four London boroughs. They found that, in a sample of 860 households which had moved during the period of the poll tax, almost half cited taxes or services as

important influences on their decision to reside in a particular location. Moreover, residential choices were 'Tiebout-rational': households which emphasised the importance of taxes moved to low-tax boroughs, while those which stressed service levels moved to boroughs with a reputation for better services. John et al. (1995: 396) conclude that their results 'demonstrate to a sceptical British urban studies community that public choice is not to be lightly dismissed with a critique of its unrealistic assumptions'. However, the implications of such results for public choice theories of governmental behaviour are limited. Fiscal migration shows that businesses and households are sensitive to local taxes and spending, but it does not show that local policy-makers are sensitive to fiscal migration. Thus the impact of competitive structures on performance in British local government remains an open question.

CONCLUSION

In this chapter a comprehensive public choice model of inter-authority competition has been developed. This model consists of three components: structure, autonomy and finance. Local authorities are more likely to behave competitively if (a) structures are fragmented and deconcentrated, and there are few barriers to the entry of new units; (b) local autonomy from central controls is high; and (c) central funding is low and serves to equalise variations in local needs and resources. This conceptual model was then applied to two questions. First, to what extent do the local government systems in the UK and the USA meet these conditions for effective competition? Secondly, is the view that competitive conditions lead to better performance supported by empirical evidence?

The institutional arrangements of local government in the UK and USA differ markedly. Fragmentation is much greater in the USA than the UK, as is the scope for new units (and in particular special districts) to enter the local government market. While the number of local authorities has declined in the UK during the last twenty years, the total in the USA has continued to increase. The scope for variation in taxes and services is also greater in the USA, not least because there is a separate pattern of central–local relations

in each state, rather than the single 'line of command' in the UK (or possibly four lines if Scotland, Wales and Northern Ireland are deemed to constitute separate systems from England; see Boyne, 1992b). Finally, levels of grant support are far higher in British than American local government. Indeed, local authorities in the UK have become so dependent on central funding in the 1990s that only 20% of their net expenditure is covered by local revenues. Thus the structure, autonomy and finance of local government in the USA are close to the public choice model, while British local government is far removed from the conditions for inter-authority competition.

Within the USA, the competitive characteristics of local government systems vary across and within states. Extensive empirical work has been conducted on the relationship between competitive conditions and local authority behaviour. Much of this suggests that expenditure is lower in local government systems which are fragmented and deconcentrated, and implies that barriers to entry are associated with higher expenditure. Thus the broad pattern of the US evidence is *consistent with* public choice arguments that competitive arrangements lead to higher efficiency in local government. However, the studies do not provide strong or direct support for this proposition. Most importantly, there are few attempts to control for the quantity or quality of local service provision when competitive effects are estimated. It would be helpful to compare the US results with similar studies conducted in the UK. Even though the conditions for competition are generally weaker, there are still variations in structural characteristics such as fragmentation and concentration. However, no empirical work has been undertaken in Britain on the validity of the public choice model of competition between local authorities.

In sum, tests of the relationship between the competitive characteristics and performance of local government systems are limited in scope. First, the emphasis has been on structural arrangements – the role of variations in autonomy and finance is largely unexplored. Secondly, the dependent variables in the empirical studies are measures of spending rather than efficiency. Thirdly, there is very little evidence on the relationship between competition and responsiveness to local preferences concerning taxes and services.

Although the balance of the existing evidence is in favour of public choice theory, it would be unwise to draw strong conclusions from such a weak base. Neither the supporters nor the opponents of public choice theory can derive much comfort from analyses of the impact of inter-authority competition on performance in the local public sector.

3 Competition between Political Parties

The aim of this chapter is to evaluate whether party competition is associated with superior performance in local government. Does party competition make a difference to the behaviour of local political leaders, or do they simply follow their personal or ideological preferences regardless of competitive pressures? Are policies more responsive to public demands if there is close competition between parties for political power?

The first part of the chapter examines the concept of party competition, the Downs (1957) model of party behaviour, and the measurement of competition between political parties. Downs argues that competition forces party leaders to meet the demands of the median voter. In the absence of competition, politicians would be free to pursue their own goals and ignore public opinion. The second section of the chapter assesses the extent of local party competition in the UK and USA. Attempts to measure local party competition are reviewed, and evidence on the competitiveness of local elections is evaluated. The focus here is on two measures: 'dominance', which refers to the strength of the ruling party; and 'volatility', which concerns changes in party strength over time. The third part of the chapter analyses empirical evidence on the impact of party competition in local government, and draws conclusions on the validity of the public choice model of local party behaviour.

1. THE THEORY OF PARTY COMPETITION

(a) The Concept of Party Competition

What does it mean for one local party system to be more competitive than another, or for the same party system to become more or less competitive over time? The most basic conditions for competition

are that parties are allowed to seek office, and that more than one party is actually striving to win an election. It may be argued that only the *threat* rather than the actual presence of a rival party is required for competition. This argument draws upon the theory of 'contestable markets' which has been applied to firms in the private sector (Shepherd, 1984). If there are no significant barriers to entry in a market, then even an organisation with monopoly power must behave *as if* there were competition; otherwise new firms will enter the market and defeat the monopolist by matching the price and quality of products more closely to consumer preferences. Similarly, if a monopoly party fails to keep its promises or respond to new public demands, then a new party could be established with the potential to defeat the incumbents. Thus if the political market is contestable, only one party need exist in order to ensure high performance by political leaders. There are, however, significant barriers to entry in politics, such as the costs of creating a party organisation, selecting candidates, mobilising support and campaigning (Holcombe, 1991; Strom, 1989). In addition, the absence of proportional representation in local elections is in itself a significant entry barrier against new parties. It is therefore unlikely that the theory of contestable markets applies to competition in local party systems.

A second criterion of party competition is that there is some prospect that the losers at one election will be the winners at the next. As Elkins (1974: 680) argues, party competition implies that governments 'will not be self perpetuating and that elections can, and in some cases do, lead to the replacement of one set of officials with another set. The chance, or probability, of turnover is perhaps the most salient feature of this system of accountability, and that probability… is the correct and most useful interpretation of the concept of party competition'. If competition works then the ruling party is fearful of loss of office and seeks to produce policies that satisfy the electorate. Correspondingly, opposition parties will adopt a platform which is intended to be more popular than that of the incumbents. In the absence of competition, the ruling party would be free to neglect public opinion and pursue 'extreme' policies in line with the views of its activists or financial backers (Robertson, 1976).

It is important to note that this criterion of competition emphasises the *possibility* of a change in party control rather than *actual* change. The same party may have won time and again, but defeat may have been a realistic possibility at each election. Thus the absence of turnover in office does not necessarily indicate the absence of competition. According to Elkins (1974: 684) it is uncertainty about the result, rather than the result itself, which is the essence of competition: 'the less certain we feel about our ability to predict . . . the outcome of an election or vote, the more competitive we feel it to be. In a competitive situation, the outcome could go either way.' Similarly, Schlesinger (1991: 99) argues that 'the more competitive a constituency, the more unsure anyone is of election and re-election. It is uncertainty that leads the politically ambitious to respond to the will of the electorate.' However, it is important not to push this argument too far: uncertainty is not the same as competition. The outcome of a lottery is uncertain, but there is no competitive struggle between the people who have bought tickets. Competition implies not only that the outcome is uncertain, but that ruling and opposition parties are striving to position themselves at the optimum point in policy space. If the result of the election is random, or is not open to influence by the rival parties, then there is no point in competitive behaviour: politicians may as well sit back and see if their number comes up. In other words, a competitive structure will not lead to competitive behaviour unless politicians *believe* that they can influence electoral outcomes – whether voting patterns are really influenced by local policies is immaterial.

(b) The Downs Model

Downs' theory of party competition was a response to the problem that 'little progress has been made toward a generalised yet realistic behaviour rule for a rational government similar to the rules traditionally used for rational consumers and producers' (1957: 3). He uses the self-interest axiom to construct a model in which party competition for votes leads to policies which reflect the preferences of the electorate, just as competition between firms in private markets supposedly leads to products which satisfy consumer

demands. In this model it is assumed that politicians are motivated by the desire for office:

> From the self-interest axiom springs our view of what motivates the political actions of party members. We assume that they act solely in order to attain the income, prestige and power which come from being in office. Thus politicians in our model never seek office as a means of carrying out particular policies, their only goal is to reap the rewards of holding office per se. They treat policies purely as a means to the attainment of their private ends, which they can reach only by being elected. (Downs, 1957: 28)

If there is competition for office between two major parties then politicians must pitch their policies toward the middle of the political spectrum. This result holds regardless of whether the distribution of public preferences is normal or skewed (Laver, 1997). In a competitive political marketplace, sovereignty rests squarely with the electorate: public demands dictate policy content. Downs also assumes that the electorate is rational, which 'implies that each citizen casts his vote for the party he believes will provide him with more benefits than any other' (Downs, 1957: 36).

In the median voter model, parties and voters are interdependent. The electorate spends its votes in order to buy a government which then produces policies in an attempt to secure a 'repeat purchase' at the next election. Each set of political actors 'uses the other to achieve its own goal. Voters have as their goal the attainment of a government responsive to their wants; they make use of parties to run this government. Parties have as their goal the rewards of being in office; they make use of voters to get elected. Thus the interlocking of two different goal-pursuing processes forms the political system' (Downs, 1957: 137). Downs assumes that all political preferences can be arrayed on a single continuum. He argues that this is a plausible approach 'if we reduce all political questions to their bearing on one crucial issue: how much government intervention in the economy should there be' (1957: 115). The effect of competition is to pull both parties to the position of the median voter: 'As the two parties move closer together, they become more moderate and less extreme in policy in an effort to win the crucial middle-

of-the-road voters, i.e. those whose views place them between the two parties. This center area becomes smaller and smaller as both parties strive to capture moderate votes; finally the two parties become nearly identical in platforms and actions' (Downs, 1957: 117). This spatial model of party competition draws directly on economic theories of competition between private firms (Hotelling, 1929; Smithies, 1941). References to the similarity between political and economic markets are scattered throughout Downs' analysis of party behaviour. For example, he argues that 'the pressure of competition motivates the government in the same way that it motivates private firms, though the number of competitors is much smaller, and the competition is for votes instead of dollars. This pressure even causes parties to innovate so as to meet new social needs and keep technically in step with their competitors' (Downs, 1957: 69–70).

Downs (1957: 21) emphasises that his model should be tested by the accuracy of its predictions. It is ironic, therefore, that much of the subsequent work on the theory of party competition has explored not its empirical validity but the logical implications of altering its assumptions (Mueller, 1989). Nevertheless, most of the twists and turns on the basic model have retained the core hypothesis of a positive relationship between competition and responsiveness to public demands (see Breton, 1974; Comanor, 1976; Holcombe, 1989; Mueller, 1989).

The Downs model of party behaviour can be contrasted with an alternative perspective which suggests that politicians are motivated by ideology rather than by power alone. Whereas Downs argues that all politicians seek to satisfy the median voter, in the ideological model different parties tailor their policies to different parts of the electorate, depending on their views of where the costs and benefits of policies should fall. The argument that politicians are motivated by policies rather than power implies that:

> rational politicians will not compromise their beliefs to win or retain office since doing so destroys the value of victory. There is certainly some truth to this position. Aside from the individual who has given up office for a principle, the continued existence of parties with no likelihood of ever participating in government

> or even winning a seat and the fervour with which some parties espouse positions they know to be costly electorally imply that there must be some motive beside office seeking. (Katz, 1986: 52)

The Downs model implies that elections are a mechanism for the public to choose between *leaders* (because, whoever wins, they will get very similar governmental decisions). By contrast, the ideological model suggests that elections are an opportunity for the public to choose not only leaders but also *policies*. The ruling party does not consist of mere 'delegates' who must follow the median voter's every whim. Instead, the public elects a government to run the political system on the basis of campaign commitments made by the party leadership. In between elections, many unanticipated issues arise, and it is the responsibility of the government to act on the basis of the ideological stance which brought it electoral success. Ideological parties offer the electorate a genuine choice between policy packages, not simply a chance to replace one team of political calculating machines with another. The ideological model turns the Downs model on its head by assuming that 'parties are solely interested in policy and that winning the election is just a means to that end' (Wittman, 1973: 495).

(c) Measures of Local Party Competition

There is a large literature on the extent of inter-party competition in the USA, largely at the state level. The first systematic test of the link between party competition and policy decisions was by Dawson and Robinson (1963) who analysed the determinants of variations in welfare expenditure. Some discussions of competition predate Dawson and Robinson's study and therefore have little interest in constructing variables that are relevant to the analysis of local decisions (e.g. Schlesinger, 1955). Even later studies, however, are often concerned with the measurement of competition *per se* – the indices they prescribe may therefore not be relevant to the explanation of variations in local authority behaviour (e.g. Pfeiffer, 1967; Broh and Levine, 1978; King, 1989; Aistrup, 1993). Indeed, much of the literature on party competition is 'technical' rather than

theoretical, so there is little discussion of the Downs model of party behaviour. Nor do empirical tests of the Downs model pay much attention to the literature on the measurement of competition. The lack of dialogue between researchers in these two closely related areas may be because the competition papers are by political scientists while the median voter tests are mostly by economists. The two literatures therefore tend to appear in different journals – analyses of competition typically in the *American Political Science Review* and empirical evaluations of the median voter model in *Public Choice*.

The literature on the measurement of party competition, then, does not directly discuss the measures that are most relevant to the explanation of variables such as expenditure, efficiency and responsiveness. In addition, much of the discussion of competition in the American states is concerned with the complexities of deriving a measure that covers the office of governor, the houses of the state legislature, and the division of power between these bodies (Tucker, 1982). These issues do not arise in most local government systems where competition for control of a single body is at stake. Therefore it is necessary to review the main issues in the long-running debate on the measurement of competition, and to consider their implications for tests of public choice theory.

As noted above, the essence of competition is the probability of a change in control at the next election, as perceived by the ruling party. If party leaders are unaware of a competitive threat, or discount its strength, then they are unlikely to modify their behaviour in an attempt to retain office. An ideal measure of competition, then, would consist of responses by incumbents to questions about their likely fate at the polls: do they feel entirely secure, or highly vulnerable? This approach to the measurement of competition is feasible for a contemporary snapshot of a small number of cases (Stern, 1972). However, in dealing with a large number of localities in various time periods, it is necessary to seek proxy measures of competition that reflect the structural conditions which may influence politicians' perceptions of their security in office.

One common measure of competition is the *dominance* of the ruling party, as indicated by the closeness of the result at the previous election (Tucker, 1982). However, the concept of 'closeness'

is far from straightforward. First, should the success of the victor be measured in votes or seats? In systems with proportional representation the two measures are highly correlated, but where elections are settled by simple plurality there is likely to be a significant gap between the two (Strom, 1989). Indeed, the winning party may not have received the highest number of votes. This suggests that 'seat share' rather than 'vote share' should be the starting point for measuring the vulnerability of the ruling party. Another issue in the measurement of the closeness of the outcome of the previous election is whether the ruling party's margin of victory should be gauged against all other parties or against only the second party. Elkins (1974) argues that it is necessary to know not just the share of the vote obtained by the winning party but also the division of the vote amongst the losers. For example, an incumbent with 50% of the vote may feel much more threatened by a 40%–10% split between two opposition parties than a 25%–25% split. The ruling party's supporters may be less inclined to switch to one of the opposition parties if neither seems to have a realistic prospect of success. Thus, two parties with an identical share of votes or seats may actually face quite different competitive threats, depending on the strength of their nearest rival.

The closeness of the previous election result does not in itself indicate the probability of change at the next election. It is also necessary to take the *volatility* of party strength in the local area into account. As Riley (1971: 511) argues:

> the fact that the winning candidates in state X usually get 55% of the vote could mean that the state has a more or less permanent minority of 45% of the electorate, or that the state's party identifiers are rather evenly split and there is a highly volatile set of 'independent voters' swinging from one side to the other. It seems clear that if (governmental) responsiveness relates to the possibility of defeat, these are different situations which could result in different attitudes and behaviours on the part of office seekers and holders.

It is therefore necessary to measure changes in party strength in past elections in order to identify the level of competition in the present. Indicators of volatility include the proportion of previous

contests won by the current ruling party, and the aggregate net shift in proportions of seats held by all parties over a number of elections (Dawson and Robinson, 1963).

2. THE EXTENT OF LOCAL PARTY COMPETITION

(a) UK

Conventional wisdom holds that the concept of party competition has little relevance to British local government. First, local elections are widely viewed as little more than opinion polls on the popularity of central government. There is considerable evidence that local party fortunes are strongly influenced by national political issues (Miller, 1988). This view is clearly shared by some local politicians – Conservative leaders who lost power at recent local elections were quick to blame their national counterparts. For example, a defeated Conservative in Tunbridge Wells in 1994 commented that 'This has nothing to do with local issues. We have an exemplary record locally. This was a traditional protest vote against the national Government' (*Sunday Telegraph*, 8.5.94). Similarly, the loss of Conservative control of Wyre council in West Lancashire in 1995 brought the following response: 'People had decided that enough was enough and the only way they could make the government listen to their feelings was through the ballot box. Unfortunately they got the wrong ballot box as far as we were concerned' (*Guardian*, 6.5.95).

However, while broad shifts in local party strength may reflect national issues, there is also evidence that local variations in electoral behaviour are linked to local issues. For example, Gibson (1988) has shown that changes in local taxes and expenditures had a significant effect on election results in the non-metropolitan counties and metropolitan districts in the 1980s. He found that 'rate changes have an important role in local elections when their effect on swing in votes is estimated… The effect of rate changes appeared to be large enough to explain why local councillors anticipate detrimental electoral effects from rate increases' (Gibson, 1988: 205). This evidence suggests that the policies of the ruling

party can influence local election results, and that there is some role for party competition in local government.

It has also been claimed that party competition is irrelevant to local government because many areas stay under the control of the same party for long periods. For example, Dunleavy (1980: 137) argues that 'there are large areas of the country in which a single party consistently dominates or maintains control of a local authority ... a very large majority of the population will live in areas where alterations of power at the most important governmental tier never take place'. Similarly, Stoker argues that 'in many authorities, primarily those at a lower tier, the prospect of an alteration in control is remote' (1991: 55).

There are two problems with such arguments. First, as noted above, competition requires only that the ruling party feels threatened by the possibility of loss of office, not that defeat actually occurs. Secondly, the claim that most people live under continuous one-party control is simply not true. For example, between 1974 and 1994 only one English county council was continuously controlled by the same party (Durham, Labour); and only fourteen of the thirty-six metropolitan districts had continuous one-party control (thirteen Labour and one Conservative). Dunleavy's argument is valid for the London boroughs, but even here it applies to a bare majority of councils (seventeen out of thirty-two). Furthermore, in contrast to Stoker's claim, most of the lower-tier authorities in the English shires have experienced a change of party control. Only forty-eight of the 296 English non-metropolitan districts were under the majority control of one party from 1974 to 1994.

Boyne and Ashworth (1997) provide the only comprehensive assessment of party competition in English local government. They measure both dominance and volatility in all English councils from 1974 to 1994. The level of competition at the beginning and end of this period is shown for the three main groups of councils in Table 3.1. These are the thirty-two London boroughs, thirty-six metropolitan districts and thirty-nine non-metropolitan counties.

The dominance figures show the average percentage of seats held by the largest party on each council. The results for this measure suggest that party competition became stronger over time in London and the county areas – the average seat share of the largest

party declined. By contrast, competition became slightly weaker in the metropolitan districts. This reflects the growth in the strength of the Labour Party in these urban authorities – Labour's seat share increased from 47% to 64% between 1980 and 1993. In both time periods, party competition was highest in the non-metropolitan counties. Indeed, in the early 1990s, the average seat share of the largest party in these councils was insufficient to command an outright majority. Stronger competition was the result of the growth of 'three party' politics during the 1980s when many of the counties became 'hung' (Leach and Stewart, 1992).

Table 3.1: Party Competition in English Local Government

	Dominance[1]		*Volatility*[2]	
	1970s	*1990s*	*1970s*	*1990s*
London Boroughs	74	65	14	14
Metropolitan Districts	63	65	18	8
Non-Metropolitan Counties	55	49	31	17

Notes
1. Dominance is the average percentage of seats held by the largest party on each council.
2. Volatility is the net percentage transfer of seats between parties at an election.

Data source: Boyne and Ashworth, 1997.

The figures for volatility in Table 3.1 show the change in the percentage of seats held by each party from one election to the next. A minimum volatility score of zero is obtained where an election produces exactly the same distribution of seats between the parties as before. This does not mean that all the parties have won the same seats or wards again, but simply that there is no change in the total held. Party leaders' perception of their security of tenure is more likely to be influenced by the net change in seats rather than the gross turnover. The maximum possible volatility would occur where a former monopoly party lost all of its seats to a new party. In this case, if all the seat share changes are converted into positive values, the measure of volatility would give a value of 200. The

volatility scores in Table 3.1 show the percentage of seats that change hands at each election when this total measure is divided by two. The results indicate that volatility has declined in the metropolitan districts and the non-metropolitan counties – the transfer of seats between parties at each election was substantially lower in the 1990s than in the 1970s. By contrast, the level of volatility was unchanged in the London boroughs. The most turbulent borough was Hillingdon in outer London, where there were large-scale transfers of seats between Labour and the Conservatives. For example, in 1978 Labour's seat share fell from 60% to 20%, while Conservative strength rose from 40% to 80% of council seats; and in 1986 Labour representation increased from 14% to 49%, while the percentage of seats held by the Conservatives declined from 83% to 41%.

Over time, competition has declined in the metropolitan districts: ruling groups have larger majorities, and their power is less likely to fluctuate greatly from one election to the next. In the London boroughs, by contrast, competition has increased: average levels of dominance have fallen, while volatility has stayed the same. In other words, ruling parties have smaller majorities in the 1990s than in the 1970s, but can be no more confident that even this reduced strength will be retained. Finally, the two measures of competition give contradictory longitudinal results in the non-metropolitan counties: levels of dominance are lower, but volatility has also fallen. This raises questions concerning the relative importance of the two dimensions of competition. Which situation is more competitive: a large majority which is prone to substantial fluctuations, or a small majority which is less subject to shifts from one election to the next? This issue has not been addressed in the literature on the concept of competition, so it is difficult to provide even an abstract answer to this question. Nor is there any empirical evidence on politicians' perceptions which would facilitate a conclusion on whether competition is influenced more strongly by dominance or volatility. If more weight is given to the dominance measure, then local party systems have become more competitive. By contrast, if politicians' behaviour is shaped more heavily by volatility, then there is less competition. Whatever the relative importance of dominance and volatility, the evidence indicates that the two dimensions of competition are not only conceptually but also empirically distinct.

This implies that empirical tests of public choice theory should take both aspects of competition into account.

(b) USA

There is little party competition in local government in the USA. The reason for this is simple – parties are debarred from contesting elections in many municipalities. This is a legacy of the 'reform movement' which emerged in response to the corruption associated with 'political machines' in the late nineteenth and early twentieth centuries. Banfield and Wilson (1966) note that machines are non-ideological party organisations, interested only in distributing money to people who run them and work for them. Put bluntly, 'machine government is, essentially, a system of organised bribery' (Banfield and Wilson, 1966: 125). Political machines flourished in areas with a large number of immigrants who were encouraged to exchange their votes for material benefits. The reform movement was established to eliminate corruption, increase efficiency and enhance democracy in local government. As Ross et al. (1991: 76) note, 'civic activists sought to restructure municipal systems in order to produce governments that would surmount what they saw to be the parochial demands of localised ethnic groups and the self-serving actions of political party officials. The reformers wanted to create governments that would act efficiently in the public interest of the city as a whole.'

The reform programme had three main elements. First, the replacement of 'district' election systems, in which each politician represents a particular area, with 'at large' systems, in which all politicians represent the whole locality. The rationale was that councillors would be forced to pursue the general interest rather than the narrow interests of a particular neighbourhood. Bledsoe and Welch (1987: 205) argue that 'the switch from district to at-large council elections depersonalised community politics, shifting the role of the representative from that of an ombudsman or personal servant of constituents to one of a legislator or issue-oriented rule maker… there was a fundamental change in the nature of the representative/constituent relationship, a change damaging to the functioning of the traditional party machinery'. Secondly, the

reformers preferred 'council-manager' or 'commission' forms of government to the 'mayor-council' form which, it was argued, gave too much power to politicians and too little to administrators and professionals. The reduction of politicians' powers would reduce the scope for patronage and the corrupt distribution of the spoils of election victory. The third element of the reform programme was the abolition of partisan elections. The introduction of non-partisan elections removed the party affiliation of candidates from the ballot paper, and was intended to decouple local elections from national party politics (Lineberry and Sharkansky, 1971). Non-partisanship was also believed to facilitate voting on the basis of 'the issues' rather than partisan alignments. Hawley (1973: 14) argues that while the reform movement had many targets, 'the attack on partisan local elections was probably the one charged with the most symbolic significance. Parties were pictured not only as corrupt but corrupting; their role, even in the absence of corruption . . . was an insult to the democratic spirit and to the capacity of the average person to determine his own destiny.'

