

THE TENABLE RANGE OF FUNCTIONS OF LOCAL GOVERNMENT

George J. Stigler, professor of economics, Columbia University

The members of the legislative, executive, and judiciary departments of 13 and more States, the justices of peace, officers of militia, ministerial officers of justice, with all the county, corporation, and town officers, for 3 million and more of people, intermixed, and having particular acquaintance with every class and circle of people, must exceed, beyond all proportion, both in number and influence, those of every description who will be employed in the administration of the Federal system (*The Federalist*, No. 45).

The preservation of a large role in governmental activity for local governments is widely accepted as an important social goal. No one can doubt that the individual citizen gains greatly in political dignity and wisdom if he can participate in the political process beyond casting a vote periodically. It is also generally conceded that a good political system adapts itself to the differing circumstances and mores of different localities, or, as I would wish to rephrase it, the system should allow legitimate variations of types and scales of governmental activity to correspond with variations in the preferences of different groups of citizens.

Nor will it be denied that this social goal is being increasingly sacrificed. In 1900, virtually all questions of housing, public health, crime, and local transportation were dealt with exclusively by State or local governments, and the role of the Federal Government in education, regulation of business practices, control of natural resources, and redistribution of income was negligible. Today the Federal Government is very active in each of these areas, and its share of responsibility is gradually increasing.

I propose to examine some of the reasons which are given for the growing centralization of political processes. The proper range of activities of government in general will not be raised. Our question is simply this: If the people in a given community wish to embark on a particular governmental policy, when does the efficient discharge of this policy require that it be imposed by a central authority also upon other communities?

In many minor areas of governmental activity no real questions are raised, as yet, about the feasibility of local sovereignty. If a given community wishes to have superb library facilities, it can build and pay for them; if another community wishes instead a skating rink, it may so choose. If individual citizens in any community disagree strongly with the majority preferences, they may move to a more congenial community. Since governmental functions must often be provided upon a considerable scale to be tolerably efficient in execution, a

sufficiently eccentric individual may not be able to find any community with enough like-minded individuals to be able to adopt that series of governmental policies which would exactly suit his taste. For example, he may wish to live in a community with gravel streets and a magnificent observatory, and find no community willing to provide this combination. This sort of limitation is also encountered in consuming the products of private enterprise—I may not find precisely the automobile or typewriter that suits me.

In most areas of governmental activity, however, it is increasingly felt that local governments are inefficient units. When any of three types of governmental activity are sought, it is said that the unit of effective administration must be large in scale—

1. When the object of a regulatory policy can be nullified by the competition of (including migration to) other local governmental units.
2. When the source of revenue of the activity can escape financial responsibility by migration to another unit.
3. When the policy is incapable of efficient performance upon a local scale.

We consider these problems in turn.

THE PROBLEM OF COMPETITION

Suppose that a community wishes to set a high standard of factory safety, and requires the installation of a very expensive safety device. Then the local portion of a much larger industry will be undersold in the common market by factories in other communities, provided they do not also simultaneously set as high standards of safety practices. The local branch of the industry then dies or migrates. These facts can be taken as data for our discussion.

The essence of this argument is that competition, which usually works so well in the area of private enterprise, serves to defeat desirable goals in the area of government. If every governmental unit, save one, were to desire and require elaborate safety devices in the factories of some industry, it is claimed that their desire could be stultified by the presence of the exceptional community which did not have this desire, because the regulated industry would migrate to this community and escape regulation, and the knowledge that it would do so is often enough to prevent the various communities from attempting to regulate it.

It may be remarked that a similar argument is often encountered in the private-enterprise sector. Plants with low wage rates, it is often said, force plants with high wage rates to reduce their wages in order to compete successfully in the common market. In this case the argument is reversible: the plants with high wage rates force plants with low wage rates to raise their wages in order to compete successfully for workers in the common labor market. Both formulations, however, are singularly uninformative, for they do not lead directly to the correct conclusion, which is that the wages of all (similar) workers must approach equality in all plants under competition, and the common wage rate will be governed by the value of the worker's services in those plants which can pay this rate. Can it be that some parallel obscurity attaches to the customary formulation of the unfortunate effect of competition among governments?

The governmental analysis is, in fact, incomplete. Suppose any community set the required level of safety practices as high as it wishes, and then gave a subsidy to each enterprise in the locality equal to the additional cost that these safety devices imposed upon the enterprises. Then there would be no tendency for the local industry to be handicapped in competition with other areas with lower safety standards, and the community would enjoy more worker safety and less of other things than other communities. If 47 percent of the localities or 99 percent of the localities embark upon this policy, then 47 or 99 percent of the factories will have the desired safety practices, and the nonconformist competitors will not have the slightest tendency to injure or attract these safe and expensive factories.

When a community imposes the safety regulations without giving a compensating subsidy, its troubles arise from the fact that it is seeking to push these higher costs off on consumers, and neither local nor distant consumers wish to assume this burden. The problem of competition resolves itself into an unwillingness of the community to bear the costs of its policy when they are posed as an explicit burden.

A similar analysis holds when the community wishes to require of some consumer good that it be of unusually high quality. If it specifies that only goods of this unusual quality be sold in the community, the producers will be quite eager to meet the specifications—at a remunerative price.

Although it involves a digression, it may be profitable to discuss more generally our example of factory safety devices because the discussion will serve to illuminate the workings of competition in general. If workers are faced with the choice of working in one plant, unequipped with safety devices, at an hourly rate of \$1.50 but with expected losses from injuries of 5 cents per hour, and in another plant with safety devices they are offered \$1.46 with no expected losses from injuries, we should expect them to choose the latter plant. If under these conditions they do not choose the safer plant, the most probable explanation is that they do not correctly appraise the expected losses from injuries and the remedy is to inform them of the consequences of working in factories unequipped with safety devices. In a fully competitive system the entrepreneurs will supply at cost all the safety devices that the workers demand, and all safety devices which return (to the worker, in terms of reduced injuries) as much or more than the cost will be adopted. It may well be that in this situation there will be safety devices which do not pay but which would reduce injuries further, and that the community as a whole sets a higher value on avoidance of these injuries than the workers themselves do. Some moral philosophers might argue that these workers should set a higher value on the avoidance of injuries, but the workers do not, and in a society with free choice of occupation they cannot be made to pay for more safety than they wish. Hence the society must bear the costs of achieving more safety, and the sole question is whether the costs be borne by consumers through compulsory installation of the safety devices and restriction of supply, or by direct grant from public funds.

The competition of other communities as tax collectors is an important form of the alleged difficulty arising out of competition. Suppose community A wishes to have splendid and expensive schools,

streets, housing, poor relief, and what not. If it levies sufficient taxes to finance this elaborate program, a large portion of the tax base (industries and well-to-do individuals) will leave the community while simultaneously a large number of beneficiaries of the generous program may immigrate. The tax rates on the narrower tax base will have to be prohibitive (from the viewpoint of the remaining taxpayers) to finance the sumptuous program.

Again we can accept the facts, with one temporary amendment. Let us assume that the same income is received by every family, and no questions of income redistribution are involved. Will the presence of communities with lower tax rates defeat the ambitions of community A? The answer is clearly in the negative. There will be some redistribution of population among communities: those people who prefer cheaper public services and lower tax rates will move elsewhere, and others with opposite taste will move