The philosophy of the reform movement thus rested on a peculiar view of democracy: first, in contrast to the Downs model, that party competition hinders responsiveness to public preferences; and secondly, that there is an objective general interest which is obscured by the quest for partisan advantage. Banfield and Wilson (1966: 153) argue that many civic reformers believed that 'the only proper function of city government . . . was to provide certain necessary public services and facilities and to provide them as cheaply as possible. In this view, there was no need or justification for politics.' Similarly, Hawley (1973: 12) notes that the municipal reformers 'argued, in effect, that politics should be classless since people's interests were basically the same. Reforms such as nonpartisanship were but ways, they thought, of eliminating artificial barriers to the perception that the individual's interest and the public interest were coincident.'

The policies of the reformers may have reflected a naive view of politics, or a rather more subtle attempt to bias local political systems in favour of middle-class and business interests (Fraga, 1988; Welch and Bledsoe, 1988). Whatever their motives, the reform programme had substantial practical success. The first large city to

abolish partisan elections was Boston in 1909 (Banfield and Wilson, 1966: 154). Thereafter, non-partisan elections were adopted in almost 70% of US municipalities (Svara, 1977). Such formal non-partisanship, however, conceals a complex pattern of informal party activity – Bledsoe and Welch (1987) show that non-partisanship suppresses but by no means eliminates party activity.

Adrian (1959) distinguishes between three types of non-partisanship. First, local elections in which parties play an active but informal role. Hawley's (1973) extensive study of non-partisan elections revealed that 'parties may function in cities with nonpartisan ballots to inform the voter, to get out the vote, to recruit and support candidates – just as they do in cities with the partisan ballot'. For example, Chicago is formally non-partisan but it is 'practically impossible to be elected to the city council except as a candidate of one of the major parties . . . the council is composed of 47 nonpartisan Democrats and 3 nonpartisan Republicans' (Banfield and Wilson, 1966: 151). Similarly, Hagensick (1964) found that 70% of candidates for non-partisan local offices in Milwaukee had formal affiliation with partisan organisations. Indeed, 'in many instances . . . incumbents of non-partisan offices hold important leadership positions within their parties' (Hagensick, 1964: 118). More generally, Wolman et al. (1990) show that most mayors in nonpartisan cities identify themselves clearly as 'Republican' or 'Democrat'. The impact of party activity in formally non-partisan elections is important. Lieske (1989) analyses the determinants of electoral outcomes in the non-partisan city of Cincinatti, and finds that endorsement by the Democratic party has a significant positive effect on candidate success. A second type of non-partisan election system is where the Democrats and Republicans play no part at all, but purely local parties are active in the selection of candidates and election campaigns. National parties sometimes disguise themselves behind such organisations (see Ross et al., 1991). And thirdly, there are non-partisan systems with no active parties, national or local. In most small cities, in particular, candidates either create their own organisations or campaign alone.

Although it is possible to identify such variations in non-partisanship, 'unfortunately it is impossible to say what proportion of cities . . . belong to each of the three types' (Banfield and Wilson,

1966: 152). Thus the extent of effective party competition in formally non-partisan municipalities cannot be identified. Nor is there much evidence on the level of formal or informal party activity in elections for other units of local government (a rare comment in the US literature is by Lineberry and Sharkansky, 1971, who note that while 75% of school boards are elected, there is no party politics). Even for partisan cities, there are only a few fragments of evidence on the level of competition (see Gilbert and Claque, 1962; Gilbert, 1964; Wolman et al., 1990). Thus there is insufficient information to draw general conclusions on the level of party competition in US local governments, in systems which are either formally non-partisan or partisan. All that can be said is that in most local units parties play no official role, and therefore there is no party competition of the form envisaged in the Downs model.

3. THE IMPACT OF PARTY COMPETITION ON LOCAL AUTHORITY BEHAVIOUR

(a) Testing the Downs Model

The 'median voter theorem' implies that the relationship between public preferences and public policies is contingent on the level of party competition. If competition is strong, then policies should closely reflect the views of the median voter; but if competition is weak, then there is likely to be a substantial gap between public demands and the outputs of government. This model of the role of political parties implies that the impact of competition is *mediative* rather than *additive*. That is, party competition influences the strength of the connection between median voter preferences and policy decisions. A motoring analogy may help to explain the difference between additive and mediative effects. Some variables are 'drivers' – they have a preference about direction and destination; other variables are 'vehicles' – they are mechanisms which can help or hinder the achievement of drivers' goals. Different vehicles will increase or restrict the miles travelled in a given direction, but a vehicle in itself has no preferences. Driver variables can have additive effects – they indicate policy preferences which stem from the values of the

members of an organisation. For example, it may be argued that the Labour Party has an inherent bias towards high levels of public services, that green pressure groups have an inbuilt disposition towards stronger environmental regulation, and that farmers have an innate hunger for agricultural subsidies. Measures of such political variables can be expected to have an additive effect on policies because they reflect the preferences of individuals and organisations.

By contrast, political variables which do not reflect the values of organisations cannot have additive effects because there is no inherent bias towards one type of policy rather than another. These are the vehicles rather than the drivers – they reinforce or inhibit the relationship between other variables and policies. Party competition falls into this category. Measures of competition do not refer to organisations with members who have views about policies. Competition has no inherent bias towards any particular policies but instead facilitates or inhibits the impact of party control on policy outputs. Strong competition can be expected to reduce the effect of party ideology on policies, whereas weak competition reinforces this effect. Thus a Labour council faced by weak competition may be a high spender, while one faced by strong competition is only a moderate spender. Similarly, a Conservative council under little competitive pressure may have low expenditure, but one which is confronted by a close rival may be nearer to the average for all councils. Competition is the vehicle, not the driver, and has only a mediative, not an additive effect.

The implication is that measures of competition should not simply be entered additively into multivariate models of local authority behaviour. If, as public choice theory predicts, competition strengthens the relationship between median voter preferences and policies, an additive specification is inappropriate and is likely to produce insignificant results. Rather, a valid test of the Downs model requires an investigation of the mediative effect of competition on the responsiveness of policies to public demands.

(b) Evidence from Empirical Studies in the UK

The impact of party politics on local policy variation in the UK has been tested in over fifty studies. The evidence generally indicates

that the ideological disposition of the ruling party is a significant influence on policy outputs (Boyne, 1996c). The impact of party competition, by contrast, has been examined in only a handful of studies; and most of the evidence suggests that this variable has little relationship with policy decisions.

The additive effect of party competition has been tested in four studies. It was argued above that there is no theoretical reason to expect an additive relationship between competition and policies. The results of the empirical studies support this view: almost all of the coefficients for measures of competition are insignificant. Alt (1971) examines the relationship between party competition and local expenditure and taxation in forty-four county boroughs from 1958 to 1967. He calculates competition by subtracting from 50 the difference between 50 and Labour's percentage of total council seats. The variable ranges from 0 (no competition where Labour holds none or all of the seats) to 50 ('perfect' competition where Labour holds exactly 50% of the seats). Alt argues that 'councils on which Labour holds 30 per cent or 70 per cent of the seats are held to be equally competitive and each has a score of 30' (1971: 52). However, this symmetry is obtained only where Labour is faced by a single rival. Where there are three parties, a seat share for Labour of 70% may be substantially less competitive than one of 30%, if the division of seats between the other two parties in the latter case is, for example, 55:15 or 35:35. Alt finds that his measure of competition is significantly related to only two of eleven dependent variables.

Danziger (1978) also provides a comprehensive set of evidence on the additive effect of party competition in the county boroughs in the 1960s. He tests two measures of competition. First, an index of competition derived from the following formula:

$$1 - [(\text{First Party seats} - \text{Second Party seats}) / \text{Total seats}]$$

If one party wins all the seats, then the measure of competition is 0, if there is a difference of only one seat between the first and second parties then the formula gives a figure close to 1. Danziger's second measure of competition is the percentage of uncontested council seats, which is not in itself a reliable indicator of competition. Sup-

pose, for example, that the level of uncontested seats is 20% in each of two authorities. This indicates nothing about the relative strength of two rival parties – seats may be divided equally or one may have a large majority. Furthermore, even if the balance of seats is the same on each council, it is necessary to know how the uncontested seats are divided between the ruling party and the opposition in order to judge the level of competition. Thus Danziger's competition index is probably a better measure than the percentage of uncontested seats. At best, the two variables are tapping different dimensions of party competition, as indicated by a correlation between them of –0.38. In the event, neither measure turns out to be related to the twenty-seven policy variables which Danziger examines. On a purely random basis, each of the competition measures might have produced two coefficients significant at the 0.05 level with this many tests (Mock and Weisberg, 1992). However, only one of the fifty-four tests yields a significant result.

Another test of the additive effect of competition is by Karran (1982) who analyses policy variations across twenty-five county councils from 1950 to 1971. He applies factor analysis to the percentage of uncontested seats and a competition index (similar to that used by Alt). The competition index itself has an average correlation of 0.08 with thirteen measures of local spending and taxation. When it is merged with uncontested seats in a 'party conflict factor' the results are little different. The new variable is significant in eleven out of twenty-one years for one policy output, but is not significant in six years or more for any of the others (Karran's presentation of the results prevents a more precise interpretation).

The last analysis of the additive role of competition is by Hoggart (1985) who seeks to explain variations in council house sales by English housing authorities between 1974 and 1983. He specifies six dummy variables for different categories of party control, including a 'competitive' category which is defined as a change of control either from or to Labour during the study period. The dummy variable for Conservative control is omitted from the regressions and is therefore the baseline for evaluating the other party variables. The competition coefficients are small and generally insignificant, which indicates that council house sales policies are similar in Conservative and competitive councils. However,

Hoggart's definition of competition is problematic because it confuses competitive conditions with actual turnover in office. Even if there is no change of control, party competition may be close and the ruling party may modify its policies accordingly.

Four studies provide evidence on the mediative role of party competition. Sharpe and Newton (1984) examine whether competition influenced the relationship between party control and expenditure levels in county boroughs and county councils between 1960 and 1972. They divide councils into five groups: Conservative monopoly (more than 80% of seats); Conservative dominant (60%–80%); two-party (ruling party less than 60%); Labour dominant; and Labour monopoly (as equivalent Conservative categories). They find that spending rises consistently across these groups in all but four of thirty cases. It therefore appears that party competition moderates the relationship between party ideology and expenditure levels.

However, there are several problems with this evidence. First, there are no controls for other explanatory variables such as central grants, the local tax base and service needs. Secondly, the level of competition in one year is tested against the current level of spending which reflects decisions taken over a much longer period. A better test would be to examine the impact of competition on the relationship between party control and *changes* in spending. Sharpe and Newton do follow this procedure, but they combine Labour and Conservative councils together into monopoly, dominant and two-party groups. They claim that 'there is an unmistakable trend in both country boroughs and counties for the increase (in spending) to be greater with increasing one party dominance' (1984: 201). However, only one of their six cases fits this pattern, which is hardly surprising because the 'dominant' and 'monopoly' groups contain high-spending Labour councils and low-spending Conservative councils. A third and final problem with Sharpe and Newton's evidence is that no significance tests are used to assess the probability that the expenditure differences across the various groups of councils arose by chance.

Hoggart (1984) provides evidence on the relationship between party competition and capital investment in housing and highways by fifty-seven county boroughs from 1966 to 1971. He divides

Labour and Conservative councils into two categories: a 'safe control' group where the ruling party had at least 60% of the seats for four years or more from 1965–70; and a 'marginal control' group where a party was in control for at least four years, but with less than 60% of council seats. Hoggart (1984: 10) argues that these categories

> make allowance for the marginality of control. The 60 per cent figure is arbitrary, but it is not unrealistic, for in these 57 cities between 1960 and 1970 parties which lost their majority following an annual election held an average of 55.95 per cent of seats in the year prior to the election. Using the 60 per cent figure is not a perfect mechanism, but it does provide a useful device for distinguishing party control on the basis of its safety.

Hoggart includes a dummy variable for each category of Labour and Conservative control in regression equations which also contain measures of service needs and central grants. Only six of twenty-eight tests indicate that the impact of party control is moderated by competitive pressures. However, Hoggart's control categories are blurred because they refer to only four of the relevant six years. A council which was safe for the first four years may have been highly marginal for the last two; similarly, councils could have changed from marginal to very safe in the final two years. Thus the difference in competition between Hoggart's safe and marginal categories may be less clear than their labels imply.

A more direct test of the mediative role of party competition is provided by Boyne (1987a) who analyses the relationship between median-voter preferences and changes in the level of local taxation. The measure of median-voter interests is their existing local tax payment. On the basis of the self-interest axiom it is assumed that median voters who face higher current taxes will be more resistant to further increases. If competition affects responsiveness to median-voter preferences, then the negative relationship between median-voter tax payments and subsequent tax increases should be strongest in competitive two-party systems. However, the statistical results suggest that there is little link between median-voter interests and tax policies across local authorities in general. Nor is this link significant in the sub-group of councils where party competition is strongest.

Finally, Boyne (1997c) investigates the impact of party competition on the relationship between party control and local spending decisions. In a preliminary stage of the analysis, it is shown that Labour control has a significant positive effect on changes in expenditure, and that the impact of Conservative control is significantly negative. If the Downs model of party competition is valid, then parties should modify their policies when they face a serious electoral threat. Competition should induce 'moderation': Labour councils which confront a realistic possibility of defeat should be less likely to follow their ideological preference for extra spending, and Conservative councils which fear loss of office should be less likely to cut spending. This assumes that the median voter is politically moderate and is opposed to large increases or decreases in spending.

The statistical results show that competition did not have the hypothesised impact on spending decisions in Labour or Conservative councils. The behaviour of local politicians was not influenced by the dominance of the ruling party in the present, or the volatility of seat shares on the council in the past. In order to search further for competitive effects, various combinations of measures of dominance and volatility were tested. In addition, the model was estimated in a sub-group of 'two-party' authorities in order to approximate as closely as possible the 'pure' version of the Downs theory. These attempts to save the competition hypothesis proved unsuccessful: the coefficients for the measures of competition remained insignificant.

Taken together, the general pattern of the evidence on party control and party competition support an ideological model of party behaviour rather than the median-voter model. Why is the relationship between party control and spending not influenced by the competitive conditions in local political systems? Why do competitive conditions not lead to competitive behaviour? The answers to these questions may be that local political leaders in Britain lack both the *opportunity* and the *incentive* to compete effectively.

Consider first the opportunity for parties to seek office by converging on local median voter preferences. Here it is important to note that the distribution of public opinion in local areas is not simply a microcosm of the national pattern. Some rural or suburban areas

may be heavily 'anti-tax' while some urban areas are heavily 'pro-spending'. Effective party competition in these areas would require local politicians representing the major national parties to align their policies with local median voter preferences. However, local politicians in the UK lack the freedom to do this because they are tied to the 'image' of the national party. The policies adopted by national party leaders constrain the credible range of ideological positions that can be adopted by local party leaders. This range is unlikely to stretch to cover the position of the median voter in areas where local opinion is much further to the right or left than the national pattern. Local politicians may have some room for manoeuvre, but the local electorate's view of the ideological meaning of a party label is often shaped by messages from the national mass media. In such circumstances, effective competition between the two main national parties is blocked, and the dominant party may be free to neglect median voter preferences and pursue its own ideological preferences.

Even if local ruling parties in Britain had the freedom to compete, the balance of incentives and rewards would still be strongly towards ideology rather than office. Party leaders may realise that their policy decisions are, at best, a marginal influence on local electoral behaviour. If local elections are dominated by national rather than local issues then it is difficult for ruling parties to buy votes with responsive policies. In effect, there is a large number of 'floating' voters at local elections, whose behaviour depends on their view of the performance not of the local council but the national government. If a council is controlled by the same party as the national government, then it may lose office on an anti-government swing regardless of any attempt to abandon ideology and follow 'consensus' policies. In this case parties may as well follow their ideological preferences while they have the chance to do anything at all. Similarly, if a party in opposition at the national level is in control locally with a small majority, then it is likely to gain votes on the basis of an anti-government swing. Thus, such councils, too, have little to lose from policies that express their ideology. This course of action may be construed as a rational choice of a certain policy gain in the present over an uncertain electoral gain in the future.

(c) USA

Since Dawson and Robinson's (1963) analysis of influences on welfare expenditures, there have been many studies of variations in state policies in the USA, most of which have tested the impact of political variables on policy outputs (see Boyne, 1985). By contrast, there have been few tests of party effects on *local* policies in the USA. Variations in policy outputs across municipalities, county governments and school districts have been extensively analysed by economists. For example, a vast number of supposed tests of the median voter model have been conducted at the local level. Such studies typically include a measure of the income of the median voter, but do not examine whether the influence of this variable on local policies is mediated by party competition (e.g. Barr and Davis, 1966; Bergstrom and Goodman, 1973; Chicoine et al., 1989; Deacon, 1978; Inman, 1978; Murdoch et al., 1993; Reid, 1991; Sjoquist, 1981; Stevens and Mason, 1996; Turnbull and Djoundourian, 1994). The problem with these studies is that median voter characteristics may be significantly related to policy decisions even in the absence of party competition. For example, the balance of pressure group activity may reflect the views of the median voter, or local bureaucrats may believe that they have a professional responsibility to respond to the political 'middle ground'.

Only six analyses of local authority behaviour in the USA provide direct evidence on party effects. Schumaker and Getter (1977) examine the relationship between socio-economic and political variables and 'responsiveness bias', that is the extent to which local governments respond unequally to the preferences of various parts of the population. They find no significant relationship between responsiveness bias and an index of Democratic party strength which is derived from actual control of offices and the party's 'reputation for influence'. However, in a subsequent study of responsiveness to pressure groups, Schumaker and Getter (1983) find a significant negative relationship between Democratic strength on the council and policies that favour upper income groups. Lovell (1978) tests a statistical model of variations in education spending per pupil by local governments in Connecticut. His measure of party politics is the Democratic percentage of registered voters. It is not clear how

this variable relates to actual party strength in local government, but the variable does have a positive relationship with educational expenditure.

Three studies test party effects on the level of total spending by American municipalities. Hoggart (1989) analyses expenditure variations across urban local governments in Pennsylvania, New Jersey and New York. His measure of party strength is the share of votes at elections for state governor, except in Pennsylvania where he uses the actual party affiliation of council members. In all three states Hoggart concludes that 'political party considerations were an insignificant component of the policy determinant process' (1989: 124). Walzer et al. (1992) examine the determinants of spending changes and find that cities with a Democratic mayor have significantly lower rates of expenditure growth. They offer no rationalisation for this finding, but the low level of statistical explanation provided by their model ($R^2 = 14\%$) casts doubt on the validity of the result. Finally, Miranda and Walzer (1994) test for the impact of Democratic mayors on expenditure levels and growth, but find no significant party effect. They do, however, find a positive relationship between expenditure and the 'fiscal liberalism' of mayors and councillors. Taken together, the results for Miranda and Walzer's two political variables suggest that the actual ideological disposition of local politicians in the USA is important, even if the formal party affiliation of the mayor is not.

Although these tests suggest that local party behaviour in the USA fits the ideological model rather than the median voter model, they provide little direct insight on the role of competition for three reasons. First, some studies include measures of party control and others include measures of party domination (seat share or vote share), but there is no direct comparison of the two types of measures. Thus it is impossible to say whether policies are more strongly influenced by the extent of domination than by control alone. If size of majority 'makes a difference' to policy decisions, then this would provide some support for the Downs model. Secondly, the data sets seem to include both partisan and non-partisan local governments. Party effects might emerge more clearly in a separate analysis of cities with partisan elections. And thirdly, the measures of party strength in some studies are suspect because they refer to

local results for state or national elections rather than municipal elections. This probably attenuates any statistical link between party domination and policy outputs.

Another set of evidence that is relevant to party competition is contained in studies that test the effects of non-partisanship. What are the consequences when party competition is, formally at least, entirely absent? Some evidence suggests that in non-partisan cities Republicans are over-represented on the council, and that policies are unresponsive to the needs of minority groups (see Cassel, 1986; and Welch and Bledsoe, 1988, for a critical review of these studies). However, it may simply be that Republican areas are more likely to have 'reformed' governmental structures. In addition, the absence of responsiveness to minority interests cannot necessarily be attributed to the absence of party competition. The Downs model itself suggests that competition will enhance responsiveness to *median voter* preferences. Thus, even when competition is present, the views of minorities may be neglected by politicians.

Hoffman (1976) provides the only direct test of the impact of party competition on local responsiveness in the USA. He calculates the extent to which expenditure and tax levels in ten large cities are consistent with median voter preferences. The measure of responsiveness is a 'percentage difference' score, which is calculated by subtracting the percentage of survey respondents who prefer lower spending (or taxes) from the percentage who prefer higher spending. The underlying idea is simply that, if the Downs model is accurate, the scores should be roughly zero. As Hoffman argues (1976: 53) 'the policy pursued by a responsible government representing the median voter's preference should generate in the population a distribution of preferences *equally divided between those who prefer more spending on the policy and those who prefer less*' (emphasis in original). This outcome would suggest that policies match the preferences of the median voter. In the event, Hoffman finds considerable 'under-provision' of services in all ten cities: the percentage difference scores range from an average of 6 for welfare spending to 59 for expenditure on pollution control.

The data suggest, then, that none of the cities is matching its policies with median voter demands. However, the performance of the cities is variable – the mean percentage difference score

across all services is lowest in Milwaukee and San Diego (+ 29) and highest in Atlanta (+ 52). Hoffman then explores whether this variation in responsiveness is related to local party competition. His measure of competition is based on the Democratic share of the vote for US president and state governor in each city. The hypothesis is that high levels of competition will be associated with lower percentage difference scores, thereby indicating greater responsiveness in competitive party systems. Hoffman (1976: 71) concludes that the empirical analysis shows 'that party competition enhances responsiveness', but the evidence does not support this interpretation. Only one of four tests produces a significant negative correlation (–0.60 between competition and the percentage difference score for welfare spending). Thus it appears that, in most service areas, inter-party competition has no impact on responsiveness.

Firm conclusions cannot, however, be drawn from only one empirical study. Moreover, Hoffman's analysis contains some methodological problems that undermine the validity of the results. First, the sample size of only ten cities is probably too small to yield robust correlation coefficients, and certainly too small to draw general conclusions on the validity of the Downs model. Secondly, in part because of the small sample size, other potential influences on responsiveness are not held constant when the impact of competition is estimated. Thirdly, the percentage difference scores for expenditures and taxes are contradictory: on average respondents seek higher spending on all services but also desire lower taxes. As Hoffman concedes (1976: 63–4), this suggests that the tax constraint has not been properly incorporated into the survey instrument. And finally, the measure of competition does not refer to *local* elections. Indeed, it is not even clear that all the cities in Hoffman's sample are effectively partisan. The end result, then, of Hoffman's study (and the others outlined above) is that there is little satisfactory information on the consequences of local party competition in the USA. Whether competition influences responsiveness, or even expenditure, is largely unknown.

Nevertheless, it is possible that the influence of local party competition will eventually emerge as stronger in the USA than the UK. As noted above, local politicians in Britain lack the freedom

of movement to compete effectively. By contrast, in the USA local parties are much less closely tied to national party organisations. As Eldersveld (1982: 100) argues, there is no 'ideological straitjacket into which party units, national and state and local, are forced'. Erikson et al. (1989) have shown that, even at the state level, there is considerable variation in the policy programmes of the Democratic and Republican parties. Whereas British Labour and Conservative positions tend to be ideologically distinct, Democrat and Republican positions overlap or even 'cross over' if one state is compared with another. For example, in some Southern states, Democrats are further to the right than Republicans are elsewhere. This implies that, unlike their British counterparts, American parties are free to match their policy positions with geographical variations in local public opinion. Thus Democrats and Republicans will still be to the left and right respectively of the median voter in each locality, even if their relative positions fluctuate across areas.

The capacity of US parties to compete effectively in every locality implies that they will be more strongly motivated by office than are British parties which lack this freedom of movement. A similar conclusion can be drawn concerning the incentive to compete in the two systems. Whereas national issues dominate local elections in the UK, local campaigns in the USA focus much more on local than national issues. The relationship between the standing of national parties and local election results does not even arise in the US literature on local elections (see, for example, Sharp, 1987; Fleischmann, 1997). This is in marked contrast to the considerable interest this issue has generated in the UK (Miller, 1988). In the USA, local politicians have a clear incentive to satisfy local public preferences because there is a direct reward for good performance. Local ruling groups have little to fear from the unpopularity of their national counterparts and, correspondingly, little to gain from their popularity. In this context there may be a strong connection between policies that are aimed at the median voter and local electoral success. Therefore the objectives of politicians are further directed towards the benefits of power rather than policies, and party behaviour is likely to conform more closely with the median voter model than the ideological model.

CONCLUSION

Party competition is central to the operation of systems of representative democracy. If the ruling party faces a serious threat that it will lose power to a political rival, then it is more likely to pay attention to public preferences. The closer the competition, the more likely politicians are to adopt policies that satisfy the demands of the electorate. This, in essence, is the public choice view of the role of party competition in local government. More specifically, the Downs model suggests that competition should reinforce the responsiveness of policy-makers to the views of the median voter.

The first part of this chapter identified two dimensions of the concept of party competition. First, 'dominance' which refers to the strength of the ruling party in the present. The higher the level of dominance, the lower the likelihood that the governing party will be defeated at the next election. Secondly, 'volatility' which refers to the extent of turbulence in party strength at past elections. The greater the level of volatility in a local political system, the higher the probability that the ruling party will be defeated. The second part of the chapter compared levels of local party competition in the UK and USA. The relevance of the concept of party competition to British local government has been questioned. However, it was shown that, whether the focus is on dominance or volatility, the extent of competition is substantial. Moreover, party competition on local councils has generally become closer since the 1970s. By contrast, there is little explicit party competition in the USA because most local elections are formally non-partisan. There may be fierce competition between individual candidates, but this does not fit the Downs model in which two rival parties seek to occupy the middle ground in the electorate as a whole. Furthermore, there is little evidence on the extent of competition in local governments where formal party activity is permitted. In sum, party competition in US local government is absent in the majority of local units, and unquantified in the minority of units where it is present.

In the final stage of the analysis, empirical evidence on the impact of competition on local authority behaviour was evaluated. It was argued that the Downs model implies that the role of party competition is mediative rather than additive. Therefore, empirical

analyses of the additive effect of competition are likely to produce insignificant results. The evidence from tests of the additive impact of party competition in British local government confirmed this expectation. However, contrary to public choice theory, mediative tests have also shown that competition has no influence on local policies. This may reflect the constraints and incentives which confront local politicians in the UK. Local leaders are tied to the image of national parties, so it may be difficult to shift position towards median voter preferences in each area; and local elections are heavily influenced by national issues, so there may be few extra votes to be gained when local politicians successfully meet median voter demands.

Evidence on the impact of local party competition in the USA is exceptionally sparse, despite the fact that many studies claim to have tested the median voter model. These studies have simply examined whether there is a relationship between the fiscal circumstances of the median voter and local tax and expenditure policies. There has been no evaluation of the influence of party competition on the strength of this relationship. However, it is possible that future studies will discover that the effect of local party competition is significant in the USA. Where local parties play a formal role in local elections, it is likely that, compared with their British counterparts, they have more room for manoeuvre and a greater electoral incentive to meet the demands of the median voter. For the present, however, the public choice model of party competition is bereft of empirical support in either local government system. The few valid tests offer no evidence that rivalry between political parties is associated with greater responsiveness to public preferences.

4 The Extent of Competition between Public and Private Producers of Services

The final form of competition to be evaluated in this book has been the most widely debated by academics and policy-makers in the last ten years. This is competition between local authority departments and outside suppliers for the right to provide public services. The pressure of external competition poses a threat to the very existence of the parts of a local authority that are responsible for directly providing services. The 'in-house' providers therefore have no choice but to match, at least, the levels of performance promised by external agencies. In this way, competition is supposed to ensure that local services reach high standards of efficiency and quality. Indeed, it may be possible to achieve such standards even if no bids are actually received from other agencies: the simple threat that the penalty for poor performance will be redundancy should be sufficient to produce competitive results.

This chapter explores the theoretical basis of these ideas and investigates the level of competition between public and private organisations. The first part analyses public choice arguments on the behaviour of bureaucrats: in 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, will strive to keep production 'in-house'. As Kirlin et al. (1977: 134) argue, 'the ability to say that one is an official with a city with one thousand employees confers greater status than the statement that one is an official of a city with seventy-one contracts'. This view can be contrasted with Dunleavy's (1991) argument that senior 'bureau

shaping' officials are eager to divest themselves of routine service responsibilities. The second part of the chapter reviews the extent of competition for local service production in local government in the UK and USA. The main contrast here is that competition is compulsory for many services in the UK, that is, councils are forced by legislation to seek external bids to provide services; but in the USA service contracting is voluntary, at the discretion of local policy-makers. The reasons for geographical variations in the extent of competition for service production are also explored.

1. PUBLIC CHOICE THEORIES OF BUREAUCRATIC BEHAVIOUR

(a) The Early Models: Tullock and Downs

Tullock's book entitled *The Politics of Bureaucracy* (1965) is generally regarded as the first sustained public choice analysis of the behaviour of public officials. The book is written in an informal style which lacks the rigour associated with later analyses of bureaucracy, such as that of Niskanen (1971). Indeed, Tullock himself concedes that his arguments could be regarded as a Machiavellian guide to 'how to get ahead in a bureaucracy', rather than as a formal empirical model. Nevertheless, his analysis does introduce three of the fundamental features of the public choice perspective on bureaucracy: officials are motivated primarily by selfishness, they are not constrained by competition, and their behaviour is difficult to monitor and control. Tullock's arguments are not entirely 'theoretical' – he illustrates the main points with examples of bureaucratic behaviour, some of which are drawn from his own experience as an official in the US government. He justifies this approach as follows: 'For a number of the assertions that will be made in this book, the supporting evidence must be found in the mind of the reader… instead of presenting concrete evidence, I shall simply try to convince the sceptical reader by appealing to his own intuition and experience… if his "understanding" leads him to the same conclusions that I have reached in a particular case, he can then accept my statement of the principle as being true' (1965: 15). The 'scept-

ical reader' whom Tullock is addressing might regard this is an appeal to prejudice rather than experience. However, for the moment, it is necessary to consider only the theoretical content of public choice arguments on competition in the market for service production. Empirical issues are discussed in Chapter 5.

Tullock assumes that public officials are motivated not by a desire to serve the public interest, but by a desire to maximise their own chances of promotion. In the context of an organisational hierarchy, selfishness implies 'the desire to get ahead, to move up in the hierarchy… [this] should not be interpreted or described entirely in terms of creature comforts or large bank accounts… [but] normally political power and physical comfort are closely correlated in any hierarchical structure. Even monastic religious orders, functioning with a vow of poverty, normally provide their higher officials with a few more of the conveniences of life than the ordinary members' (1965: 29–30). Tullock argues that, in a competitive market, staff with the ability to enhance the performance of an organisation will rise to the top. By contrast, in the typical government bureaucracy there are no objective measures of performance. The consequence is that promotion depends not on bureaucrats' contribution to the achievement of formal organisational goals, but on their capacity to please their superiors. Bureaucrats will frequently be confronted with choices between policies that best serve their own interests or the public interest. According to Tullock, 'an obvious requirement for efficient administration is that the opportunity to make such choices be minimised. When a member of a hierarchy takes a course of action that is best for his own career but that is not best for the achievement of the objectives of the organisation, two major disadvantages are to be noted. First, at the very least, organisational goal achievement is not maximised. Second, the concentration of people near the top of the hierarchy who are not particularly interested in the "function" of the organisation is increased' (1965: 20).

A consequence of the absence of competition is that public sector organisations are inherently and inescapably inefficient. Organisational goals are neglected or ignored, but the personal goals of officials are pursued vigorously. The problem, Tullock argues, is that 'governments are essentially monopolistic. The external check of competition that is present in business organisation is absent.

Government agencies can follow inefficient policies for very long periods without being eliminated . . . The (official) is much less subject to pressures for "efficiency" than is the normal business manager. To the individual (official), "efficiency" is meaningful not in terms of the organisation's goals, but in terms of his own' (1965: 68). In the absence of competition, good performance might be secured through close scrutiny of the results of officials' behaviour. However, this proves to be a difficult path to follow in the public sector. Tullock argues that in the absence of unambiguous measures of performance, such as profit, it is difficult to control or evaluate the behaviour of agencies or individuals. Tullock concludes that 'much of modern bureaucracy is simply a mistake . . . the continuing failures of bureaucracies are met in part by continuing reorganisations, the reasoning being that the failure has resulted from the organisational details. In part, the failures are met by concealed shifts in the objectives of the organisation . . . The governmental bureau becomes the permanent fixture, with the objectives continually changing. Over time, the vested interests of the bureaucrats themselves become more and more important in justifying the organisation' (1965: 193).

Shortly after Tullock's book was published, Downs (1967) produced a further public choice analysis of bureaucracy. Downs draws directly on Tullock for some parts of his argument (for example, relationships between superiors and subordinates, problems of organisational control), but generally paints on a much wider canvas. He covers many of the issues discussed in conventional studies of organisational behaviour – for example, communication in bureaux, organisational search processes and organisational change (see Jackson, 1982, for a discussion of the links between the organisational studies literature and public choice models of bureaucracy). Downs also lays the foundations for subsequent developments in areas such as implementation theory and principal-agent theory. The breadth of the analysis is indicated in a concluding chapter which culminates in a statement of sixteen 'laws' and almost 300 'propositions'. Here the focus will be restricted to arguments which are relevant to bureaucratic behaviour in the absence of competition.

The 'fundamental premise' of Downs' theory is that 'bureaucratic officials, like all other agents in society, are significantly –

though not solely – motivated by their own self-interests' (1967: 2). Downs follows Tullock in arguing that the pursuit of self-interest by public officials leads inevitably to inefficiency because of the absence of competition and the problems of controlling bureau behaviour. Thus there is no assumption that public sector staff are more selfish or less able than their private sector counterparts. It is the distinctive characteristics of the public sector that lead to poor performance: 'most bungling arises from the intrinsic difficulties of running large nonmarket organisations, rather than from any particular incompetence on the part of individual officials' (1967: 133). Downs argues that all decisions in governmental agencies are biased towards the private interests of bureaucrats, and that there are few restraints on such behaviour: 'these biases are likely to exist to a greater degree among bureau members than among members of profit-making firms. In such firms, the existence of profit as an objective measure of performance provides at least some ways of detecting strong biases amongst subordinates. Hence this measure acts as a limit to the amount of bias firm members believe they can safely embody in their actions. But the equivalent limits in bureaus are far more obscure and uncertain' (1967: 78).

Downs identifies nine goals that may be pursued by bureaucrats. Five of these are 'pure self-interest' goals: power, money, prestige, convenience (resistance to organisational changes that require more personal effort), and security (low probability that the achievement of the first four goals will be impaired in the future). The remaining goals are, at best, indirect expressions of self-interest: loyalty to colleagues or the organisation, pride in work, a desire to serve a perception of the public interest, and a commitment to a specific policy. The emphasis that public officials give to these nine goals depends on their personalities and opportunities. However, Downs claims that even officials who appear to be motivated by a desire to serve the public interest, or claim to be so motivated, are fundamentally selfish. In the absence of a competitive environment, self-interested behaviour is not channelled towards public ends:

> Although many officials serve the public interest as they perceive it, it does not necessarily follow that they are motivated

> solely or even mainly by a desire to serve the public interest *per se*. If society has created the proper institutional arrangements, their private motives will lead them to act in what they believe to be the public interest. . . . Therefore, whether or not the public interest will in fact be served depends upon how efficiently social institutions are designed to achieve that purpose. Society cannot insure that it will be served merely by assigning someone to serve it. (Downs, 1967: 87)

One problem in establishing 'proper institutional arrangements' is, as Tullock also notes, the lack of valid information on performance. Downs takes this line of analysis a stage further by discussing the establishment of special 'monitoring agencies' to evaluate bureaucratic behaviour. According to Downs, the creation of such agencies is the only way that a senior official can 'check up on the accuracy of his own bureau and, by using the threat of such checks, force the bureau to give him information selected by principles similar to his own'. However, the generation of data by a monitoring agency results in another set of problems. First, the operations of the agency may be expensive, perhaps more so than simply accepting biased information. Over time, a monitoring agency itself becomes a bureau with activities that reflect the interests of its staff. According to Downs' 'Law of Ever Expanding Control', the consequence is that 'the quantity and detail of reporting required by monitoring bureaus tends to rise steadily over time, regardless of the amount or nature of the activity being monitored' (1967: 150). Secondly, the organisation which is being monitored will itself incur higher costs in order to respond to requests for information. Thirdly, the organisation under scrutiny will expend considerable effort in attempting to thwart the monitoring agency. This is Downs' 'Law of Counter Control' which states that 'the greater the effort made by a sovereign or top-level official to control the behaviour of subordinate officials, the greater the effort made by those subordinates to evade or counteract such control' (1967: 262). And finally, senior officials may lack the motivation to remove the bias from the performance data that an agency provides:

> Even if an official knows he is receiving distorted information from his subordinates, he may believe it is in his own interest to

> retain that distortion in his decision making. He may even find it desirable to add to this distortion in forwarding the information to his own superiors . . . officials all have a tendency to exaggerate the capabilities of their own sections of a bureau . . . conversely, they try to minimise any unfavourable information, especially if it might reduce the resources available to that section. (1967: 123)

An important consequence of the problems of monitoring performance is that public sector bureaux display 'excessive growth'. Downs argues that all organisations have inherent tendencies towards expansion, but this phenomenon is especially pronounced in the public sector. The essential problem is that public agencies do not receive their revenue from customers who choose voluntarily to pay for their services. Thus the size of the 'real' market for the output of a bureaucracy does not check expenditure growth. Rather, a defining characteristic of a bureau is that the majority of its income is provided by 'political sovereigns' on behalf of taxpayers. In this context, 'the bureau's ability to obtain income in a market cannot serve as an objective guide to the desirability of extending, maintain or contracting the level of expenditures it undertakes . . . the inability of bureaus to rely on markets as objective indicators of output value affects their entire operation' (Downs, 1967: 30).

What, then, are the effects of bureaucratic expansion? First, the excessive size of bureaux is a form of protection against abolition. Agencies literally 'outlive their usefulness'. As they become older, bureaux become less responsive to new needs: 'all organisations tend to become more conservative as they get older . . . (but) this principle is especially applicable to bureaus because they are relatively insulated from competition' (Downs, 1967: 30). Second, as organisations grow, control and co-ordination become more difficult. Downs labels these arguments the 'Law of Diminishing Control' and the 'Law of Decreasing Co-ordination'. The result of the operation of these 'laws' is that 'in any large multi-level bureau, a very significant portion of all the activity being carried out is completely unrelated to the bureau's formal goals, or even to the goals of its topmost officials' (1967: 136). And finally, as bureaucracy grows, so the efficiency of resource utilisation falls. Downs provides no evidence for this proposition, but simply states that

> we can intuitively postulate that the total amount of waste and inefficiency in society is likely to rise as bureaucracy becomes more prominent. This seems probable because true waste is so much harder to define and detect in bureaus than in private firms. Also, there are no automatic mechanisms for limiting it in the former as in the latter. This admittedly untestable [sic] conclusion implies that society should arrange to have services produced by market-oriented firms rather than bureaus, when possible, other things being equal. (1967: 257)

(b) Oversupply and Inefficiency: the Niskanen Model

Public choice arguments about officials' behaviour were drawn together and developed by Niskanen (1971) in a formal economic model of bureaucracy. Niskanen addresses four important questions: what are the defining characteristics of a bureau? what are the goals of bureaucrats? what is the basis of bureaucratic power? and what is the effect of bureaucratic power on the performance of public agencies? His answer to each of these questions is considered below.

Niskanen defines bureaux as 'nonprofit organisations which are financed, at least in part, by a periodic appropriation or grant' (1971: 15). It follows that bureaux differ from purely private firms in two main ways. First, the staff of bureaux do not make a personal financial gain from the difference between organisational revenues and the cost of supplying services. Thus, unlike the employees of a private firm, bureau employees have no direct monetary incentive to minimise costs or maximise profits. Second, some of the revenue of a bureau is provided 'en bloc' by a 'political sponsor', rather than derived from the sale of discrete services at a price per unit. Niskanen argues that 'a bureau whose sponsor is willing to compensate for any loss of revenues from sales, or that is a monopoly supplier of a service with a nearly invariant demand, will usually be quite indifferent to the interests of its customers' (1971: 34).

Like Tullock and Downs, Niskanen proceeds from the self-interest axiom to deduce the motives and behaviour of policy-makers. Niskanen argues that bureaucrats are not robots which are

programmed to obey the voices of their political masters: 'any theory of the behaviour of bureaus that does not incorporate the personal preferences of bureaucrats . . . will be relevant only in the most rigidly authoritarian environments' (1971: 5). What, then are the 'personal preferences' of bureaucrats? Niskanen argues that the aim of bureaucrats is simply to maximise their budget, that is, to squeeze as much money as possible out of the politicians who are responsible for allocating public funds: 'Bureaucrats maximise the total budget of their bureau during their tenure, subject to the constraint that the budget must be equal to or greater than the minimum total costs of supplying the output expected by the bureau's sponsor.' In Niskanen's model, budget maximisation is necessary for bureaucrats' personal satisfaction and professional survival:

> Among the several variables that may enter the bureaucrats' utility function are the following: salary, perquisites of the office, public reputation, power, patronage, output of the bureau, ease of making changes, and ease of managing the bureau. All of these variables except the last two, I contend, are a positive monotonic function of the total *budget* of the bureau . . . The problems of making changes and the personal burdens of managing a bureau are often higher at higher budget levels, but both are reduced by *increases* in the total budget. This effect creates a treadmill phenomenon, inducing bureaucrats to strive for increased budgets until they can turn over the management burdens of a stable higher budget to a new bureaucrat. (Niskanen, 1971: 38)

Niskanen's budget maximisation assumption 'is not necessarily based on a cynical interpretation of the personal motivations of bureaucrats. Some bureaucrats, by either predisposition or indoctrination, undoubtedly try to serve their perception of the public interest' (1971: 39). However, the behaviour of all bureaucrats is channelled in the direction of budget maximisation:

> It is *impossible* for any one bureaucrat to act in the public interest, because of the limits on his information and the conflicting interests of others, regardless of his personal motivations. This leads even the most selfless bureaucrats to choose some feasible,

> lower-level goal, and this usually leads to developing expertise in some narrow field. The development of expertise usually generates a sense of dedication, and it is understandable that many bureaucrats identify this dedication with the public interest . . . a bureaucrat who may not be personally motivated to maximise the budget of his bureau is usually driven by conditions both internal and external to the bureau to do just that. (Niskanen, 1971: 39)

If the assumption that bureaucrats *desire* budget maximisation is accepted, then what reason is there for believing that they have the *power* to achieve this goal? Bureaucrats and the political sponsor who approves the allocation of funds are in a position of bilateral monopoly: the bureau is the sole supplier of a service, and the political sponsor is the sole purchaser (a monopsonist). This would appear to bestow equal power on each side, but Niskanen argues that bureaucrats are more powerful than politicians because of the difficulty of measuring service outputs and service costs. The outputs of many public services are difficult to identify: for example, in education, is the output the formal qualifications obtained by students, the improvement in their 'happiness' or the contribution to a 'better society'? In these circumstances, Niskanen argues, the political sponsor is forced to allocate funds in exchange for 'activities', for example, the number of students taught. Not only is output obscure, so is the cost per unit of activity. Niskanen argues that only the bureaucrats know the true cost of delivering the level of activity desired by the political sponsor. It is, therefore, possible for officials to hoodwink politicians into allocating more money than is really required to provide services. By contrast, bureaucrats are able to make an accurate guess about their political sponsor's 'budget-output function' which represents the maximum funds the sponsor is prepared to provide for a given level of service activities:

> there is usually a great disparity in the relative information available to the sponsor and the bureau. A bureaucrat can usually estimate his sponsor's budget-output function quite accurately from previous budget reviews, recent changes in the composition of the sponsor organisation, and recent constituent influences on these officers. As a rule, however, a bureaucrat will know a great deal more about the factor costs and production processes for the

> bureau's services than will the officers of the sponsor organisation. Previous budget-output offers by the bureau sometimes reveal little to the sponsor about the minimum budget that would be sufficient to supply a given output. A bureaucrat needs relatively little information, most of which can be estimated by revealed behaviour, to exploit his position as a monopoly supplier of a given service. The officers of the collective organisation, in contrast, need a great deal of information, little of which can be estimated from revealed behaviour, to exploit their position as a monopoly buyer of this service. (Niskanen, 1971: 29)

The main information which the political sponsor lacks is the *marginal cost* of producing extra units of activity. All the sponsor sees is the *average cost* across the total level of activity produced by the bureau. This provides the bureau with the opportunity to push production well beyond the 'optimum' level where the marginal cost per unit of activity is equal to the marginal value to the sponsor. Thus bureaucratic empires are built on politicians' ignorance about outputs and costs. Even if such information is available, Niskanen argues, political sponsors lack the incentive to monitor bureaucratic performance: 'There is no apparent characteristic of government ... that would make the motivations of the executive and legislators consistent with maximising the total net benefits to the entire population. These officers usually cannot directly appropriate as personal income any part of the net benefits' (Niskanen, 1971: 137). In addition, the members of the 'review committee' responsible for allocating funds to a bureau are usually 'self-selecting' and have a vested interest in the bureau's service. For example, a review committee for a health budget is likely to contain politicians with a high number of hospitals or health service employees in their constituencies. Therefore, the review committee's demand for the bureau's service is greater than the demand of the population at large.

If bureaucrats have the desire and the power to pursue budget maximisation, what are the effects of their self-interested behaviour? According to Niskanen (1971, 1975) the major effects are *oversupply* and *inefficiency* in public service provision: 'given the demand for service represented by the collective organisation, all bureaus are too large, that is both the budget and output of all

bureaus, will be larger than that which maximises the net value to the sponsor' (1971: 49–50). Niskanen compares the performance of a public bureau with a private monopoly and a set of competitive firms. He argues that if 100 units of service output were produced by competitive firms, then a private monopoly would produce 50 units and a bureau as many as 200 units. The private monopoly restricts output in order to raise prices and maximise profits or *net* revenue. By contrast, bureaucrats are motivated by the maximisation of budgets or *gross* revenue. Therefore, the public bureau uses its monopoly power to expand services far beyond the 'equilibrium point' under competition where the marginal cost of production is equal to the marginal benefit to the sponsor. The level of the budget is raised further by bureaucrats' indifference to service costs: no part of any 'efficiency saving' accrues directly to bureau staff, therefore they have no incentive to economise on the use of taxpayers' money.

(c) Summary

A clear practical implication of public choice theory is that competition from private sector organisations can significantly improve the performance of public agencies. If political sponsors can choose between several alternative suppliers, then their relative prices can be compared. This information shifts the balance of power from bureaucrats to politicians, and renders the package offered by each bureau highly susceptible to changes in price. For example, Niskanen (1968: 305) argues that contracting-out is a remedy for the problems of bureaucracy: 'the type of goods and services now provided by bureaus could be financed through government or foundations as is now the case, but the provision of these services would be contracted to private, profit-seeking economic institutions. The bureaucracy, as such, would disappear, except for the review and contracting agencies.' This does not imply that transferring responsibility for a publicly funded service to a private organisation is sufficient to increase efficiency: it is competition in the market that is important, not whether production is public or private. This characteristic of public choice theory can be contrasted with the literature

on 'property rights' which suggests that ownership does affect performance (Miranda, 1994a; Vining and Boardman, 1992)

2. THE EXTENT OF COMPETITION FOR THE PRODUCTION OF LOCAL SERVICES

(a) Competitive Tendering in the UK

There is a long history of 'contracting-out' in UK local government (Ascher, 1987). For example, councils conventionally employed private contractors to build houses and roads; and bought items such as office and computing equipment from private companies. In addition, some authorities decided not to provide services directly because they had insufficient work to occupy an 'in-house' team of staff. For example, the district of Chester-Le-Street in county Durham did not have its own legal section, but instead let contracts for this work to the county council and several private firms (Minogue and O'Grady, 1985). Even some larger councils chose not to produce all of their own services. The London borough of Wandsworth contracted out its refuse collection service to the private sector from 1939 to 1965. This policy was discontinued only when the boundaries of the borough were redrawn following local government reorganisation in London, and the ruling Conservative group lost office to the Labour Party (Institute of Personnel Management, 1988).

However, most local services have traditionally been delivered to the public by council employees. Thus the most important contracts in local government were 'contracts of employment' between councils and their staff, rather than 'contracts for service production' with external agencies. Almost all local authority departments fitted the public choice definition of a bureaucracy: monopoly suppliers of services within their geographical area, and reliant largely on an allocation of resources from their political sponsor rather than fees from customers. Legislation in 1980 brought 'market forces' to bear on services traditionally produced by local authorities themselves. During the twentieth century, most councils had established

a 'Direct Labour Organisation' (DLO) for minor construction projects and the maintenance of highways and houses. The Local Government Planning and Land Act forced councils to seek outside bids for this work, and to accept the lowest external or internal bid, unless there were compelling reasons not to do so (for example, a belief that the service could not actually be provided to the required standard at the price quoted). Thus, in contrast to the previous pattern of *voluntary* externalisation of production, local councils in the UK were for the first time faced by *compulsory* competitive tendering (CCT). The specification of the quantity and quality of service remained the responsibility of the council (the 'client'), but responsibility for delivering the service passed to the organisation which submitted the best bid (the 'contractor). In the event, most contracts were awarded internally and on many occasions no external bids were submitted.

Although the legislation applied only to a very small part of local authority activity, it may have had a wider impact on the competitive climate in which services were provided. There were fears (and, in some councils, hopes) that CCT would be extended to other services, which may have resulted in a pre-emptive search for 'efficiency gains'. Moreover, a minority of councils embarked on a programme of voluntary competitive tendering (VCT) for functions not covered by the CCT legislation. For example, Southend District Council in Essex reached a 'pioneering' decision to contract-out its refuse collection service in 1980 (Evans, 1985); and the London borough of Wandsworth extended its previous policy by contracting-out not only refuse collection but also other functions including leisure services, cleaning of streets and housing estates, and catering in residential homes (Institute of Personnel Management, 1988). However, the great majority of councils retained the monopoly position of their own workforce. Out of 401 councils responsible for refuse collection in England and Wales, only fifty-five had sought competitive tenders for the service by 1986, and in only twenty-nine of these had the winning tender been submitted by a private organisation (Domberger et al., 1986). Furthermore, the limited enthusiasm for VCT was largely restricted to Conservative councils. Only one Labour authority, Delyn District Council in North Wales, contracted-out its refuse collection service (Parker, 1990).

The lack of 'voluntary progress' in competitive tendering led the Conservative government to extend legal compulsion to a range of services in 1988. These services are listed in Table 4.1, which also shows the impact of the legislation on contestability and competition. The figures in the first column show the percentage of councils where service production is exempt from CCT, as a result of 'de minimis' regulations which stipulate that work worth less than £100 000 in total need not be subjected to compulsory competition. The reasoning is simply that the costs of preparing and monitoring small contracts are likely to outweigh any efficiency benefits. The consequence of this exemption clause in the legislation is that the market for some services is not even contestable in many parts of the country. The markets for refuse collection and educational and welfare catering are entirely contestable – all contract values are larger than £100 000; but at the other end of the scale, a substantial number of councils retain their monopoly status in functions such as vehicle maintenance and building cleaning.

Table 4.1: Contestability and Competition in the Market for Local Service Production in the UK

	% councils where service exempt from CCT	*% contracts with no external bids*	*% councils where CCT has resulted in actual competition*
Refuse collection	0	10	90
Grounds maintenance	3	6	91
Building cleaning	28	9	66
Street cleaning	6	10	81
Catering (education & welfare)	0	34	66
Other catering	46	40	25
Vehicle maintenance	39	41	28
Sport & leisure management	5	54	43

Source: Calculated from data in Local Government Management Board, 1996; estimates based on 'live' contracts in England and Wales at May 1996.

The data in the second column of Table 4.1 show the percentage of contracts which attracted no external bidders. In other words, there was contestability but no competition. The absence of external competition is most marked in sport and leisure management, vehicle maintenance and catering – in these services it is not unusual for the council's own Direct Service Organisation (DSO) to be the only bidder for the service contract. By contrast, external agencies submit tenders for at least 90% of contracts in refuse collection, grounds maintenance and cleaning. In these services, the CCT legislation has stimulated genuine competition for most contracts.

The figures in columns one and two of Table 4.1 can be combined to produce a rough estimate of the percentage of councils which have faced actual competition in each service area. These estimates, which are shown in column three, assume that *all* contracts for a function in each council were awarded either with or without competition. To the extent that some contracts attracted external bids while others did not, the figures understate the proportion of councils that have experienced actual competition in each service area. With this caveat in mind, it can be concluded that CCT has resulted in widespread competition in some service areas (e.g. refuse collection, grounds maintenance), but limited challenges to local monopolies in others (especially vehicle maintenance and parts of catering). Thus the extent of competition is substantially less than might be expected from the bare bones of the 1988 legislation. First, the market for local services is not contestable in some councils; and even when the market is contestable, many contracts are awarded to the DSO without an explicit competitive threat from an external agency.

The relationship between the level of actual competition and control of service production by DSOs is explored in Table 4.2. The first column shows the average number of outside bids received per contract in each service area. This ranges from four bids per contract in building cleaning, to less than one bid per contract in sport and leisure management. The figures in the second and third columns indicate the DSO 'success rate' in CCT, as measured by the percentage of contracts won by councils themselves and their share of contract values. The difference between the two measures of success shows that DSOs win a disproportionate share of the largest

contracts, which may indicate that councils are able to take advantage of economies of scale when competing with private contractors. The rank order of the services by percentage of contract won by the DSO is almost exactly the reverse of that for external tenders per contract. For example, the lowest DSO success rate is in building cleaning (42% of contracts), and the highest is in sport and leisure management (82%). These data suggest that the level of competition is strongly linked to the outcome of CCT: the larger the number of external bidders, the less secure is the position of the DSO.

Table 4.2: External Competition and Direct Service Organisation (DSO) Success Rates in the UK

	External tenders per contract	*DSO success rate, % contracts won*	*DSO success rate, % of contract values*
Building cleaning	4.0	42	73
Ground maintenance	3.2	54	72
Refuse collection	2.7	61	65
Street cleaning	2.5	64	74
Vehicle maintenance	1.8	71	80
Catering (other)	1.4	62	75
Catering (education and welfare)	1.2	71	77
Sport and leisure management	0.8	82	90

Data source: As Table 4.1; figures based on 8000 CCT contracts awarded between 1990 and May 1996.

The competitive threat to councils' share of service production varies not only between services, but also across different parts of the UK. Table 4.3 shows the average number of external tenders per contract in the English regions, Scotland and Wales. The level of actual competition declines fairly consistently from the south to the north: the average number of bids per contract is highest in the south-east of England and lowest in Scotland. These geographical variations in private bids to run public services may be linked to the

extent of Labour Party domination of local councils, which tends to be higher in Scotland and the north of England than elsewhere. Also, as Painter (1991: 201) notes, these are areas 'where the trade union movement is particularly strong, and this may have deterred private contractors'. Many Labour councils are hostile to CCT, and approach the process with the explicit intention of retaining responsibility for service production. Colling (1993) provides a fascinating case study of CCT in a Labour county council. He found that 'the tendering process was managed very tightly so as to deter competition wherever possible. Specifications were detailed and comprehensive (one contained 6 pages on how an inside toilet was to be cleaned), the level of competition was restricted to the minimum required by the legislation, and even these contractors were subjected to rigorous scrutiny. The strategy was largely successful in its own terms. All contracts were awarded to in-house services and the level of competition was low' (Colling, 1993: 3). Further insight on the impact of local party politics is provided by a survey of CCT in twenty-three councils in the north of England (Shaw et al., 1994). They found that some Labour authorities allowed 'technically naughty' collaboration between council officers in client and contractor roles. While there is little general evidence of illegal 'anti-competitive' behaviour by councils (Greenwood and Wilson, 1994), such practices may not be necessary to deter private contractors. In a survey of CCT in sport and leisure management, Nicholls (1995: 26) found that 'commercial companies explained their decisions on which contracts to bid for as strongly determined by the political attitude of the authority. After their initial expression of interest, if the local authority was obviously hostile, there was no point in continuing with the bid.'

An alternative interpretation of the geographical pattern of external bids is that, prior to CCT, councils in the north were already more efficient than those in the south. In this case, private contractors may have concentrated their efforts in the south where they would have had more chance of defeating the DSO. However, there is no evidence on the relative efficiency of authorities in different areas to substantiate this view. Whatever the explanation for regional variations in the number of bids per contract, the figures in Table 4.3 suggest that the level of competition faced by councils is

Table 4.3: Regional Variations in External Tenders Per Contract in the UK

	L	*SE*	*SW*	*EA*	*EM*	*WM*	*Y&H*	*N*	*NW*	*Wa*	*Sc*
Building cleaning	5.2	5.5	2.8	5.8	3.2	3.1	2.2	1.3	1.2	1.9	1.0
Grounds maintenance	3.9	4.2	3.7	3.2	3.3	3.7	2.2	2.2	2.2	4.7	1.6
Refuse collection	3.6	3.5	3.3	3.5	2.8	2.8	1.7	2.1	1.8	2.1	1.0
Street cleaning	2.8	3.3	3.2	4.5	2.0	2.5	2.3	1.5	1.8	1.7	0.6
Vehicle maintenance	1.7	1.6	1.9	1.3	1.1	1.9	0.5	0.7	0.6	1.4	0.8
Catering (other)	2.0	2.2	3.0	1.6	1.5	0.7	1.1	0.6	0.8	0.8	1.1
Catering (education & welfare)	2.6	2.9	1.3	2.0	4.5	0.9	0.6	2.5	0.6	0.1	0.8
Sport & leisure management	1.1	1.2	1.2	1.1	0.9	0.5	0.5	0.1	0.4	0.4	0.1
Mean	2.9	3.1	2.6	2.9	2.4	2.0	1.4	1.4	1.2	1.6	0.9
(Rank)	(2=)	(1)	(4)	(2=)	(5)	(6)	(8=)	(8=)	(10)	(7)	(11)

Key

L = London
SE = South East
SW = South West
EA = East Anglia
EM = East Midlands
WM = West Midlands
Y&H = Yorkshire & Humberside
N = North
NW = North West
Wa = Wales
Sc = Scotland

Data source: Local Government Management Board, 1996.

substantially higher in some parts of the country than others. When DSOs were aware of such variations during the tendering process, they tailored their own bids accordingly (see Colling, 1993). In other words, it may be expected that changes in behaviour as a result of CCT would be more pronounced in the south than the north. Furthermore, the likely absence of external competition may have a significant effect on the potential for efficiency savings when contracts are renewed. For example, Kerley and Wynn (1991: 39) note that in Scotland, 'several officers and members have suggested . . . that particularly in light of the results of the first round of tendering with many uncontested in-house bids, unions and staff will be more reluctant to agree any diminution in pay and conditions when preparing future bids'.

During the early 1990s, CCT was extended by the Conservatives to a range of 'white collar' services such as information technology, finance, personnel and housing management. However, the Labour government elected in 1997 is committed to the abolition of CCT. A new regime of 'best value' is to be introduced as an alternative method of promoting the efficiency of service provision. It is possible that competitive tendering will be a part of the new arrangements, but its precise role is as yet unclear. Thus the 'CCT experiment' in UK local government appears to be over. The results of the imposition of compulsory competition, and the implications of the evidence for public choice theory, are evaluated in Chapter 5.

(b) Contracting-out in US Local Government

There has, historically, been less direct service provision by local governments in the USA than in the UK. Many American cities and counties have had a mixed pattern of service production by internal and external agencies. The latter include not only the private sector, but also voluntary organisations and other units of government (e.g. cities may have contracts with other cities, counties or the state). The use of external contractors by local governments became more widespread in the 1970s as a result of fiscal stress. Miranda (1992: 32) argues that 'for nearly two decades, cities throughout the US have experienced difficulties raising revenues. Taxpayer revolts, declining federal aid, and sluggish growth in local economies have

only heightened these difficulties… it was within this context of anti-government sentiment and austerity that privatization became an attractive policy option'.

The pattern of contracting-out in US local government is summarised in Table 4.4. Cities and counties still produce a majority of services themselves, especially personnel, police, information technology and leisure facilities. However, every service is contracted-out in some part of the local government system. Contracts with private organisations are most common for daycare centres, refuse collection and legal services; the services most often produced by the voluntary sector include homeless shelters, museums, daycare centres and mental health programmes; and inter-governmental contracting is frequent in the areas of mental health, transport, homeless shelters and libraries. The extensive use of service contracts for welfare services can be traced to the introduction of inter-governmental funding for these activities in the 1960s. Local governments chose to channel this new money to external agencies for two reasons (see Stein, 1990a). First, municipalities lacked the expertise to expand services quickly, so they relied on existing voluntary and state organisations. Secondly, local policy-makers feared that the new grants would be withdrawn as quickly as they had been introduced, and believed that the programmes could be more easily closed down if they were run by outside organisations rather than their own workforces.

Although contracting-out has grown in the US local government as a whole since the 1970s, there are substantial geographical variations in the use of external producers. A number of empirical studies have attempted to identify why some local governments contract-out more than others. The major explanatory variables which have been investigated include fiscal stress, scale and market structure, public preferences, and the power of public employees. The evidence on the influence of each of these variables is considered in turn.

Fiscal stress

If fiscal stress has caused an increase in contracting-out over time, then it may also explain geographical variations in contracting-out.

When service production is transferred to an external agency, localities under fiscal pressure may be able to maintain service quality and cut costs, and thereby satisfy both service recipients and taxpayers.

Table 4.4: Contracting-out in US Local Government

	(a) % Cities & counties where services produced exclusively in-house	*(b)% Cities and Counties Contracting With*		
		Private Sector	*Non-Profit Organisation*	*Other Units of Government*
Public works & transport				
Residential refuse collection	47	37	1	2
Commercial refuse collection	23	54	1	2
Refuse disposal	32	32	1	27
Street repair	43	29	1	5
Street cleaning	70	17	1	3
Passenger transport	23	20	15	49
Public Safety				
Police	88	1	1	7
Fire	70	14	8	13
Social Services				
Daycare centres	6	54	35	18
Child welfare programmes	16	4	13	63
Elderly welfare programmes	21	6	24	34
Mental health programmes	7	15	29	67
Homeless shelters	0	5	54	40
Leisure and Recreation				
Leisure facilities	75	5	3	11
Parks maintenance	74	10	2	8
Libraries	49	1	4	39
Museums	19	2	37	26

Support Services				
Buildings/ground maintenance	66	20	2	2
Vehicle maintenance	55	27	3	4
Information technology	80	8	1	6
Legal services	38	47	3	3
Personnel services	91	4	0	1

Notes

1. Source: Municipal Yearbook, 1994.
2. Rows may sum to more than 100 because some local units contract for a service with more than one supplier.
3. Rows may sum to less than 100 because some local units provide services in other ways (e.g. franchises and subsidies).

Three main measures of fiscal stress have been used in the empirical studies of variations in contracting-out. First, the ratio of local taxes to local incomes. The hypothesis for this variable is that where the tax burden is high, local governments are more likely to seek savings by contracting-out services. Second, the imposition of limits on local tax levels by state governments. The argument here is that local governments that are subject to such limits cannot expand services or maintain existing services by raising taxes; therefore they are constrained to make better use of existing resources, for example by contracting-out. The third measure of fiscal stress is the share of local spending which is funded by inter-governmental revenues. This is hypothesised to have a negative effect on contracting-out because local governments which are more generously funded are, *ceteris paribus*, under less financial pressure.

The empirical evidence on the relationship between fiscal stress and contracting-out is summarised in Table 4.5. Most of the results are statistically insignificant. Some studies claim to find strong support for the fiscal stress hypothesis, but their results do not substantiate this interpretation. For example, Ferris and Graddy (1988: 282) conclude that 'fiscal forces are consistently important', but only six of sixteen tests yield a positive relationship with contracting-out. Similarly, Morgan et al. (1988: 368) claim that 'the choice of external over internal production is more common when . . . fiscal pressures are prominent', yet only ten of their thirty-six tests

Table 4.5: Evidence on the Impact of Fiscal Stress on Contracting-out in US Local Government

	Tax Burden			*Tax Limit*			*Grants*		
	+	–	(n)	+	–	(n)	+	–	(n)
Ferris, 1986	1	0	(1)	2	0	(2)	1	0	(1)
McGuire et al., 1987	0	1	(1)	–	–		–	–	
Ferris & Graddy, 1988	4	0	(8)	2	1	(8)	–	–	–
Morgan et al., 1988	2	0	(9)	8	0	(18)	1	0	(9)
Stein, 1990a	0	0	(1)	1	0	(2)	0	0	(1)
Morgan & Hirlinger, 1991	0	0	(7)	0	0	(7)	1	0	(7)
Benton & Menzel, 1992	0	0	(1)	–	–	–	0	0	(1)
Chandler & Feuille, 1994	0	0	(2)	2	0	(2)	0	0	(2)
Miranda, 1994c	1	0	(7)	5	0	(7)	0	0	(8)
Hirsch, 1995	0	1	(2)	–	–		0	1	(1)
Mean (%)	19	15		56	2		16	12	

Notes

1. The figures show for each variable that is tested in each study: the number of tests that yield a significant positive relationship with contracting-out (+), the number that yield a significant negative relationship (–), and the total number of tests (n).
2. The mean figures at the bottom of the table show the percentage of tests that yielded significant positive or negative results (see text for details of the method of calculation).
3. – = variable not tested.

support this conclusion. The only measure of fiscal stress which is supported in a majority of the tests is 'tax limits' – almost all of the significant coefficients for this variable are positive. Only one-third of the results suggest that the effect of the local tax burden is significant, and there is almost as much evidence for a negative effect as for the hypothesised positive effect. The theoretical impact of grants is even less strongly supported: only one study finds that grants are inversely related to contracting-out, while three find some evidence that higher grants are associated with greater use of external service producers.

Taken at face value, then, the evidence provides little support for the view that fiscal stress is a significant constraint on decisions to contract-out. However, the validity of these tests of the fiscal stress hypothesis is questionable.

The concept of fiscal stress implies that there is a mismatch between fiscal capacity and service needs; in particular, revenues fail to keep pace with expenditure requirements. Wolman and Peterson (1981: 773) define fiscal stress as 'a situation in which a governmental unit… must, even after accounting for any increase in tax revenues due to an expanding tax base, choose between (1) taking action to increase revenue in order to maintain existing real expenditure and service levels (2) reducing real expenditures and services (3) engaging in some combination of these activities'. Thus local governments which suffer from fiscal stress are trapped by a 'pincer movement' which consists of financial resources on one flank and service needs on the other. However, there are no measures of service needs in the empirical studies and therefore the operationalisation of the concept of fiscal stress is incomplete. This may explain why the evidence in some studies shows that the impact of grants on contracting-out is 'unexpectedly' positive. If inter-governmental funding is targeted on areas with socio-economic problems, then grants may be acting as a crude proxy for service needs (Ferris, 1986).

A further problem is that the variables in the empirical studies are poor indicators even of the revenue side of fiscal pressure. This is because fiscal stress is a *dynamic* phenomenon: the concept refers to relative changes in revenues and service needs. All of the measures of fiscal stress, however, are static. None of the studies seeks to

capture the movement in taxes or grants which preceded contracting-out. Indeed, the direction of causality between the 'independent' and 'dependent' variables is unclear because they are often measured contemporaneously. For example, several interpretations of the statistical results for the relationship between the level of taxes and contracting-out are possible. If the coefficient on the tax burden variable is positive, this implies either that fiscal stress leads to contracting-out, or that contracting-out leads to fiscal stress; similarly, if the coefficient is negative, this implies either that contracting-out is less likely in fiscally stressed cities, or that contracting-out reduces fiscal stress. Confusion concerning the direction of causality is clearly present in some of the empirical studies. For example, Greene (1996) tests a theoretical model in which fiscal stress is the 'independent' variable. However, when the impact of local taxes turns out to negative rather than positive as hypothesised, he states that

> it is not possible to determine cause and effect from these findings. Although it is possible that privatization reduces fiscal pressure, it is also possible that the lack of fiscal stress may promote privatization. That is, cities successful at cutting costs may have a greater tendency to use privatization. Fiscally stressed cities may have too many difficulties coping with their existing situation to introduce a substantial policy change like privatization. (Greene, 1996: 141)

If account had been taken of the potential simultaneity bias in the model, such speculation would have been unnecessary.

Finally, the theoretical relevance of fiscal stress to decisions on contracting-out must be reconsidered. Several surveys of contracting-out have found that 'cost savings' are not the only motive for seeking an external producer (e.g. Florestano and Gordon, 1979, 1980). Many local governments, especially small units, adopt contracting-out in order to improve service quality. This is recognised in a few of the empirical studies (e.g. Morgan et al., 1981; Stein, 1990a), but fiscal stress variables are still included in their statistical models. Within the group of municipalities which contract-out in order to enhance the standard of services, it is likely to be those which are *least* fiscally stressed that can afford to pursue this policy

most vigorously. Higher quality, after all, is likely to command a higher price in the marketplace. Thus, across those local governments which are pursuing service quality, the relationship between fiscal stress and contracting-out may be negative; while across those local governments which are pursuing cost savings, the relationship may be positive. In short, the empirical studies may have falsely combined two distinct sub-groups into a single sample. In this context, a plausible hypothesis would be that the impact of fiscal stress across local governments as a whole would be insignificant, a view which is supported by the general pattern of the evidence produced by the empirical studies.

Scale and market structure

Arguments concerning these two variables focus on the size of the potential cost savings from contracting-out: whereas local governments are supposedly 'pushed' towards external producers by fiscal stress, they are 'pulled' in this direction by the promise of scale economies and a competitive market.

The hypothesis for scale effects is that small local governments are more likely to contract-out in order to achieve economies of scale in service production. Large cities or counties, by contrast, are already big enough to benefit from scale economies, and therefore have less incentive to externalise service production. For example Ferris (1986: 292) argues that 'small governments have little flexibility in managing inputs to avoid underutilization, particularly in the case of services that are capital-intensive or exhibit peak-load demands'. Similarly, Stein (1990a: 47) argues that 'in many instances the comparative advantage for the production of a specific good or service lies outside the municipal government. The scale of production for private producers is often, but not always, more flexible than the jurisdictional borders that define the scale of production for a governmental unit.'

All of the empirical studies which test the impact of scale use population size as a measure of this concept. The evidence on the relationship between population and contracting-out is shown in Table 4.6. Only around one-quarter of the results support the hypothesis that smaller local governments are more likely to use

external contractors. By contrast, over one-third of the results suggest that contracting-out is more common in large authorities. Furthermore, even when contracting-out does decline with scale, some studies find that this relationship is reversed in the local governments with the largest populations (Ferris and Graddy, 1988; Hirsch, 1995). This may reflect the 'purchasing power' of the biggest cities which can negotiate favourable terms for large contracts (Ferris, 1986). The balance of the evidence, then, is inconsistent with the scale hypothesis. There are, however, two substantial deficiencies in the empirical tests.

Table 4.6: Evidence on the Impact of Scale and Market Structure on Contracting-out in US Local Government

	Population Size			*Metropolitan Status*		
	+	–	(n)	+	–	(n)
Morgan et al., 1981	2	1	(5)	0	2	(5)
Ferris, 1986	1	0	(1)	0	0	(1)
McGuire et al., 1987	0	1	(1)	0	0	(1)
Ferris & Graddy, 1988	1	3	(8)	2	3	(8)
Morgan et al., 1988	5	0	(8)	0	0	(9)
Stein, 1990a	0	0	(1)	0	0	(1)
Morgan & Hirlinger, 1991	–	–		5	0	(7)
Benton & Menzel, 1992	0	0	(1)	1	0	(1)
Chandler & Feuille, 1994	2	0	(2)	–	–	
Miranda, 1994c	2	0	(8)	0	0	(8)
Hirsch, 1995	0	1	(1)	1	0	(1)
Greene, 1996	–	–		0	2	(2)
Mean (%)	35	26		30	18	

Note
For explanation of figures, see notes to Table 4.5.

First, population size is an inappropriate measure of the scale of service production. The theory of economies of scale is concerned with the impact of service *output* on unit costs, not the impact of the number of local inhabitants (Boyne, 1995). Service outputs vary considerably across areas with the same population size, depending on their socio-economic characteristics and political preferences.

Furthermore, the empirical studies ignore the difference between 'plant-level' and 'firm-level' economies of scale. The use of population figures in the statistical tests effectively assumes that scale effects are a function of the size of a local authority as a whole, not the size of individual libraries, leisure facilities or social service centres. However, evidence on scale economies in the private sector suggests that it is the output of separate plants which is the key to efficiency, not the output of whole firms (Shepherd, 1990). This has two implications for testing the effects of scale on contracting-out. First, it may be only those local governments which cannot reach the minimum efficient scale of plant operation which have an incentive to contract-out. Second, the 'threshold' size of plant is likely to vary across the services that a local government produces, and scale effects should therefore be tested separately on each service. An aggregate measure of service output for all services (let alone population size) may be weakly related to the relevant measure of scale for individual services.

A second problem with population size is that this variable may be acting as a proxy for the composition of municipal service portfolios. Large cities provide a wider range of services than small cities, therefore a positive coefficient for a population variable may simply indicate that such services are more likely to be contracted-out, not that population *per se* is important. For example, Stein (1990a) argues that redistributive services are more often provided by larger (and older) cities. These services (such as child welfare and elderly welfare programmes, homeless shelters and mental health programmes) are more likely to be contracted-out than any other group of services (see Miranda and Anderson, 1994). Thus the pattern of municipal services should be held constant when scale effects on contracting-out are tested. Some statistical models do contain variables which measure the percentage of municipal spending on redistribution (Stein, 1990a; Miranda, 1994c). However, their measure of scale is population size, so the results for scale effects are still unreliable.

Turning to market structure, the argument is that local governments with access to a competitive service market are more likely to contract-out. First, a larger number of potential suppliers represents a greater opportunity for transferring production to an external

agency; and secondly, a market with many suppliers is more likely to be competitive and thereby offer higher cost savings. The measure of market structure which is used in almost all of the empirical studies is whether a local government is located inside or outside a metropolitan area. The hypothesis is that non-metropolitan cities and counties have less incentive to contract out because 'they are less likely to face a competitive supply of external producers' (Ferris, 1986: 298). By contrast, local governments in metropolitan areas 'have the best of all possible worlds. The competitive nature of their market provides these cities with lower contract costs. The specialization present in larger markets provides the opportunity to target contracts to components of service responsibility, retaining the balance for other specialized vendors or for municipal provision or production' (Stein, 1990a: 125). This argument applies not only to the availability of private contractors in metropolitan areas, but also to the role of other governments as potential contractors. According to Morgan and Hirlinger (1991: 134–5), 'metropolitan cities, regardless of size, should have considerable access to other governments and thus have abundant intergovernmental sources of supply'.

The statistical results for the relationship between metropolitan status and contracting-out are summarised in Table 4.6. Around one-third of the evidence is consistent with the hypothesis that contracting-out is more common in metropolitan areas. By contrast, almost one-fifth of the evidence implies that metropolitan local governments are less likely to contract-out, while the remaining tests find an insignificant relationship between these variables. Some studies which claim to find strong support for the metropolitan measure of market structure seem to 'overinterpret' their evidence. For example, Ferris (1986: 306) argues that his results support the view that 'the selection of external production is more likely when there is a greater degree of competitiveness in supply'. This conclusion is based on the regression coefficient for a variable which distinguishes between 'large metropolitan city' (coded 0) and 'non-metropolitan city' (coded 1). The coefficient on this variable is significantly negative; however, the coefficient on a variable which distinguishes between 'large metropolitan city' and 'small metropolitan city' is also significantly negative. Therefore Ferris'

results imply that it is size rather than metropolitan status which matters. Similarly, Morgan et al. (1988: 367) conclude that 'above all… the availability of suppliers is a critical factor in deciding to contract across a variety of services'. Their method of analysis is similar to that used by Ferris. They find that, within metropolitan areas, large cities are more likely to contract-out than small and medium-sized cities; and that large metropolitan cities contract-out more than non-metropolitan cities. However, there appears to be no significant difference in the level of service contracting between metropolitan and non-metropolitan areas of the same size. Therefore the conclusion that metropolitan status matters is unjustified.

It would, however, be premature to reject market structure as an explanation of contracting-out. The mixed and mostly insignificant results for the metropolitan variables may reflect problems of measurement rather than conceptualisation. The indicators of metropolitan status may be picking up the market structure in both the private sector and the local government system. Whereas more competition in the private market may increase the attractiveness of contracting-out, more competition between local governments may mean that contracting-out is unnecessary because efficiency is already high. This view is supported by Miranda (1994c) who finds that, when metropolitan status is held constant, there is a negative relationship between the number of city governments in a state and the level of contracting. Thus the metropolitan measure of market structure may be picking up two countervailing effects: a positive effect from competition in private markets, and a negative effect from competition in public markets. The implication is that these two dimensions of market structure need to be tested separately in models of contracting-out.

Public preferences

Whereas fiscal stress, scale and market structure can be viewed as 'economic constraints' on contracting-out, the preferences of the local population may be interpreted as a political constraint. The theory which underpins measures of public preferences is that local policy-makers pay attention to the demands of their constituents:

the greater the political pressure to limit the role of local governments, the greater the level of contracting-out.

Two main aspects of public preferences have been included in the empirical studies. First, the average income of the local population. Tests of this variable are based on the assumption that high-income groups are opposed to state intervention and therefore support contracting-out in order to cut taxes and spending. For example, Hirsch (1995: 235) argues that 'because higher income individuals tend to be politically more conservative than lower-income individuals and, therefore, are more likely to be ideologically opposed to large government, they can expect to be also more favourably disposed to contracting out government services'. A similar point is made by Greene (1996: 139): 'tensions between the wealthy and poor over redistributive benefits cause wealthy residents to attempt to limit the scope of functional responsibility of their cities. This could provide an impetus to privatize.'

The second dimension of public preferences which has been tested concerns the size of groups who are assumed to favour direct municipal production. Measures of these groups in the empirical studies include the percentage of the local population which is poor, black or elderly. These variables may be negatively related to contracting-out for four reasons. First, contracting-out may be perceived as a threat to the very existence of a service. As Ferris (1986: 294) argues, 'the elimination of a government department may signal a weakening public sector commitment to the particular service . . . (therefore) contracting out is more likely to occur in jurisdictions where public service constituencies have relatively less influence on service delivery choices'. Secondly, minority groups may not only receive fewer service benefits if a service is contracted-out, they may also have fewer job opportunities. Ferris and Graddy (1988: 277) note that this may be linked to local policies on redistribution: 'the ability to achieve distributional goals, such as increased minority hiring or targeted benefits, is less certain through contract specification . . . Public officials can more easily tailor benefits to politically "worthy" groups via public production. Private firms are more likely to dole out benefits as cheaply as possible, but not in a politically optimal way. To the extent that such distributional goals are important, the prospects for contracting out

diminish'. Thirdly, local officials may believe that the political costs imposed by constituency groups are likely to outweigh any efficiency gains. McGuire et al. (1987: 216) argue that 'constituents may impose costs on decision makers who select input utilization patterns contrary to their preferences. These costs may result from protest activities or other actions . . . the bureaucracy is likely to prefer less of these costs rather than more'. And finally, pressure groups who oppose contracting-out are likely to be better organised than taxpayers in general. Thus, according to Ferris (1986: 295), 'opposition to contracting out, rather than support for it, is likely to be articulated in fiscal policy processes'.

The empirical evidence on the impact of public demands is summarised in Table 4.7. There is considerable support for the hypothesised effects of income and poverty on contracting: three out of five studies find that the impact of income is positive, and three out of four studies find some evidence that the impact of poverty is negative. However, as these two variables are inverse proxies for each other, it is impossible to tell from the results whether contracting-out is influenced by pressure from high-income groups, low-income groups, or both. Another problem is that the measures of income and poverty conflate preferences and ability to pay. The inhabitants of prosperous areas may prefer contracting-out, but can more easily afford public production (which, by assumption, is more expensive). Similarly, the local population in poor communities may be opposed to external production, but find it difficult to afford municipal suppliers. It is unclear, therefore, whether the evidence on these measures of 'public preferences' should be taken to indicate the influence of economic or political constraints.

In contrast to the results for the income and poverty variables, there is very little support for the hypothesised effects of the percentage of local residents who are black or elderly – most of the results for these variables are insignificant. Some studies, nevertheless, seek to draw strong conclusions from such evidence. For example, Morgan et al. (1988: 368) claim that their results demonstrate that contracting-out is more common in localities where 'a lower proportion of the cities' population is composed of dependent populations'. However, only five of twenty-nine tests yield the significantly negative coefficients which are required to support this inference.

Table 4.7: Evidence on the Impact of Public Preferences on Contracting-out in US Local Government

	Income			*% Poor*			*% Black*			*% Elderly*		
	+	–	(n)	+	–	(n)	+	–	(n)	+	–	(n)
Ferris, 1986	–	–		0	1	(1)	0	0	(1)	0	1	(1)
McGuire et al., 1987	0	0	(1)	–	–		–	–		–	–	
Ferris & Graddy, 1988	–	–		–	–		3	0	(8)	1	0	(8)
Dubin & Navarro, 1988	1	0	(1)	–	–		–	–		–	–	
Morgan et al., 1988	–	–		0	4	(9)	1	1	(9)	0	0	(9)
Morgan & Hirlinger, 1991	0	1	(7)	–	–		1	0	(7)	0	3	(7)
Benton & Menzel, 1992	–	–		0	0	(1)	0	0	(1)	0	0	(1)
Miranda, 1994c	–	–		0	4	(7)	–	–		–	–	
Hirsch, 1995	1	0	(1)	–	–		–	–		–	–	
Greene, 1996	2	0	(2)	–	–		–	–		–	–	
Mean (%)	60	3		0	50		10	2		2	29	

Note
For explanation of figures, see notes to Table 4.5.

A major weakness in almost all of the empirical studies is that preferences are inferred from the socio-economic characteristics of the local population. Only two studies attempt to measure local preferences more directly. Hirsch's (1995) model of local contracting-out includes the pattern of presidential voting at state level and the party affiliation of the state governor. The impact of these variables is insignificant. Hirsch argues that this 'suggests that ideology and politics may not be a major determinant in the decision to privatise' (1995: 237). However, as he concedes, the measures of public preferences may be insignificant because they were measured at the state rather than the city level. This problem is avoided in the study by Dubin and Navarro who use the degree of support for the Democrats in each municipality 'to proxy the ideological preferences of the community as revealed by party preferences' (1988: 225). They find that this variable has a highly significant negative relationship with the external production of refuse collection services. It would be unwise to generalise on the basis of a single study, but this evidence does suggest that the importance of public preferences is likely to emerge if direct measures are used at the appropriate spatial scale.

Power of public employees

Arguments on the role of local government staff draw heavily on public choice theory. In most empirical studies it is assumed that local government managers and their workforces have selfish interests which they pursue at the expense of the public interest. For example, Dubin and Navarro (1988: 221) argue that selfish behaviour 'should lead labor interests to lobby policymakers in support of government intervention in the form of public monopoly because this form of noncompetitive market organization is more likely to generate distributable rents than a competitive private market or a competitive private monopoly'. Four main measures of the power of local government employees have been tested: the ratio of staff to the local population, the level of unionisation, the level of wages, and whether the structure of municipal government is council-manager rather than mayor-council. For each of these variables, two contradictory arguments have been proposed: either the impact of

public employee power on contracting-out is negative because there is more opposition to contracting-out, or it is positive because the potential benefits of contracting-out are greater.

In most of the empirical studies a negative relationship between 'municipal employees per capita' and contracting-out is hypothesised. For example, Ferris and Graddy (1988: 277) argue that 'because contracting out reduces the size of public organisations, we would expect public employees to resist it given the threat to their jobs'. This resistance could be expressed by employees in their role as producers (e.g. through strikes) or in their role as citizens (e.g. by voting against politicians who advocate contracting-out). The latter point is emphasised by Miranda (1994c: 247): the larger the workforce, 'the more likely politicians will represent them in a governing coalition . . . political leaders recognise that municipal employee unions endorse and provide campaign contributions to candidates for local offices'. However, while the number of employees per capita may be linked to the level of opposition to contracting-out, it also raises the incentive to find an external supplier. Larger organisations may offer more potential for cost savings. These contradictory theoretical effects of the size of the workforce are recognised by Chandler and Feuille (1994).

The ambiguous relationship between public employee power and contracting-out is also reflected in arguments on the impact of unionisation. Some authors predict that, on balance, the impact of unionisation is likely to be negative: 'cities with large and influential public sector unions and relatively little unionization in the private sector are likely to contract out relatively little of their solid waste disposal services, even though they are likely to have incentives to do so' (Hirsch, 1995: 235). By contrast, in other studies the net impact of unions is expected to be positive: 'public employee unions have been successful in winning wage premiums and other favorable job conditions. Therefore, we expect that the more unionised the labor force, the greater would be local government's incentive to contract out. Of course, this effect might be muted to the extent that the union has been able to win concessions that protect the jobs and income of their members' (Ferris and Graddy, 1988: 281).

Some authors hypothesise a straightforward positive relationship between local public sector wages and contracting-out. For

example, Stein (1990a: 102) argues that 'since labor costs are the largest component of municipal service provision, I expect the ratio of municipal salaries to private sector salaries to be positively related to the incidence of nondirect service modes' (see also McGuire et al., 1987: 219). Other studies, however, recognise that this variable may contain contradictory influences on production choices. Chandler and Feuille (1994: 58) note that public sector wages indicate not only the level of potential cost savings from contracting-out, but also the political power of public employees.

The final public employee measure reflects the power of the most senior manager in a city government rather than the power of the workforce. The top officials in council-manager systems are assumed to be more powerful than their counterparts in mayor-council systems. Thus the level of contracting-out is expected to differ significantly between the two types of governmental structure. Whether the use of external agencies is higher or lower in council-manager systems will depend on bureaucratic preferences. In some studies, the presence of a city manager is expected to lead to more contracting-out. This argument is based on a version of Tullock's (1965) 'promotion maximization hypothesis'. For example, Ferris (1986: 294–5) argues that 'city managers are highly mobile and participate in a highly competitive labor market. A history of cost-efficient management should enhance the individual's market value... Hence cities with city managers are likely to have a higher propensity to contract out' (see also, Stein, 1990a: 87). However, it has also been observed that senior officials fear a 'loss of control' if production of a service is externalised; in this case, city-managers may resist pressure from politicians to contract-out. According to Ferris and Graddy (1988: 276), contracting-out reduces the 'ability to manage the service delivery process, thereby potentially threatening the continuity of service delivery, the service quality, and the ability to achieve distributional objectives. Although the importance of a particular control concern varies by service, some aspect of control is likely to be important for most services.'

The net impact of the measures of public employee power on contracting-out is therefore theoretically unresolved. It is unclear whether the hypothesised effect of these variables is positive, negative or insignificant (if the two counteracting effects cancel each

other out). A little clarity is added by the empirical evidence, which is summarised in Table 4.8. A majority of the tests of employees per capita point towards a negative relationship with contracting-out. The evidence on the level of unionisation is much more mixed, but suggests that, on balance, this variable also has a negative effect on service contracting. On the basis of such results, Ferris (1986: 304) concludes that 'clearly, the political power of public employees is a major impediment to the adoption of external production by cities'. The tests of the third measure of the power of the workforce, however, suggest the opposite conclusion. Two studies find that labour costs have a positive effect on contracting-out, while only one study finds any evidence of a negative effect (see Table 4.8).

A fundamental problem with all of this evidence concerns the direction of causality between the employee measures and contracting-out. The results are derived from cross-sectional static models, and therefore the coefficients may contain the influence of external service production on the size, unionisation and wages of the local government workforce. For example, the negative coefficient on employees per capita may reflect the fact that the number of municipal staff must be lower, *ceteris paribus*, if production is undertaken by an external agency. In this case the evidence simply confirms an inevitable consequence of contracting-out, rather than revealing the impact of employee power. An additional difficulty with this variable is that the number of staff may be largely determined by local socio-economic and political circumstances. Therefore, the extent to which the largest workforces are also the most powerful is unknown. A more relevant measure would be whether local governments appear to be 'understaffed' or 'overstaffed' when local circumstances are taken into account (Boyne, 1987b).

Stein (1990a) claims to have circumvented the problem of causal interpretation by including both the size of the workforce and the level of unionisation in his statistical model. He recognises that the size of the workforce may be influenced by the level of service contracting, but claims that 'a significant and negative effect on the incidence of nondirect modes of service arrangement, accompanied by a negative public employment effect, represents strong evidence for a pressure group explanation of contracting. A negative relationship between contracting and public employment, in the

Table 4.8: Evidence on the Impact of Public Employees on Contracting-out in US Local Government

	Employees per capita			*Unionisation*			*Public Labour Costs*			*Council-Manager Government*		
	+	–	(n)	+	–	(n)	+	–	(n)	+	–	(n)
Morgan et al., 1981	–	–		–	–		–	–		2	0	(5)
Ferris, 1986	0	1	(1)	0	0	(1)	1	0	(1)	0	0	(1)
McGuire et al., 1987	–	–		0	0	(1)	1	0	(1)	–	–	
Ferris & Graddy, 1988	0	6	(8)	1	2	(8)	–	–		1	0	(8)
Dubin & Navarro, 1988	–	–		0	1	(1)	–	–		–	–	
Morgan et al., 1988	0	7	(9)	1	0	(9)	0	0	(9)	1	0	(9)
Stein, 1990b	0	1	(1)	0	0	(1)	0	0	(1)	0	0	(1)
Morgan & Hirlinger, 1991	0	1	(7)	0	0	(7)	0	3	(7)	4	0	(7)
Benton & Menzel, 1992	–	–		–	–		–	–		0	0	(1)
Chandler & Feuille, 1994	0	0	(2)	0	2	(2)	0	0	(2)	0	0	(2)
Miranda, 1994c	0	6	(7)	1	4	(7)	0	0	(8)	3	0	(7)
Hirsch, 1995	–	–		0	1	(1)	–	–		–	–	
Mean (%)	0	64		14	38		29	6		18	0	

Note
For explanation of figures, see notes to Table 4.5.

absence of a strong union effect, is interpreted as the influence of prior usage of nondirect service modes' (Stein, 1990a: 88). However, if there is an incentive to contract-out the most heavily unionised services in order to overcome restrictive working practices, then contracting-out may have a negative effect on both the size of the workforce and the level of unionisation. Therefore a control for the level of unionisation does not transform employees per capita into an exogenous variable. A more appropriate solution would have been to include the measures of contracting-out and employee power in a system of simultaneous equations.

The only study which finds a negative relationship between public labour costs and service contracting has an especially severe causality problem (Morgan and Hirlinger, 1991). This is because the measure of public employee power is the percentage of city spending which consists of direct labour costs. Morgan and Hirlinger's interpretation of the negative coefficient on this variable is that 'those cities providing a larger proportion of municipal services through intergovernmental arrangements have lower labour costs. Such results imply that officials who want to keep payroll costs down may find intergovernmental contracts to be an attractive option' (1991: 135). However, contracting-out must lead to a reduction in direct payroll costs, even if service expenditure is maintained. In other words, it is not high labour costs which lead to contracting-out, but contracting-out which, of necessity, reduces the labour cost share of the municipal budget.

In sum, the empirical tests do not allow a clear interpretation of cause and effect between public employee power and external service production. Nor does the evidence resolve the theoretical ambiguity concerning the positive or negative impact of the local government workforce on contracting-out. The statistical results also shed little light on the influence of the council-manager form of government. No study finds any evidence of negative effects on contracting-out, which implies that senior managers' desire for service control does not dominate their quest for career advancement. However, less than one-fifth of the results show a positive relationship with service contracting, and only Morgan and Hirlinger (1991) find that over half of the coefficients for this variable are positive. A unique feature of this study is that it contains a direct

measure of 'managers' desire for control of local services', which has a uniformly negative relationship with service contracting. This evidence implies that, when the desire for service control is held constant, the coefficient on a council-manager variable picks up the 'promotion' element in officials' utility functions.

(c) Summary

The empirical studies offer little insight on the determinants of variations in contracting-out – the results for the explanatory variables are insignificant in the vast majority of cases. The hypotheses for only three of the thirteen variables which have been examined in this section are supported in a majority of tests (tax limits, income and employees per capita). Furthermore, the statistical models are suspect in a number of other conceptual and technical respects (Boyne, 1998). The poor statistical performance of the models is confirmed by R^2s which are usually less than 20%, and sometimes as low as 5% (for example, Morgan et al., 1981; Ferris, 1986; Morgan et al., 1988; Stein, 1990b; Morgan and Hirlinger, 1991; Miranda, 1994b). These levels of statistical explanation are well below the average for cross-sectional analyses of local policy variation (Boyne, 1985). Size of R^2 is not everything in statistical analysis, but it is something. At the very least, the low R^2s reinforce the conclusion that the causes of geographical variations in service contracting across US local governments remain largely unknown.

CONCLUSION

Public choice theory argues that public service production has conventionally been in the 'grip-like vice' of bureaucratic monopoly. The consequence is that the wrong services are supplied in the wrong quantities at the wrong price. By contrast, if public services are exposed to competitive pressures then greater efficiency and responsiveness will be secured. Partly on the basis of such reasoning, an extensive programme of competitive tendering has been introduced in the UK, and many services have been contracted-out in the USA. Seldom has an abstract theory of the behaviour of public

officials had such a profound effect on the practice of public service production.

In the UK, a range of functions which were previously dominated and controlled by public sector workers have been 'opened up' to external competition. At the very least, the market for these services became contestable in the 1980s and 1990s. The level of actual competition varied across services and between geographical regions, for reasons which remain largely unexplored. Nevertheless, the extent of external competition for service production increased in all local areas as a result of CCT. In the USA, voluntary contracting-out of local services has become more widespread since the 1970s. However, despite extensive empirical analyses, the reasons why contracting-out is more prevalent in some localities than others have not been identified. Furthermore, the evidence on service contracting in the USA does not permit clear conclusions on the exact level of competition in different parts of the local government system. First, even services which have been retained 'in-house' may have been subjected to competitive bidding; secondly, services may have been externalised without competition from other potential suppliers or the local government agency itself.

Although a direct comparison of the extent of competition in the UK and USA is difficult, there is one important common feature in the pattern of local service production. Where services have been exposed to competition, most of the 'business' has been retained by the local government workforce. There are at least two interpretations of this outcome. First, a public choice perspective would be that bureaucrats have manipulated the process of competitive bidding in order to protect their empires. Secondly, it may be that public suppliers were already efficient, and therefore were able easily to defeat bids from external rivals. In this case, competitive tendering and contracting-out are unlikely to be associated with substantial improvements in performance. The validity of this view is examined in the next chapter.

5 The Effects of Competition between Public and Private Producers of Services

The aim of this chapter is to evaluate empirical evidence on the impact of external competition for local service production. Three specific hypotheses can be derived from the public choice arguments on bureaucratic behaviour that were outlined in Chapter 4. The first hypothesis is that competition is associated with lower spending on those services that are produced by an external agency. The rationale here is simply that if monopoly results in budgetary growth, then a consequence of competition should be lower expenditure than would otherwise occur. By how much will expenditure fall as a result of service contracting? Niskanen's (1971) analysis of the difference between public monopoly and private competition may seem to imply that expenditure will be cut in half. However, his argument concerns the relative levels of service *output* produced by public and private organisations. It is important to emphasise that competition for service production does not necessarily entail any decline in the level of output. Indeed, external agencies which win contracts are typically required to maintain the service standards that were previously supplied by the local government's own workforce. In this case, spending cuts will be proportional to improvements in efficiency. In other words the reduction in expenditure will match the decline in unit costs, which in turn depends on the relative efficiency of monopolistic and competitive arrangements for service production. Public theory offers no precise judgement on this issue and, therefore, no specific hypothesis on the size of the expenditure cuts that result from service contracting.

A second public choice hypothesis is that competition is associated with an improvement in the technical efficiency of service

production. Under service contracting, rival agencies may submit bids to deliver a specified quantity and quality of service. The lowest bid is likely to win the contract, provided that the proposals for service production are credible. Thus the cost per unit of output should fall as a result of competitive tendering. In effect, competition solves part of the 'monitoring problem' emphasised by public choice theorists, because alternative unit costs are generated by the bidding process. At the very least, an external estimate of production costs can be compared with the existing expenditure of the municipal agency. Although service contracting can be expected to improve technical efficiency, it has no necessary impact on responsiveness: decisions on the nature and distribution of the services remain the responsibility of politicians and officials. Service contracting does not enhance the power of the consumers of services, local taxpayers or the public in general. At worst, it is possible that this form of competition simply results in the cheaper provision of services for which there is no genuine demand.

The third hypothesis is that a substantial part of any 'efficiency gain' from competition will be retained by the local government. It is important to stress that contracting will result in lower spending only for those parts of a service which are externally supplied. There is no suggestion in public choice theory that competitive tendering will lead to lower spending in the local government system as a whole. Indeed, by assumption, the most senior officials in a local authority are themselves budget maximisers. If bureaucrats were subject to no effective scrutiny, then any expenditure savings from contracting-out would be retained completely within the local government budget. However, political sponsors possess some power, and can buy votes with low taxes as well as high services. Therefore some part of the money saved by service contracting is likely to be returned to local taxpayers; but how much will simply be recycled within the local government budget? Public choice theory does not offer a specific prediction on this issue, but the literature on grant effects on local spending provides some guidance. There is evidence that local expenditures are much more responsive to an increase in grants than to an equivalent increase in local incomes. This has been termed the 'flypaper effect' because the grant revenue 'sticks where it hits'. A rise in local incomes of 10% may

result in expenditure growth of only 1%, but a 10% increase in grants may produce expenditure growth of as much as 4–7% (see Boyne, 1996a). Whereas grants are 'outside' money, any saving from service contracting is already inside the local government budget, and may be even less likely to be returned to local taxpayers. Therefore it may be hypothesised that the 'retention rate' for efficiency savings will be at least as great as that for grants-in-aid.

1. IMPACT OF COMPETITIVE TENDERING IN THE UK

There are two main types of empirical study on the effects of competitive tendering. First, cross-sectional statistical studies, which are typically used to analyse the effects of voluntary competitive tendering (VCT) on service spending and efficiency. These studies usually test multivariate models which contain measures of service quantity and quality and other variables that influence expenditure. If the coefficient on a variable which measures the presence of VCT is negative, it can be inferred that competitive tendering leads to lower spending; and, if service standards are held constant, higher efficiency. The source of the extra efficiency may be a smaller workforce, lower pay, or greater productivity per member of staff, for example because of better management or more capital-intensive methods of working (see Berenyi and Stevens, 1988).

A second, and cruder, type of study is typically used for the evaluation of compulsory competitive tendering (CCT). This method of analysis involves the comparison of service costs and quality before and after CCT, in either a single local authority or a survey of a group of authorities. These longitudinal analyses are usually less sophisticated than cross-sectional studies because few make any attempt to hold other relevant variables constant. Direct inferences on the validity of public choice theory can be drawn only if it is assumed that the observed changes in service costs and standards are solely (or largely) attributable to CCT. In the clearest case, if spending falls while quality remains constant then, as public choice theory predicts, efficiency has improved. Of course, efficiency may improve after CCT even if spending rises; but an expansion of

service provision as a result of competition is not consistent with public choice models of bureaucratic behaviour.

The results of the empirical studies of competitive tendering are summarised in Table 5.1. The evidence includes four analyses of VCT and five of CCT. All of the results suggest that competition is associated with a reduction in expenditure. Furthermore, five studies find that competitive tendering had no effect on service quality, and one finds that quality improved. In general, then, the results of six of the nine studies are consistent with the view that competition leads to higher technical efficiency in local service production. Moreover, there is no evidence whatsoever that the impact of competitive tendering is higher expenditure or lower efficiency. Two studies find that competition is associated with lower spending *and* lower service quality. However, the implications of these results for efficiency are unclear because the relative decline in expenditure and quality is unknown. If the percentage fall in spending is less than the fall in quality then efficiency is lower, and vice versa.

Thus the empirical evidence appears to provide strong support for public choice hypotheses on the effect of competition on public services. Furthermore, taken at face value, the results offer a resounding endorsement of the Conservatives' imposition of CCT on local government. Left to their own devices, it is unlikely that many authorities in the 1980s and 1990s would have voluntarily subjected their services to external competition, especially as local councils were increasingly dominated by Labour. The results of the empirical studies imply that CCT broke the monopoly power of local bureaucrats and thereby curbed extravagance and inefficiency in local government. However, it is inappropriate to rush to judgement on the basis of this empirical evidence. Before firmer conclusions can be drawn, it is important to analyse the methodology of studies in detail and to evaluate the validity of their conclusions.

(a) Voluntary Competitive Tendering

Cope (1995) provides a case study of VCT in the school cleaning service in Kent County Council. His aim is to assess 'whether cost savings materialised or not and whether school cleaning standards improved or deteriorated as a result of the decision to privatise school

Table 5.1: Results of Studies of Competitive Tendering in UK Local Government

(a) Voluntary Competitive Tendering

Study	*Service & Sample*	*Impact on Expend-iture*	*Impact on Quality*	*Impact on Efficiency*
Cope, 1995	School cleaning in Kent	Lower	Lower	Unclear
Hartley & Huby, 1985	Building maintenance, cleaning, refuse collection, 75 councils	Lower	No change	Higher
Domberger et al., 1986	Refuse collection, 305 councils	Lower	No change	Higher
Szymanski & Wilkins, 1993	Refuse collection, 366 councils	Lower	No change	Higher

(b) Compulsory Competitive Tendering

Study	*Service & Sample*	*Impact on Expend-iture*	*Impact on Quality*	*Impact on Efficiency*
Chaundy & Uttley, 1993	Refuse collection, 37 councils	Lower	Better	Higher
Knox & Young, 1995	Refuse collection, street cleaning, 15 councils	Lower	Unknown	Unknown
Szymanski, 1996	Refuse collection, 365 councils	Lower	No change	Higher
Walsh & Davis, 1993	Eight services, 40 councils	Lower	No change	Higher
McMaster, 1995	Six services, 9 councils	Lower	Lower	Unclear

cleaning' (1995: 30). The Kent case is unusual in that there was no in-house bid – the trade unions boycotted the whole process because they believed (correctly) that competitive tendering would lead to fewer staff, lower wages and poorer conditions of employment. Thus the only competition was between the private agencies which sought to win contracts for cleaning the 500 schools and colleges in the county. The contracts were distributed between five private cleaning companies in 1983.

The outcome of VCT, Cope argues, was lower spending *and* lower service standards, which implies an indeterminate impact on technical efficiency. There are, however, doubts about the extent of the decline in expenditure and service quality. Cope cites ten different estimates of the cost implications of employing private contractors. These range from a reduction in spending of £1.4m to an increase of £0.4m in the first year. To some extent, the different figures reflect different assumptions about redundancy payments to the council's workforce. If these redundancy costs were all borne in the first financial year then there was a net initial cost of VCT, but this was heavily outweighed by anticipated savings in subsequent years. Although Cope's conclusion on spending appears accurate, his judgement of the impact of VCT on service quality is more questionable. His assessment that service standards declined following VCT is based largely on 'before and after' data on the percentage of schools satisfied with the standard of cleaning. The figures are 95.9% and 93.6% respectively which, Cope argues, 'shows a very slight general deterioration in standards of cleaning in the Council's schools and colleges'. Indeed, the reduction is so slight, that the change is probably statistically insignificant – it could easily reflect random fluctuations in perceptions of cleanliness. The safest judgement therefore, is that there was no change in service standards after VCT. Two other pieces of evidence support this view. First, the cleaning contracts were designed to maintain the previous level of service. Secondly, the very process of VCT resulted in greater attention to standards of cleanliness. For example, a new system of fortnightly reporting by schools was introduced when the private contractors began providing the service. As Cope (1995: 38) notes, 'The same dust, unnoticed before privatisation, was noticed because of privatisation.' If this evidence of no signi-

ficant change in service quality is combined with the estimates of lower spending, then it appears that VCT resulted in not only lower costs but also higher efficiency.

Broader evidence on VCT in local government is provided by Hartley and Huby (1985) who obtained data on cost savings from a survey of seventy-five councils. The services covered in this study included building maintenance, cleaning and refuse collection. The average cut in spending as a result of VCT was estimated at 26%, with a range from savings of 68% to extra costs of 28%. It is not clear from the presentation of the data whether these figures relate only to direct service costs, or also take account of the costs of preparing and monitoring contracts and making staff redundant. Another problem with the evidence is that in around one-quarter of the contracts there was no in-house bid. The number of private bidders in these cases is also unknown – there may have been no actual competition. Any efficiency savings may simply have resulted from a transfer of responsibility for the service to a private company, rather than from rivalry between public and private providers, or from competition between private bidders. In other words, the estimates of changes in spending after VCT may partly confuse the effects of competition and *ownership*. Finally, the response rate to Hartley and Huby's questionnaire was only 18%. It may be that some authorities which experimented with CCT, but failed to reap the anticipated cost savings, did not reply. In this case, Hartley and Huby's finding of average savings of 26% may be overestimated. Nevertheless, if there were some cost savings then it may be that efficiency also improved, because all councils in the survey stated that contractors were required to provide the same standard of service as previously supplied by the council itself.

The most sophisticated evidence on VCT has been produced by several econometric studies of refuse collection. These studies use data for the period prior to the 1988 legislation which introduced CCT for this service. Domberger et al. (1986) undertake a cross-sectional regression analysis in order to evaluate the impact of VCT in a sample of 305 of the 401 councils responsible for refuse collection in England and Wales. Fifty-five of these councils voluntarily sought tenders for the service, and twenty-nine awarded the contract to a private company. This pattern in the data allowed

Domberger et al. to investigate two main issues: does competitive tendering cut costs, and does it make any difference whether the contract is won by the council itself or the private sector?

Domberger et al. include dummy variables for 'tendering' and 'ownership' in a regression model of inter-authority variations in refuse collection costs. The impact of these variables is estimated while controlling for other influences on refuse expenditure: scale of output, measures of service quality (frequency and method of collection) and a range of local factors that may affect service costs (e.g. population density, extent of waste reclamation activities, average wages of manual workers in the local area). Thus, if the model is fully specified, it should yield valid estimates of the effects of tendering and ownership. However, it should be noted that several variables which are widely considered to influence expenditure variations are omitted from the model – for example, local financial resources, central grants and party politics (Boyne, 1996a). It is possible that the coefficients on the tendering and ownership variables are biased by these omissions, and the empirical results therefore need to be treated with some caution.

The evidence suggests that the savings from VCT are roughly 17%–22%, and that these savings accrue regardless of whether the contract is won by the council or the private sector. It is important to note that these estimates of reduced cost are derived when controlling statistically for variations in some aspects of service quality. Therefore the regression results are consistent with the view that VCT is associated with not only lower spending but also higher efficiency. The evidence also shows that average savings are lower in the first year of competitive tendering (12%) than in the second year (25%). Domberger et al. attribute this difference to the costs of redundancy and contract preparation in the first year.

In a subsequent study, Cubbin et al. (1987) explore the source of the costs savings which Domberger et al. identified. They note that 'many critics of competitive tendering policy allege that the main sources of savings are lower wages and reduced fringe benefits rather than better management of resources and higher physical productivity of inputs' (1987: 49–50). Cubbin et al. use Data Envelopment Analysis in order to evaluate the validity of this argument. Their results suggest that, where the refuse collection contract is

won by a private company, around three-quarters of the efficiency savings reflect improvements in productivity rather than reductions in staffing or remuneration. By contrast, where the council wins the contract, less than half of the efficiency savings can be traced to higher productivity. Cubbin et al. speculate that the in-house teams may be more poorly managed than private contractors, and are therefore forced to cut staff and pay in order to remain competitive.

The validity of the results obtained by Domberger et al. (1986) has been challenged by Ganley and Grahl (1988) on a number of counts (see also the response by Domberger et al., 1988). First, they analyse refuse collection costs over time, and find that authorities which pursued VCT had costs only 10% lower than other councils, roughly half the level estimated by Domberger et al. However, Ganley and Grahl's figure is based on a crude bivariate analysis – no other explanatory variables are taken into account. Therefore, Domberger et al.'s estimate of cost savings from VCT is more credible. Secondly, Ganley and Grahl note that the authorities which undertook VCT may already have been the most efficient – in this case the 'tendering effect' uncovered by Domberger et al. may be spurious. However, it is equally plausible that the least efficient authorities exposed their services to competition. There is evidence that some councils resorted to VCT in the 1980s as a 'last resort', having failed to persuade their own workforce to adopt new methods of service delivery (Cope, 1995; Evans, 1985; Shaw et al., 1994).

The final study of VCT in refuse collection to be considered is by Szymanski and Wilkins (1993). They use similar regression methods to Domberger et al. (1986), but cover a longer time period (1984–8), specify three dependent variables (cost per collection unit, cost per employee and employees per collection unit), and use a slightly wider set of explanatory variables (for example, party political control is included in their statistical model). The broad pattern of the results is similar to that obtained by Domberger et al.: competitive tendering cuts service costs by 18%–24%, and these savings accrue regardless of whether the contract is awarded internally or externally. The regression models contain measures of service quality, and therefore the results imply that VCT results in greater efficiency as well as lower expenditure.

Szymanski and Wilkins' analysis also sheds light on some other issues. First, the number of staff employed per collection unit is lower where services have been subjected to VCT, which confirms that part of the cost saving is attributable to staff cuts. Secondly, the cost per employee is not significantly lower in tendered services, which suggests that the remaining employees are, financially at least, no worse off than their counterparts elsewhere. As Szymanski and Wilkins (1993: 128) note, 'most of the cost savings associated with contracting out can be identified with productivity improvements. This means that fewer people were doing the same job at the same employment cost per person. Whilst this appears to confirm that direct pay reductions were not the source of the cost savings, it may be that the productivity increase involved a fall in the effective hourly rate.' Thirdly, the findings contradict Ganley and Grahl's (1988) argument that authorities which pursued VCT were already the most efficient: 'the existence of lower than average costs in tendering authorities does not predate the beginning of the first contract, supporting (though not proving) the hypothesis that the lower costs observed in the tendering authorities are associated with the act of competitive tendering itself' (Szymanski and Wilkins, 1993: 128). Finally, the cost advantage of VCT authorities decreased over the study period, possibly because all councils reorganised their services in anticipation of CCT. In addition, the VCT authorities may themselves have lost the benefit of competitive pressures when contracts were renewed. Szymanski and Wilkins (1993: 116) note that 'in around 50 per cent of cases where contract renewal came up before the introduction of CCT, contract renewal took place on the basis of a single negotiation between the local authority and the existing contractor'. In other words, the private contractor acquired at least some of the monopoly power held previously by the in-house producer, and costs rose accordingly. In order to provide direct support for this argument, it would be necessary to compare cost changes in councils where contracts were renewed by competitive tender with cost changes in councils where there was no competition. However, Szymanski and Wilkins provide no evidence on this issue. Another interpretation of the gradual convergence in costs between VCT and non-tendering authorities is that the successful contractors may have 'underbid' in order to

win the contract, and thereby gain the advantage of incumbency when it came up for renewal. Whatever the explanation, Szymanski and Wilkins' results suggest that the difference in the cost of refuse collection between VCT authorities and other areas tends to diminish over time.

(b) Compulsory Competitive Tendering

Evidence on the impact of compulsory competition on the refuse collection service is provided by Chaundy and Uttley (1993) who draw conclusions from a questionnaire survey of councils conducted in 1992. They received responses from only thirty-seven of 403 authorities: 'the remaining authorities either lacked resources or cited commercial factors for not responding' (Chaundy and Uttley, 1993: 30). Whatever the reasons for the low response rate, the data should be interpreted as illustrative only – the sample may be unrepresentative of the financial effects of CCT on refuse collection in general. Furthermore, the sample size on some questions is substantially lower than thirty-seven cases (see below). Another limitation of this 'before and after' study is that there is no attempt to control for other variables that may have influenced changes in the cost of refuse collection, such as the financial pressures in the local government system in the early 1990s when the poll tax was introduced. Finally, Chaundy and Uttley use no tests to gauge the statistical significance of their findings, which is an especially important omission in view of their small sample size.

With these important caveats in mind, the principal findings can be summarised as follows. The decline in direct service costs as a result of CCT was 29% (sample size = 14), but when the costs of contract monitoring are taken into account, the net saving falls to 26% (sample size = 7). A substantial part of this 'efficiency gain' may have been caused by a 17% reduction in staffing after CCT. The fall in expenditure does not appear to reflect poorer service standards. Of the thirty-six councils which provided relevant information, twenty stated that quality had improved, while only four stated that it had deteriorated. Thus, taken at face value, the evidence suggests that CCT has produced greater efficiency.

A much more comprehensive and sophisticated study of CCT in refuse collection was conducted by Szymanski (1996). The impact of competition is tested in a multivariate model of local expenditure on refuse collection by 365 local councils for the period 1984–94. The model is estimated in a pooled sample for the whole period, which provides over 3,500 'separate' cases and permits analysis of changes in spending before and after the introduction of CCT. The results suggest that competitive tendering is associated with significantly lower costs and that this is not 'a consequence of lower standards in terms of service specification' (Szymanski, 1996: 2). The size of the expenditure saving appears to vary with ownership as well as competition: the average cost reduction was 20% when refuse collection contracts were awarded to a private firm but only 10% when contracts were won by the in-house workforce. Furthermore, the apparent improvement in efficiency deteriorated over time. The cost reductions achieved by private contractors were halved by the fourth full year of the contract; and by the third year of contracts won by local authority agencies, costs had returned to their pre-CCT level. It is unclear, therefore, whether the 'second round' of CCT also produced savings of the magnitude identified by Szymanski's analysis of the 'first round'.

Walsh and Davis (1993) analyse the effects of competition on all eight council services subject to CCT under the 1988 legislation. The evidence, which is based on a sample of forty authorities and 551 service contracts, is generally comprehensive and detailed. Nevertheless, Walsh and Davis' analysis suffers from the methodological problems common to all the 'before and after' studies in the UK: no control for other explanatory variables, and no significance tests. Therefore it must simply be assumed that any longitudinal changes in costs and quality are the result of CCT, and that the effects which are identified are more than random fluctuations.

The changes in service costs estimated by Walsh and Davis are shown in Table 5.2. These figures are adjusted for inflation, and include contract monitoring costs both before and after CCT (it is not clear whether they also include costs of initial contract preparation and staff redundancies). The biggest estimated savings are in building cleaning and refuse collection; two services, street cleaning and educational and welfare catering, show an increase in costs

after CCT. In each service, the change in costs varies substantially across contracts, from a reduction of 50% (grounds maintenance), to an increase of 63% (street cleaning). It would be interesting to know the relationship between the level of actual competition and changes in costs within each service, but the data do not permit an analysis of this issue. Walsh and Davis note that, where efficiency gains were made, this was the result of not only staff cuts but also productivity improvements: 'of the 32 comparisons of productivity that we were able to make from the data provided, all but one showed an increase. The average increase in productivity from the figures quoted was 24.8%... largely through staff working harder. There is also an increase in the capital intensity of the work' (Walsh and Davis, 1993: 147).

Table 5.2: Changes in Service Costs as a Result of CCT in UK Local Government

	Number of contracts	*Mean change in costs, %*	*Minimum %*	*Maximum %*
Refuse collection	22	–11.3	–33	+15
Street cleaning	20	+2.6	–31	+63
Building cleaning	25	–12.7	–49	+16
Catering (education & welfare)	18	+2.8	–8	+25
Catering (other)	18	–4.9	–27	+19
Vehicle maintenance	20	–1.3	–23	+48
Grounds maintenance	69	–10.9	–50	+19
Leisure management	21	–5.0	–29	+16

Source: Walsh and Davis, 1993.

The survey evidence suggests that councils have not sacrificed quality in order to cut spending. Data on service standards before and after CCT were obtained for 245 contracts. Service standards were higher after CCT in sixty-one cases, and lower in only three. Furthermore, there was no detectable difference in the performance of Direct Service Organisations (DSOs) and external agencies. This 'was easiest to judge where both were doing work on contracts in the same authority, as happened in 45% of authorities, most

commonly for grounds maintenance. Neither DSOs nor private contractors were seen as more likely to provide better or worse service in these authorities' (Walsh and Davis, 1993: 133). The improvement in service standards in around 25% of contracts may explain why costs rose in some services, and why cost savings vary across councils. Again, however, the data provided by Walsh and Davis are not disaggregated sufficiently to draw conclusions on this question.

The only direct examination of the relationship between changes in costs and quality is by McMaster (1995). This study combines the strengths of longitudinal and cross-sectional analyses by using a sophisticated econometric model to estimate the impact of CCT on changes in quality. The dependent variable in the analysis is senior managers' perception of the difference in service quality since the introduction of CCT. One of the explanatory variables is the percentage difference between the price of the successful bid and the previous cost of the service. The other variables in the statistical model include the duration of the contract, the proportion of council workers re-employed after CCT, and the intensity of contract monitoring by the client. The model was tested on 101 contracts in nine councils, for services including building maintenance, street cleaning, refuse collection, catering and grounds and vehicle maintenance. The results of the empirical test show a significant negative relationship between changes in cost and changes in quality. This may seem to be inconsistent with the findings of the other studies summarised above, which generally find little deterioration in quality despite cuts in spending. However, there is no necessary contradiction. While the average standard of services may have been maintained or improved, it is plausible that standards may have fallen (or improved least) in those councils where expenditure reductions have been greatest. At the margin, once all the available efficiency gains have been exhausted, lower spending must mean lower quality.

(c) Summary and Evaluation

The general pattern of the evidence suggests that both VCT and CCT lead to lower expenditure with no sacrifice in service quality. However, a much more hazy picture lies behind the superficial clar-

ity of the empirical results. In addition to the specific problems in individual studies noted above, four general problems cast doubt on the validity of the evidence.

Sparsity of evidence

A comprehensive set of evidence on competitive tendering would cover all relevant services in a large number of local areas (ideally, all councils or a representative sample thereof). By these criteria, the available evidence is sparse.

First, four of the six studies which find higher efficiency deal exclusively with refuse collection. The only study which covers all eight of the CCT services specified in the 1988 Local Government Act is Walsh and Davis (1993). Their results show that the expenditure reduction in refuse collection is higher than the average for other services. Indeed, CCT appears to lead to additional spending in street cleaning and some aspects of catering. Furthermore, in each service area there are examples of substantial cost increases as well as decreases (see Table 5.2). Thus figures for average savings from CCT seem to be biased upwards by the emphasis on refuse collection, and disguise the fact that, in some councils, competition has imposed extra financial burdens on local taxpayers. This finding is inconsistent with the view that bureaucrats are uniformly powerful, extravagant and inefficient.

Secondly, the sample size in the empirical studies varies from one (Cope, 1995) to 367 (Szymanski and Wilkins, 1993). The representativeness of the results from small samples is simply not known. This is an especially severe problem in studies which do not apply tests of statistical significance to the relationship between competition and service spending, quality or efficiency (Hartley and Huby, 1985; Chaundy and Uttley, 1993; Knox and Young, 1995; Walsh and Davis, 1993).

Measures of expenditure

The measures of expenditure in the empirical analyses refer narrowly to the direct cost of service production: that is, the funds allocated in the local authority budget to a specific item (e.g. street cleaning, vehicle maintenance). Only three studies take explicit

account of the transaction costs associated with competitive tendering (Chaundy and Uttley, 1993; Szymanski, 1996; Walsh and Davis, 1993). Nor has there been any assessment of the resources expended by local officials in their attempts to retain responsibility for service production. In addition, there is no measure of the *actual* change in direct service costs in some studies. Instead, the expenditure out-turn in the year prior to CCT is compared with the price of service provision *estimated* in the successful tender (e.g. Cope, 1995; McMaster 1995). The impact of competition on the eventual reduction in the real cost of services is therefore unknown.

Measures of service quality

The operationalisation of the concept of service quality is complex. Reeves and Bednar (1994) note that quality has been variously defined as 'value', 'conformance to specifications', 'conformance to requirements', 'fitness for use', and 'meeting or exceeding customers' expectations'. They argue that 'no one definition of quality is "best" in every situation because each definition has both strengths and weaknesses in relation to criteria such as measurement and generalizability, managerial usefulness and consumer relevance' (Reeves and Bednar, 1994: 427–8). Furthermore, perceptions of the quality of public services are likely to vary *between* politicians, professions, taxpayers and consumers, and *within* each of these groups (Walsh, 1991). Thus service quality is multidimensional, and there are many 'stakeholders' with different perceptions of any single dimension. The implication is that the measurement of quality in studies of competitive tendering needs to be comprehensive and sophisticated. However, the operationalisation of the concept of quality is usually narrow and crude.

The actual level of service quality is simply not measured in most of the studies. Rather, service standards before competitive tendering are compared with the standards *specified* in the new contract. There are two problems here. First, the quality of service produced after competitive tendering is unknown. As Szymanski (1996: 13) concedes, 'quality may fall following the introduction of competitive tendering even if the specification of the service is raised . . . on the other hand, quality may rise even if the contractor defaults on

the contract specification, because the achieved standard is still better than what went before'. In other words, conclusions on efficiency cannot be drawn from studies which use measures of quality derived from ex-ante service specifications (see Domberger et al., 1995). A second problem is that only some aspects of services are taken into account when quality is assessed on the basis of the contract specifications. For example, studies of refuse collection typically use two indicators of quality: the frequency and method of collection (front or back door). However, a further eight dimensions of the quality of the refuse collection service have been identified by the Audit Commission (Boyne, 1997c).

Some studies seek to evaluate quality on the basis of achievements rather than contract specifications (McMaster 1995; Walsh and Davis, 1993). However, the measure of quality after competitive tendering is based solely on the views of service managers, whose perceptions of the change in standards may be remote from the experience of direct consumers or the views of the wider public. Moreover, none of the studies attempts to identify whether elements of service provision were 'lost' as a result of competition. However, there is evidence that staff have abandoned functions which are no longer their formal responsibility (McIntosh and Broderick, 1996). This seems to be partly attributable to the loss of trust between managers and workers as a result of greater formal monitoring after CCT (Davis and Walker, 1997).

Controls for other variables

Five of the nine empirical studies use a simple bivariate method to evaluate competitive tendering (Chaundy and Uttley, 1993; Cope, 1995; Hartley and Huby, 1985; Knox and Young, 1995; Walsh and Davis, 1993). This approach assumes that any observed changes in expenditure or efficiency are solely (or largely) attributable to the introduction of competition. For example, Chaundy and Uttley's (1993) longitudinal analysis implies that CCT has produced greater efficiency in refuse collection. However, the efficiency of this service was improving before the introduction of CCT, and even before there was much VCT. Between 1979 and 1984, unit costs in the refuse collection service fell by 25% (Audit Commission, 1984).

It is therefore possible that at least part of the improvement in efficiency which Chaundy and Uttley attribute to CCT would have occurred anyway. More broadly, there were general pressures on local government during the late 1980s and early 1990s that may have resulted in lower expenditure and higher efficiency, for example fiscal stress and the publication of performance indicators. A claim that the observed changes in local authority behaviour are attributable to CCT is naive. At the very least, it needs to be demonstrated that improvements in efficiency in services subjected to CCT were greater than in other services.

2. IMPACT OF SERVICE CONTRACTING IN THE USA

Reviews of the evidence on local service contracting in the USA have generally concluded that it does produce the results which public choice theory predicts. For example, Stein (1990a: 498) claims that 'research on contracting for individual goods and services *has consistently found* this mode of service arrangement to be more efficient than direct service provision and production' (emphasis added). Similarly, Kiewiet (1991: 166) concludes that '*virtually every study* that has ever compared the operations of public bureaus with those of private firms providing identical services has found data to support the inefficiency hypothesis' (emphasis added). Finally, Bennett and Johnson (1980: 392–3) assert that '*without exception*, the empirical findings indicate that the same level of output could be provided at substantially lower costs if output were produced by the private sector rather than the public sector… The private sector production of public services offers an excellent opportunity for tax reductions without sacrifice of services; the best of all possible worlds, at least in this case, can be achieved' (emphasis added; for similar claims see also Savas, 1979; Ferris, 1986; McGuire et al., 1987; Miranda, 1994a).

The most common method of evaluating the impact of service contracting in the USA is multivariate statistical analysis of a cross-section of local governments. This allows the expenditure of contracting and non-contracting municipalities to be compared while

controlling for other explanatory variables (which typically include socio-economic characteristics of the local area). Inferences on the effect of service contracting on efficiency can also be drawn if the statistical model includes measures of service quality. A second cross-sectional method of estimating the impact of contracting is simply to compare cities which produce services themselves with those which employ external agencies. In this type of study there is no attempt to control for other variables which influence service costs and efficiency. The results of such studies must therefore be treated with great caution. A variant of this method is to compare service costs within cities which have contracted *part* of their service to another supplier. This allows the performance of a municipal agency and rival producers to be compared in a setting where some circumstances are effectively held constant (e.g. total size and tax-base of the city). However, unless the municipal supplier and external organisations in each city are assigned customers at random, it is still important to ensure that all relevant explanatory variables are taken into account in assessing the impact of contracting.

The effects of contracting-out have also been evaluated longitudinally. In principle, given a sufficient time period, this type of study could also employ multivariate statistical methods in order to identify the net effect of service contracting. In practice, the longitudinal tests, like their British counterparts, consist of crude 'before and after' estimates of costs and efficiency. Some studies take a sample of local governments which have switched to contract supply, whereas others include only a single case. If conclusions are to be drawn from studies of contracting which include no statistical control for other variables, then the evidence from longitudinal studies is probably better than that produced by cross-sectional snapshots. Although the circumstances in which services are provided are likely to vary substantially from one city to the next, such circumstances may be fairly stable within a city in the short term. For example, the wealth of the local population or the number of customers in receipt of a service is unlikely to change much from one year to the next.

In sum, the credibility of the evidence produced by the empirical studies can generally be ranked in the following order:

1. Multivariate cross-sectional statistical analyses
2. Bivariate longitudinal analyses
3. Bivariate cross-sectional analyses.

While this categorisation provides a clear ranking of the studies, it is unidimensional. The studies contain many other characteristics and defects which influence the validity of the evidence on contracting. Other things being equal, however, results derived from multivariate statistical analyses should be given most weight in the scales of judgement.

(a) Supply of Refuse Collection by Private Contractors

Evidence on the impact of contracting for refuse collection has been produced by ten empirical studies (see Table 5.3 for a summary of the studies and their results). Seven studies find that private supply is associated with lower expenditure, and six of these also indicate that external contractors are more efficient than municipal agencies. The general pattern of the evidence therefore appears to support public choice theory.

However, only two of the five multivariate statistical tests yield results that are consistent with public choice hypotheses. Berenyi and Stevens (1988) conclude that municipal production is 28%–42% more expensive than private production, and Kemper and Quigley's (1976) evidence suggests that contract supply is 13%–30% cheaper than public supply. Both of these studies control for variations in service quality, as measured by the frequency and location (front or back of building) of refuse collection. Their results therefore imply efficiency gains as well as spending cuts. By contrast, Stevens (1978) finds that contracting leads to lower spending and higher efficiency only in cities with more than 50 000 inhabitants; in smaller cities, the performance of public and private suppliers is not significantly different. The other two multivariate analyses suggest that contracting-out makes little difference to costs or efficiency, regardless of population size (Collins and Downes, 1977; Dubin and Navarro, 1988).

The three longitudinal studies of contracting all obtain evidence which implies that expenditure falls and efficiency rises if refuse

Table 5.3: Contracting for Refuse Collection in US Local Government

Study	*Cases*	*Type of study*[1]	*Impact of Contracting on:*		
			(a) Expenditure	*(b) Quality*	*(c) Efficiency*
Kemper & Quigley, 1976	148 local governments in Connecticut, 1970s	1	Lower	Held constant	Higher
Savas, 1977a	Minneapolis, 1971 to 1975	2	Lower	Higher	Higher
Savas, 1977b	170 cities, 1975	3	Insignificant	Held constant	None
Collins & Downes, 1977	57 municipalities in St Louis County	1	Insignificant	Held constant	None
Stevens, 1978	340 cities, 1974	1	Lower in cities where population over 50 000; insignificant elsewhere	Held constant	Higher in cities with population over 50 000; none elsewhere
Savas, 1981	6 cities	3	Lower	Unknown	Unclear
Berenyi, 1981	10 cities	2, 3	Lower	No change	Higher
Fitzgerald, 1986	Knoxville, 1978 to 1985	2	Lower	No change	Higher
Berenyi & Stevens, 1988	20 municipalities in the Los Angeles area, early 1980s	1	Lower	Held constant	Higher
Dubin & Navarro, 1988	261 cities	1	Insignificant	Held constant	None

Note

1 Type of study:
- 1 = multivariate cross-sectional statistical analysis
- 2 = bivariate longitudinal survey or case study
- 3 = bivariate cross-sectional survey or case study

collection is transferred to a private firm. Savas (1977a) analyses service costs in Minneapolis between 1971 and 1975. Prior to this period, the city agency and private contractors collected different types of refuse, but from 1971 all types were combined. The territory of the city was divided between the municipal supplier and a consortium of private firms. In 1971 the cost per tonne of refuse collected was 11% higher for the city agency than for the private contractors, but by 1975 this gap had narrowed to only 1%. Savas attributes this to the competitive threat posed by the presence of the external contractor, but his analysis does not control for the characteristics of the neighbourhoods and households served by each type of supplier. Indeed, public choice theorists might predict that city officials would allocate the 'easier' territory to their own workforce.

More weight can be attached to the other two longitudinal studies, because they contain evidence on the impact of a complete switch to private contractors. Berenyi (1981) finds that contracting leads to reductions in service costs that vary from 8% (in Berwyn, Illinois) to 70% (in Middletown, Ohio). Furthermore, the decline in spending is accompanied by an increase in efficiency: 'points of pick-up and the frequency of collection remained the same in all cities after the change. Thus, cost reductions were not achieved at the expense of service levels' (Berenyi, 1981: 37). A similar conclusion is reached by Fitzgerald (1986: 612): 'our preliminary study of the Knoxville experience at the end of the first year of private provision clearly indicates that privatization is keeping its promises: substantial cost savings are being realised, and the quality of service appears to have been maintained'. However, both of these longitudinal studies are problematic because they provide no evidence on changes in costs and efficiency in cities which did *not* contract-out. It is possible that general improvements in the technology or management of refuse collection were leading to improvements in all cities that were similar in relevant respects to those chosen for analysis.

Finally, the results of only one of the three cross-sectional surveys support public choice hypotheses on spending and efficiency. Berenyi (1981) compares public and private costs in four cities which have contracted-out part of their refuse collection service.

She finds that private contractors provide services of equivalent quality more cheaply than their municipal counterparts (the cost difference ranges from 13% in New Orleans to 49% in Kansas). However, another cross-sectional survey of public and private refuse collectors by Savas (1977b) suggests that there is no difference in cost when service quality is held constant. In a subsequent study, Savas (1981) finds that the costs of municipal agencies are higher than those of private contractors in cities which employ both types of refuse collector. However, his analysis controls for neither differences in service quality nor variations in other influences on spending. As he concedes, 'In many cases a competitive system is characterised by contract collection in one unique district of the city and municipal collection elsewhere . . . the area served by the public sector is generally very different than the area served by the private sector and so comparisons are difficult or impossible to make' (Savas, 1981: 49). Only two pages later, this caveat is ignored. Savas concludes that evidence on the benefits of competition 'rests firmly on a foundation of solid waste (collection) but the underlying principles appear applicable to numerous other public services' (1981: 51).

(b) Supply of Other Services by Private Contractors

While there is substantial evidence on the impact of contracting on refuse collection, information on other services is, as in the UK, sparse (see Table 5.4). As few as six local government services have been analysed, and 'bus transport' is the only function covered by more than one study. Furthermore, over half of the evidence on contracting-out in these services has been produced by one study – Berenyi and Stevens (1988). Therefore these results should be taken as merely illustrative – the general effects of service contracting are simply unknown.

The empirical evidence is consistent with public choice theory in four of the six functions: production by a private firm appears to lead to lower spending and higher efficiency in the fire service, highway construction and maintenance, property maintenance and janitorial services. However, while these results are obtained on the basis of multivariate cross-sectional analyses, the sample sizes are

Table 5.4: Contracting for Other Services in US Local Government

Service & study	*Cases*	*Type of study* [1]	*Impact of contracting on*		
			(a) Expenditure	*(b) Quality*	*(c) Efficiency*
FIRE: Ahlbrandt, 1973	Scottsdale, 1971	1, 3	Lower	Held constant	Higher
HIGHWAYS					
Berenyi & Stevens, 1988	20 municipalities, Los Angeles area, 1980s	1	Lower	Held constant	Higher
BUS TRANSPORT					
(a) McGuire and Van Cott, 1984	275 Indiana school districts, 1979	3	No clear pattern	Unknown	Unclear
(b) Perry and Babitsky, 1986	249 passenger transit agencies, 1980	1	Insignificant	Insignificant	None
PROPERTY MAINTENANCE					
Berenyi & Stevens, 1988	20 municipalities, Los Angeles area, 1980s	1	Lower	Held constant	Higher
JANITORIAL SERVICES					
Berenyi & Stevens, 1988	20 municipalities, Los Angeles area, 1980s	1	Lower	Held constant	Higher
PAYROLL					
Berenyi & Stevens, 1988	20 municipalities Los Angeles area, 1980s	1	Insignificant	Held constant	None

Note

1 See note to Table 5.3.

unusually small. Ahlbrandt (1973) tests a regression model of expenditure by forty-four public fire departments in Seattle-King County. He then applies the estimated coefficients in the regression equation to the values of the variables *in one city* which employs a private contractor. This technique allows the hypothetical cost of public production in the city to be compared with the actual cost of the private firm. He concludes that 'competitive supply, induced by a contractual arrangement between the producing and consuming units, is thus shown to be more efficient in a production sense for a comparable quantity-quality output level than supply by a bureaucratic organisation serving exclusively its own political unit' (Ahlbrandt, 1973: 11). However, the generalisability of this conclusion clearly hinges on the validity of the simulation, and the extent to which the single city is representative of other areas.

A sample of only twenty municipalities is used by Berenyi and Stevens (1988) who find that seven of eight services are significantly more expensive when produced by public agencies. The difference in cost varies from +37% (tree maintenance) to +73% (janitorial services). The only service where contracting makes no difference is payroll preparation. Berenyi and Stevens (1988: 16) argue that 'one possible reason for this exception was that despite the use of private contractors to prepare the payroll, the local government always played a substantial role, reducing the contractor's percentage of the total cost'. This seems to imply that any public–private difference would be *smaller* than in other services, not that it would be *absent*. More important than this minor puzzle, however, is the fact that all twenty of Berenyi and Stevens' cases are located in five counties in the Los Angeles area. The wider applicability of their conclusions on contracting is therefore unknown.

Neither of the two studies of bus transport suggests that contracting has a significant effect on costs or quality. Perry and Babitsky's (1986: 63) interpretation of this result is similar to the argument advanced by Berenyi and Stevens concerning payroll preparation: 'Because contract-managed agencies remain public monopolies, they are unable to capture the competitive nature of the private market. Furthermore, since the professional management team is usually only a small portion of an agency's staff, the incentives for most employees are much like the civil service arrangements in public

bureaucracies.' McGuire and Van Cott (1984: 41) claim that their evidence demonstrates the superiority of contract supply and that 'substantial dollar savings could result from privatizing the provision of school bus transport'. This conclusion is based on a somewhat selective reading of their own evidence. They present results for several measures of the cost of school transport, but choose to draw inferences from only two: 'cost per mile' and 'cost per trip'. However, as they concede, the most standardised measure is 'the cost of one student travelling one mile', which therefore offers the best basis for comparing public and private performance. For this indicator of the cost of school buses, there is a significant difference between public and private agencies in only three of ten tests, and one of these suggests that *public* agencies are more efficient. Furthermore, McGuire and Van Cott completely ignore their findings that, on average, public operators with a monopoly are substantially cheaper than those who face direct competition from private contractors in the same school district; and that private operators with a monopoly are less expensive than those who face direct competition from public agencies. In sum, the evidence suggests that there is little difference between public and private suppliers, and that competition is associated with *higher* costs. In this light, McGuire and Van Cott's (1984: 40) conclusion must be regarded as bizarre: 'our statistical results are consistent with the hypothesis that it is not public ownership per se that produces more costly public operations but, rather, the lack of effective competition'.

(c) Inter-Governmental Contracting

The impact of inter-governmental contracts on service provision has been tested in five multivariate cross-sectional studies. All of these find that contracting is associated with lower spending, but only three indicate that this is accompanied by higher efficiency (see Table 5.5). The geographical coverage of four of these studies is limited to California, and most of the evidence relates to the 'Lakewood Plan' in Los Angeles county. Under this arrangement, some cities contract with the county for services which other cities produce for themselves.

Table 5.5: Inter-governmental Contracting in US Local Government

Service and study	*Cases*	*Impact of contracting on*		
		(a) Expend-iture	*(b) Quality*	*(c) Effici-ency*
POLICE				
(a) Sonenblum et al., 1977	72 cities in Los Angeles county, 1970	Lower	Lower	Unclear
(b) Deacon, 1979	64 cities in Los Angeles county	Lower	Unknown	Unclear
(c) Mehay, 1979	71 cities in California 1968	Lower	Held constant	Higher
(d) Mehay and Gonzalez, 1985	53 counties in California	Lower	Held constant	Higher
STREET MAINTENANCE				
Deacon, 1979	64 cities in Los Angeles county	Lower	Unknown	Unclear
Mehay and Gonzalez, 1987	53 counties in California	Lower	Unknown	Unclear
TAX ASSESSMENT				
Lowery, 1982	690 municipalities in Michigan, 1976	Lower	Lower	Higher

Note: All studies are multivariate cross-sectional statistical analyses

Two of the four studies of the police service suggest that contracting leads to higher efficiency. Mehay (1979) compares police patrol spending in twenty-five contract cities with spending in forty-six cities which deliver their own service. The regression model controls for crime levels, and therefore the negative coefficient on the contracting variable is consistent with higher efficiency.

In a related study, Mehay and Gonzalez (1985) examine the impact of contracting on the performance of county sheriffs departments. Expenditures in fifteen counties which sell services to municipalities are compared with expenditures in thirty-eight counties which do not. Mehay and Gonzalez (1985), argue that 'in order to retain existing customers, or attract new ones, county departments must sell at a price that is less than it would cost the purchasing city to produce the service itself in-house. This constraint on the price that can be charged to cities creates a pressure for county departments to control production cost.' Their evidence indicates that, controlling for the level of crime, counties which produce contract services spend 20% less than other counties. They concluded that 'the accumulating evidence suggests that contracting with larger government entities may yield net benefits to the governmental unit supplying the services (and its clients) as well as to the governmental unit purchasing the services' (Mehay and Gonzalez, 1985: 85).

The results obtained by the other two studies of the police service are less clear-cut. Sonenblum et al. (1977) find that contracting is associated with lower spending and lower quality, but the relative decline in each is unclear, so no conclusions can be drawn on efficiency. Deacon's (1979) analysis suggests that spending on police is 42% lower in contracting cities than elsewhere in Los Angeles county. However, no evidence is provided on the impact of contracting on service quality, so the reduction in expenditure may not be attributable to higher efficiency. The same limitation is present in evaluations of the impact of the Lakewood plan on street maintenance expenditure (Deacon 1979; Mehay and Gonzalez, 1987).

The final study of inter-governmental contracting to be considered is Lowery's (1982) analysis of property-tax assessment services. He argues that cities which contract with the county 'can influence the performance of the vendor on both the price and quality of the product by threatening to terminate the contract and either recontracting with another vendor or producing the good internally through traditional bureaucratic mechanisms' (Lowery, 1982: 518). The statistical evidence suggests that cities which buy tax-assessment from the county have lower spending but receive poorer quality services. However, while expenditure is 50% lower, quality

is only 10% lower. Therefore it can be inferred that the impact of inter-governmental contracting is higher efficiency.

(d) Impact of Contracting on Total Local Government Spending

Five empirical studies have tested the relationship between service contracting and total municipal expenditure (see Table 5.6). All of these find that contracting-out is associated with lower spending, but none considers service quality so the impact on efficiency is unknown.

Table 5.6: Impact of Service Contracting on Total Expenditure of US Local Government

Study	*Cases*	*Measure of contracting*	*Effect on spending*
Sonenblum et al., 1977	72 cities in Los Angeles county, 1970	% of city budget contracted-out	Lower
Deacon, 1979	64 cities in Los Angeles county	whether cities purchase services from county	Lower
Ferris, 1988	500 US cities, 1981	% of services contracted-out	Lower
Stein, 1990b	1433 US cities, 1981	% of services contracted-out	Lower
Miranda, 1994b	1433 US cities, 1982 and 1984	% of services contracted-out	Lower

Note: All studies are multivariate cross-sectional statistical analyses

Nevertheless, these studies could, in principle, provide evidence on whether the expenditure cuts that result from contracting are returned to local taxpayers or recycled within municipal budgets. This issue could be examined by including a measure of 'efficiency savings per capita' in a multivariate model of total expenditure per capita. If the coefficient on the efficiency savings variable is not significantly different from minus one, this indicates that all reductions in expenditure are used to cut taxes; and if the coefficient is not significantly different from zero, then all the savings are retained by

the municipality. If, however, local bureaucrats are neither powerless nor all-powerful, then the coefficient on the contracting variable would be between minus one and zero. The exact magnitude of the coefficient would indicate the division between lower taxes and extra spending on functions which have not been contracted-out.

Unfortunately, none of the studies provides evidence in this form. The measures of contracting comprise the percentage of total expenditure on services which are contracted-out (rather than the percentage of the budget 'saved'), a dichotomous variable for the presence or absence of contracting, and the percentage of *services* contracted-out. One interpretation of the negative coefficients for these variables is that all of the savings from contracting are used to cut spending, which is inconsistent with Niskanen's (1971) assumption of bureaucratic omnipotence. However, an equally valid interpretation of the results is that a substantial part of the expenditure reduction is reallocated within the municipal budget. The form of the statistical tests does not permit an adjudication between these conflicting views. It is, therefore, unclear whether the evidence supports or undermines public choice theory.

(e) Summary and Evaluation

There have been many criticisms of service contracting in the US public sector. In much of this literature, it is argued that the efficiency gains of contracting-out must be balanced against losses of equity, citizenship and accountability (Donahue, 1989; Hilke, 1993; Kettl, 1993; Morgan and England, 1988; Voytek, 1991). Such arguments assume that the positive effect of service contracting on efficiency has been established empirically. However, claims that empirical studies find 'consistently' and 'without exception' that contracting is more efficient than municipal supply are demonstrably untrue. Even taken at face value, only around half of the studies discussed in this chapter find that contracting-out is associated with lower spending and higher efficiency. Furthermore, virtually none of the evidence can be taken at face value. Many of the US studies contain the same general deficiencies as their UK counterparts, for example, inadequate measures of service expenditure and quality. Most of the studies contain specific methodological

flaws which cast doubt on the validity of the evidence on the impact of service contracts; and in some studies, the authors draw conclusions which are not substantiated by their own evidence. Moreover, serious questions are raised by the failure of all of the studies to control for variations in scale of output and local preferences, and by the absence of direct measures of competition.

Absence of controls for local preferences

Many studies in the USA and Western Europe have found that local expenditures are influenced by the ideological preferences of local policy-makers and their constituents (see Boyne, 1996a). Put simply, some local communities prefer high spending, while others prefer low taxes. However, only one of the empirical tests of service contracting takes variations in local political values into account (Dubin and Navarro, 1988). This is an important omission, because it is likely that the communities which favour low spending also favour service contracting. In other words, the choice of this mode of service production may reflect an underlying preference for 'small government' (Hoch, 1985; Miller, 1981; Miranda, 1994c). The implication is that the negative relationship between contracting and expenditure may be spurious. Lower expenditure in the contracting cities may predate the switch to external production. Of course, it is possible that contracting-out leads to even lower spending in these cities. In order to clarify these issues it would be necessary to test the impact of service contracting in a dynamic cross-sectional model of expenditure change.

Absence of controls for scale effects

Some empirical studies recognise that contracting may bring not only competitive pressures, but also the benefits of economies of scale (e.g. Collins and Downes, 1977). If a private organisation is producing a service in more than one locality, then its scale of output is bigger than the municipality itself can reach. This scale effect is always present with inter-governmental contracting – a city is purchasing a service from a higher tier of government which serves a number of local areas. For example, Deacon (1979: 392) argues that the supply of police services to municipalities under

the Lakewood plan is 'an obvious source of potential cost reduction. With contract supply, small cities are able to obtain, on a short-term basis, the services of specialised crime laboratories and forensic personnel, without maintaining such capabilities in city departments. Similarly, they may temporarily increase or decrease levels of patrol activity to respond to unusual circumstances.'

In order to evaluate the implications of the evidence on contracting-out for public choice theory, it is necessary to separate scale effects from competitive effects. There are two reasons for this. First, the advantages of higher scale could be obtained in other ways – for example, by consolidating small units into a larger government, or by creating a special district with responsibility for the service. Secondly, public choice hypotheses on contracting emphasise the benefits of competition, not scale. Indeed, public choice theory suggests that larger organisations perform more poorly (Boyne, 1996b) which could offset the benefits of externalising service production. Therefore it is essential to hold scale constant when evaluating the competitive effects of contracting.

Only a minority of the empirical studies take scale effects into account. The most common measure of scale is the population size of the local area (Ahlbrandt, 1973; Deacon, 1979; Lowery, 1982; Mehay and Gonzalez, 1985; Miranda, 1994c; Stein, 1990a). However, as noted in Chapter 4, the theory of economies of scale suggests that efficiency is influenced by the level of service *output*, not the number of residents in the local area. The use of population as a proxy for scale implies that service output per capita is constant across local areas, which seems implausible if the need for services and the ability to pay for them is geographically variable.

Two empirical tests of contracting for refuse collection use service outputs as direct measures of scale (Berenyi and Stevens, 1988; Stevens, 1978). These indicators of scale are also problematic, however, because they relate to service output within the boundaries of each local government. While this measure of scale may be accurate for municipal agencies, it understates the scale of output of private agencies which provide services in several jurisdictions (Stevens, 1978). Therefore the negative coefficient on a contracting variable in a model of expenditure may be partly,

if not wholly, attributable to scale effects rather than competitive effects.

Absence of measures of competition

According to public choice theory, the main benefits of contracting-out are the result of competition in the market for service production. However, none of the empirical studies contains a direct measure of competition. Rather, it is assumed that competition is higher in localities where services are delivered by an external organisation. There are two difficulties here. First, contracting may be 'relational' rather than 'competitive'. Even if a contract is initially awarded on the basis of competitive bids, the relationship between a local government and a service supplier may subsequently be maintained through negotiation rather than competition (Pack, 1989). In other words, the external organisation acquires some of the monopoly power previously wielded by the in-house workforce. A second problem is that competition may be present even where a local government itself produces the service. For example, the service may have been subjected to competitive tendering, but the municipal agency submitted the best bid. Even the threat of the externalisation of a service may have been sufficient to force a municipal supplier to become more 'competitive'. Thus a dichotomous measure of public/contract supply is a crude and potentially misleading proxy for the absence/presence of competition. The implication is that the empirical studies may have understated the effects of competition on service production.

CONCLUSION

In this chapter three specific public choice hypotheses on the impact of competition for service production were identified. First, competition should lead to lower expenditure on services. The empirical evidence on competitive tendering in the UK and contracting-out in the USA appears to support this hypothesis. However, the measures of expenditure deal only with the direct costs of service

production. In some studies, no account is taken of transaction costs; and all studies ignore the resources utilised by public officials in their quest to win service contracts. Moreover, many empirical analyses compare the actual costs of service provision before competition with the estimated costs afterwards. Finally, local decisions to externalise production may reflect public preferences for small government. Lower levels of spending in communities which use service contracts may therefore be attributable to local political values rather than competition. A conclusion that the evidence supports public choice theory is therefore based on weak empirical foundations.

The second public choice hypothesis is that competition is associated with higher technical efficiency on local services. Studies in both the UK and USA claim to have produced evidence that is consistent with this view. However, this interpretation is problematic for several reasons. As already noted, it is unclear whether expenditure has declined as a result of external competition. In addition, the measures of service quality in the empirical studies capture only a few of the dimensions of this concept. Furthermore, evidence which appears to indicate higher efficiency is drawn disproportionately from studies of refuse collection. Even if competition has stimulated better performance in this service, it is not clear that this conclusion can be generalised to all local government functions. An additional problem with estimates of the impact of competition on efficiency is that few British or American studies take scale effects into account. Thus any extra efficiency as a result of the externalisation of production may reflect changes in the level of service output rather than the pressures of competition.

The third public choice argument is that a large part of any 'efficiency gain' as a result of competition is likely to be retained within the local government budget. None of the UK studies has investigated this issue. The empirical evidence in the USA suggests that service contracting does lead to a reduction in total local government expenditure, but the size of this reduction has not been quantified. The implications of the statistical results for public choice theory are therefore ambiguous.

In sum, there is no convincing empirical support for any of the three public choice hypotheses on competition for service produc-

tion in local government. In this context it is remarkable that this form of competition became so widespread in the UK and US local government systems during the last twenty years, and that evidence on its effects has been taken to support public choice theories of bureaucracy.

6 Conclusion

A central proposition of public choice theory is that public sector organisations perform better when they are subjected to competitive pressures. If policy-makers possess monopoly power then they are likely to waste resources and ignore public preferences. The consequences are excessive expenditure, technical inefficiency and a lack of responsiveness to public demands. By contrast, politicians and bureaucrats who face a competitive threat are likely to conserve resources and produce services that closely reflect the demands of the electorate. Three potential sources of competitive effects in local government have been identified by public choice theorists: competition between councils for a share of the market in tax revenues and service responsibilities, competition between political parties for legitimate power to make and implement policies, and competition between local agencies and external suppliers for service production contracts. The principal purpose of this book has been to establish whether, as public choice theory suggests, these forms of competition are associated with superior performance by local governments in the USA and UK.

This chapter is divided into three sections. First, the relative levels of competition in the two local government systems are reviewed. Secondly, the evidence on the three public choice models of competition is evaluated: to what extent do the empirical tests suggest that competition has a negative effect on spending, and positive effects on efficiency and responsiveness? Finally, a research agenda is presented for further empirical work on public choice theory. This provides guidance on how the methodological deficiencies of existing empirical studies could be remedied, and considers the theoretical issues that future tests need to address.

1. THE EXTENT OF COMPETITION

How much competition is present in British and American local government? Which forms of competition are weakest and which are strongest in the two systems?

In Chapter 2 a comprehensive public choice model of competition between local authorities was developed. Three dimensions of inter-authority competition were identified. First, the institutional structure of local government, which in turn consists of: the number of tiers, the number of separate units in each tier, the distribution of power between tiers and units, and the level of barriers to entry and exit in the local government market. A second dimension of competition between local governments is the degree of autonomy possessed by local units to select fiscal policies and to choose the package of services that is provided. The third dimension is the level of reliance on central funding rather than local sources of revenue. It was argued in Chapter 2 that effective competition between local councils is more likely in systems that are structurally fragmented and deconcentrated, in which local autonomy is high, and in which central government grants are limited to a level required for equalisation of local needs and resources.

Competition on all three of these dimensions appears to be stronger in the USA than the UK. The American local government system has far more tiers and units, is more independent from central government controls (although subject to intervention by the states), and is less dependent on inter-governmental financial transfers. Further empirical work in a number of areas would be useful in order to establish more precisely the relative levels of inter-authority competition. These include measures of vertical and horizontal concentration in both local government systems (the few empirical analyses include Boyne and Cole, 1996, 1998; Eberts and Gronberg 1990); an assessment of the net level of autonomy in the USA when federal and state controls are taken into account; and an analysis of the degree of financial support that is required in order to compensate for variations in needs and resources. Information on these issues would allow clearer historical and cross-national comparisons of the extent to which the two local government systems fit the public choice model of competition between local authorities. Nevertheless, the existing evidence is sufficient to conclude that the conditions for inter-authority competition are met more closely in the USA than in Britain.

Criteria for effective party competition were outlined in Chapter 3. The first and most basic criterion is that political parties should

be allowed to contest elections; that is, to sponsor candidates and campaign openly. Secondly, competition requires that at least two parties are striving to win office. And thirdly, there must be a realistic possibility that the winners at one election will be the losers at the next. In particular, the incumbents must believe that they face a serious competitive threat from a rival party. It was argued in Chapter 3 that politicians' perceptions of the likelihood of defeat can be proxied by two variables: the size of the ruling party's majority in the present, and the volatility of seat shares on the council in the past.

The application of these criteria reveals clearly that local party competition is stronger in the UK than the USA. The reason is simply that the bulk of local political systems in America fall at the first hurdle – formal party activity in elections is prohibited in around 75% of municipalities. In Britain, by contrast, party activity is widespread and competition (especially between the major national parties) is close in many localities. Research on the level of party competition in both local government systems is surprisingly sparse. After all, this form of competition is distinctive to local authorities as units of representative democracy. Only one comprehensive assessment of local party competition in the UK has been undertaken (Boyne and Ashworth, 1997), and there are no such analyses in the USA. Three types of evidence on inter-party competition in US local government would facilitate a more precise comparison with the UK. First, an evaluation of the role of parties in all types of local government unit (the existing evidence refers largely to cities); secondly, an investigation of informal party competition in those localities where there is no 'official' party involvement in elections; and thirdly, an assessment of the level of competition in areas that are formally partisan. Such research would provide a clearer picture of the relative levels of local competition in the two countries, but is very unlikely to indicate that party rivalry for political power is as strong in the USA as in the UK.

The level of competition in the market for local service production was assessed in Chapter 4. This form of competition can be measured in three ways: the percentage of local services that are open to competition (in other words, the extent to which the market is contestable by alternative suppliers); the percentage of services

for which there is not only potential but also *actual* competition (at least one alternative bid to operate a service is submitted); and finally, the degree of competition for such services, as indicated by the average number of external suppliers who seek to obtain contracts.

Although these measures are straightforward in principle, they are difficult to apply to the local government systems in the UK and USA for a number of reasons. Whereas a specific sub-set of local services has been subject to compulsory contestability (if not necessary compulsory competition) in the UK, local contracting-out in the USA is entirely voluntary. There may be a sense in which the prevailing 'culture of competition' in the USA implies that the market for all local services is contestable. However, firm conclusions on this issue could only be drawn on the basis of local bureaucrats' perceptions of their market position: do they believe that their monopoly status is secure, or is poor performance likely to result in a switch to an external supplier? Another problem for comparative analysis is that although information on the number of external bidders is available for UK services covered by CCT, no similar data is compiled for local government in the USA. There may have been competition when a service was contracted-out, but the extent of this competition is unknown. Thus substantial additional research is required before clear comparisons of relative levels of competition in the market for local service production can be made.

In sum, in the UK, inter-authority competition seems to be weaker than either party competition or rivalry between internal and external agencies. By contrast, in the USA, the extent of party competition is limited (indeed, absent in many localities), but the other two forms of competition appear to be more pronounced. Whether the *total* level of competitive pressures on local policymakers is greater in the USA or UK therefore depends on the relative importance of different types of competition. The evidence on this issue is considered in the next section.

2. THE EFFECTS OF COMPETITION

In this section the evidence on the impact of competition in local government is reviewed and evaluated. For each type of competi-

tion, four questions are answered. First, is public choice theory supported if the evidence is taken *at face value*? Secondly, are there gaps in the evidence? (for example in the coverage of the local government systems in UK or USA, or simply in the number of empirical studies). Thirdly, is the evidence valid? The important issues here include the measurement of the dependent variables (expenditure, technical efficiency, responsiveness), the operationalisation of the concept of competition, and the extent to which other relevant explanatory variables were held constant when the effect of competition was tested (see Boyne, 1996a, for a more detailed exposition of this form of methodological critique). Finally, when such characteristics of the empirical studies are taken into account, what are the implications of the evidence for public choice models of competition?

(a) Competition between Local Authorities

Public choice theory suggests that local government units which compete with each other will perform better than those which are monopolists or enter into collusive agreements. The empirical studies appear to support two of the three public choice propositions concerning the impact of competition on local authority behaviour: the evidence implies that inter-authority competition is associated with less expenditure and more efficiency. There is, however, no evidence on the relationship between this form of competition and the responsiveness of local governments. It is also important to note that all of the empirical tests have been conducted on local government in the USA – no studies have been undertaken of the effects of competition between British local authorities. Nevertheless, as shown in Chapter 2, the number of US tests of fragmentation, concentration and barriers to entry in the local government market is substantial. Therefore, it should be possible to draw fairly firm conclusions from the results of the studies.

However, the quality of the empirical tests is problematic in several respects. First, the focus has been on institutional structures alone – there has been no assessment of the role of the 'finance' and 'autonomy' dimensions of the public choice model of competition

between local governments. These omissions are especially serious if the effects of structure, autonomy and finance are not separate but *interact* with one another. For example, authorities in a fragmented structure may not behave competitively if they are funded largely by central government and have little discretion in service provision. By contrast, they may compete vigorously if resources are derived largely from local sources, and if they have substantial freedom in the allocation of these resources. The implication of this *combination* of circumstances is that the same level of structural fragmentation could lead different local authorities to behave in different ways, depending on the patterns of central finance and local autonomy. In this case, the structure–performance relationships in the empirical studies may be an artificial amalgam of weak effects (where central funding is high and local autonomy is low) and strong effects (where funding is low and autonomy is high).

The evidence on structural effects is also underminded by two problems of statistical control. Few of the empirical tests of the link between structure and performance take account of variations in local preferences. It is possible that the same communities that prefer fragmented local government also prefer low spending. In this case the relationship between the measures of inter-authority competition and expenditure may be spurious: both variables may reflect public demands for 'small government'. A second problem concerns the absence of measures of service quantity and quality from the models of variations in local spending. It may be argued that inferences on efficiency can be drawn from such models because they contain measures of 'service demands'. The assumption here is that equal demands lead to equal services. This approach is questionable for two reasons. Public demands are not translated into services 'automatically' – local policy-makers must interpret and respond to them. Thus similar demands can result in quite different services, depending on the characteristics of local political systems. In addition, the indicators of service demand in the empirical studies are characteristics of the local population (e.g. income, housing tenure, ethnicity). This implies that people in similar circumstances express similar demands for services, which is, at best, an untested assumption in the analyses of competition between local government units.

In sum, there is *prima facie* support for the hypothesised link between one dimension of inter-authority competition and two measures of local authority behaviour. The balance of the evidence is in line with public choice propositions on expenditure and efficiency. Nevertheless, the defects in the empirical tests are so serious that it would be wise to suspend judgement on the public choice model of competition between local authorities until better evidence is produced. Such evidence needs to encompass all three dimensions of the public choice model of competition between local governments, and to focus directly on valid measures of technical efficiency and responsiveness.

(b) Competition between Political Parties

The main public choice hypothesis on this form of competition is that rivalry between parties is conducive to responsiveness to public preferences. Inter-party competition should also be positively related to the technical efficiency of service provision: ruling parties who fear loss of office are more likely to spend money carefully in an attempt to maximise their share of the popular vote. It was argued in Chapter 3 that there is no reason, from a public choice perspective at least, to expect party competition to have a significant independent impact on expenditure decisions. Local expenditure levels are influenced by the ideological disposition of the ruling party. As party competition in itself carries no ideological 'loading' then it is unlikely to have a separate additive effect on spending. Rather, the impact of competition is likely to be mediative; that is, party competition modifies the relationship between party ideology and expenditure decisions. Some empirical studies in the UK have tested for an additive effect of competition on local tax and expenditure decisions. The theoretical basis of these tests is not clear; unsurprisingly, most of the statistical results have been insignificant.

It is impossible to evaluate the empirical validity of the public choice hypothesis that inter-party competition is positively related to the technical efficiency of service provision. The reason is straightforward – no tests of this relationship have been undertaken in UK or US local government. The state of knowledge on the link between competition and responsiveness is little better. As argued

in Chapter 3, many American studies purport to test Downs' median voter model but omit a crucial variable: party competition. These studies focus on the relationship between the income or local tax share of the median voter and local fiscal policies. Whether party competition affects this relationship is ignored. Moreover, as noted in the previous section, it is inappropriate to use measures of the economic circumstances of individuals as proxies for political values. For example, not all wealthy voters prefer low public spending, any more than all members of low-income groups prefer high spending. It is, therefore, possible that the income variables in the 'median voter tests' reflect ability to pay rather than service preferences.

Several studies have translated the public choice hypothesis on party competition and responsiveness into more accurate empirical tests. If their results were taken at face value, then it would be concluded that the impact of competition is insignificant. However, the evidence is sparse and open to criticism. In the British studies, median voter preferences are not measured directly, but instead are assumed to be 'moderate' (Boyne, 1987a, 1997b; Hoggart, 1984; Sharpe and Newton, 1984). In the only US study (Hoffman, 1977) median voter preferences are measured directly, but the operationalisation of party competition is weak. In particular, the competition variable is based on a very rough measure of the dominance of the ruling party and takes no account of past volatility in party strength. A study that combines survey data on median voter preferences with measures of competition that encompass both dominance and volatility will add significantly to the evidence on public choice theory. Indeed, this would constitute the first complete test of the Downs model on local government in either the US or UK. As argued in Chapter 3, the different constraints and incentives faced by local politicians in the two countries imply that such a study is more likely to yield significant results in America than in Britain.

(c) Competition between Service Producers

Public choice theory is usually taken to imply that competitive tendering or contracting-out will lead to lower expenditure and higher technical efficiency in local government systems. However, the

position is more complex than this. In Chapter 5 it was argued that the consequences of external competition for service production are likely to differ between (a) services that are actually exposed to competition, and (b) local government as a whole. According to public choice theory, all senior local authority officials are budget maximisers. Therefore, even if expenditure on a specific service falls as a result of external competition, bureaucrats will attempt to retain the 'saving' within the local authority budget. Thus the size of the absolute cut in spending is likely to be far greater for the service that is subjected to competition than for the local authority as a whole. Similarly, if this public choice logic is followed through, greater efficiency in services that are open to contestability or actual competition may be accompanied by *lower* efficiency elsewhere in the same local authority. The part of the 'efficiency gain' that is retained within the local budget may be allocated in a variety of ways, but public choice theory implies that some of the money will be used to provide bureaucrats with an 'easy life'. Thus competition for some services may have a perverse effect on other services that retain their monopoly status: public choice arguments on bureaucratic behaviour suggest that such services are likely to become less efficient. The only way to avoid this outcome may be to introduce external competition for *all* the services that a local authority provides.

These wider consequences of competition for service production are largely ignored in the empirical studies. All of the British tests and most of the American tests focus on expenditure and technical efficiency in services that are directly affected by competitive tendering or contracting-out. Furthermore, much of the evidence on expenditure and efficiency in both the UK and USA refers to one service, refuse collection. Thus not only is the coverage of public choice hypotheses unsatisfactory, so is the coverage of local government functions. Nevertheless, within this narrow base of evidence, fairly clear conclusions appear to have been reached by the empirical studies. All nine of the British studies and fourteen of the twenty American studies find that external competition is associated with lower expenditure. Support for the public choice hypothesis on technical efficiency is weaker, but a majority verdict is still obtained. Greater efficiency seems to be produced by competitive

tendering in the UK (six of nine studies) and by contracting-out in the USA (nine of seventeen studies). Moreover, none of the tests in either local government system shows that external competition is associated with *less* efficiency.

At last, then, it appears that there is something for public choice theorists to cheer about. Celebrations, however, would be premature. First, as already noted, the wider impact of competition for the production of particular services is unknown. Secondly, it was shown in Chapter 5 that the British and American studies contain a range of methodological defects that cast doubt on the validity of the evidence. These include the failure to control for explanatory variables such as scale of output and local political values, weak (or absent) measures of service quality, and crude measures of competition. Until such problems are rectified, it cannot be argued that the validity of public choice theory is confirmed by the effects of competition between local service producers.

(d) Summary

The superficial pattern of the evidence on public choice models of competition in local government is summarised in Table 6.1. Two of the nine cells are empty because, as argued in Chapters 3 and 5, public choice theory does not suggest that party competition influences expenditure, or that competition for service production influences responsiveness. This leaves seven public choice hypotheses on the relationship between competition and local authority behaviour. For two of these, no evidence is available: the impact of party rivalry on technical efficiency is unknown, as is the effect of inter-authority competition on responsiveness. The results of the empirical studies appear to be consistent with four of the remaining five hypotheses: lower spending and higher efficiency are associated with competition between local authorities and between service producers. Only one public choice hypothesis is contradicted by the evidence: the impact of inter-party competition on responsiveness to median voter preference is insignificant.

Taken at face value, the empirical tests provide substantial support for public choice theory. However, it has been shown in this section that a different picture emerges when the evidence is exam-

ined more closely. It is important to be clear about the implications of the methodological criticisms. The point of the argument is not that public choice models of competition are false. Rather, the quality (and in some cases the quantity) of the evidence is insufficient to accept or reject the validity of public choice propositions. In other words, it is not clear whether public choice theory should be judged 'innocent' or 'guilty' because the evidence is incomplete and inconclusive. This is a criticism of the procedures used to generate the evidence, rather than a criticism of public choice theory itself.

Table 6.1: Summary of the Empirical Evidence on the Impact of Competition on Local Authority Behaviour

Forms of competition	*Dependent variables*		
	Expenditure	*Technical efficiency*	*Responsiveness*
Between local authorities	Negative	Positive	Unknown
Between political parties	–	Unknown	Insignificant
Between service producers	Negative	Positive	–

Note: – indicates that there is no public choice hypothesis for the relationship between these variables

3. PUBLIC CHOICE AND LOCAL GOVERNMENT: METHODOLOGICAL PROBLEMS AND THEORETICAL PROSPECTS

This final section of the book has two aims. First, to highlight the main methodological problems that must be resolved in order to provide valid evidence on the relationship between competition and local authority behaviour. Secondly, to identify the theoretical questions that further 'normal science' in the public choice tradition should be used to answer.

(a) Methodological Problems

One set of methodological issues that needs to be addressed is the measurement of expenditure, technical efficiency and responsive-

ness. Detailed problems concerning these variables were discussed in Chapters 2 to 5; only the major defects that require attention are noted here.

Estimates of the impact of competition should include the expenditure of not only local governments but public agencies in general. The reason is that competition at the local level may impose 'negative externalities' on other parts of the public sector. For example, inter-authority competition may lead local authorities to neglect the needs of low-income groups if 'mobile' households are drawn disproportionately from wealthy sections of society; similarly, external competition for service production may generate efficiency savings at the expense of job losses for unskilled workers who are unable to find alternative work. The burden of helping such 'victims of competition' may fall outside the local government system, for example on health or social security agencies operated by higher tiers of government. Such indirect effects of local competition on public spending have not been recognised in empirical tests of public choice hypotheses. The reason seems to be that public choice theory emphasises monopoly as the main form of 'non-market failure' (Wolf, 1988). However, competition may also fail, and in particular create costs that do not fall on the individual buyers and sellers in the local government market.

Future studies also need to measure the technical efficiency of service production more carefully. Very few of the existing empirical tests focus directly on the cost per unit of local service output, and even fewer contain comprehensive indicators of service quality. The problems of defining and measuring quality are formidable, but must be faced if valid tests of public choice hypotheses on technical efficiency are to be undertaken. Practitioners of 'empirical public choice' usually draw heavily on economics and political science, but in order to devise good indicators of technical efficiency they may need to become more familiar with the literatures on cost-accounting and management.

Measures of the responsiveness of local authorities to public preferences are almost entirely absent in empirical tests of public choice propositions. Accurate indicators of this aspect of local authority performance are, however, crucial to the assessment of public choice arguments on competition. Lower expenditure can-

not be regarded as 'good performance' if this is inconsistent with public preferences; similarly, there is little point in achieving a high level of technical efficiency unless the outputs are tailored to public demands. There appear to be no reliable short-cuts to useful measures of public preferences. If responsiveness is to be evaluated, it is necessary to compare local demands with local policies, which almost certainly implies surveys of local public opinion (the Hoffman, 1977, survey provides a useful illustration of this approach). This may be more time-consuming and more expensive than inferring preferences from socio-economic data, but it is the only direct route to the evaluation of the public choice hypothesis that competition encourages responsive behaviour by local policy makers.

Another methodological defect in the existing evidence is the lack of attention that has been given to the measurement of competition. The central 'explanatory variable' in public choice models of local authority behaviour has usually been measured badly, and sometimes not measured at all. Further tests of competition between local government should cover indicators of autonomy and finance as well as structure; studies of inter-party competition need to assess both dominance and volatility; and evaluations of the effects of external competition should focus not simply on contestability, or on whether the service producer is public or private, but on the actual level of competition for the contract. In short, empirical studies of public choice theory must take the definition and operationalisation of their core explanatory variable more seriously.

A final major methodological issue is the requirement to control for other explanatory variables when the effects of competition are analysed. Levels of expenditure, efficiency and responsiveness in local government are likely to reflect a wide range of economic, social and political circumstances (Boyne, 1996a). Thus the primitive bivariate tests that have been used in some studies should be replaced by more sophisticated multivariate models. The central public choice argument that competition in the public sector leads to superior performance is, in essence, quite simple; but this does not imply that its empirical validity can be evaluated by simplistic methods.

(b) Theoretical Prospects

If the numerous methodological problems in tests of public choice theory are resolved, it should then be possible to investigate a range of interesting theoretical issues.

First, the validity of individual public choice propositions on competition and performance could be established, not only in the USA and UK but in local government systems in general. Indeed, the measures and methods that have been proposed in this chapter could be applied to central government agencies and other parts of the public sector. This would lead to a comprehensive and reliable set of evidence on the impact of competition on expenditure, technical efficiency and responsiveness in public organisations.

Secondly, it may be possible to compare the effects of various types of competition. For example: is expenditure influenced more strongly by competition between local authorities or by rivalry between internal and external producers of services? Is responsiveness more likely to be enhanced by inter-party competition or inter-authority competition? And which of the three forms of competition has the greatest effect on technical efficiency in local government? To date, almost all tests of public choice theory have considered each type of competition in isolation from the others. However, if the relative effects of different types of competition are to be compared, then measures of each need to be entered (separately or in combination) in the same statistical model. Otherwise, indicators of the three types of competition may act as proxies for each other, and the *total* impact of competition may be overestimated.

Thirdly, it would be useful to consider the impact of other forms of competition on the behaviour of public sector organisations. This could include rivalry between pressure groups, and contests *within* the bureaucracy for administrative territory and financial resources. It could be argued that 'normative public choice theory' has advocated new forms of competition in government (e.g. competitive tendering), and has failed to recognise that political systems already contain a wide variety of competitive forces.

Fourthly, are there 'diminishing returns to competition'? If a public agency is already constrained by pressures in the markets for tax revenue, political power and service contracts, then would a fur-

ther dose of 'market forces' change its performance for the better? Is it possible that multiple market pressures result in an environment that is so turbulent or unpredictable that 'rational' behaviour is difficult, if not impossible? Some competition may stimulate policy-makers to improve their performance, but if competition becomes fierce and pervasive then they may be 'tested to destruction'.

Finally, the empirical analyses that have been undertaken so far are concerned with an 'intrinsic' evaluation of public choice theory. In other words, they focus on the dependent variables (e.g. efficiency and responsiveness) that are emphasised by the theory, and thereby allow public choice arguments to be assessed 'on their own terms'. A wider picture of the effects of competition would be presented if 'extrinsic' criteria of evaluation were also employed. These criteria could include important attributes of democratic political systems such as participation, accountability and equity. It is generally assumed that competition between local councils or between service producers has adverse consequences for such variables (see, for example, Cox and Nartowicz, 1980; Cutler and Waine, 1994; Donahue, 1989; Hilke, 1993; Kettl, 1993; Newton, 1975; Voytek, 1991). However, there are only a few fragments of empirical evidence on this issue, and their conclusions are contradictory (Hill, 1974; Murin, 1985; Sacher, 1993).

In conclusion, substantial work remains to be done on the core public choice proposition that there is a positive relationship between competition and performance in the public sector. There are many methodological problems to be solved, and a variety of theoretical issues still to be explored. It is, therefore, likely to be some time before a clear judgement can be reached on the scientific value of public choice theory. At present, a strong acceptance or rejection of the public choice perspective on local government can be derived only from faith or prejudice, not from the evidence. In some countries (e.g. Scotland), juries in courts of law are allowed to arrive at one of three verdicts on the basis of the evidence presented to them: guilty, not guilty, and 'not proven'. It is this last verdict which best describes the current status of public choice models of competition in local government.

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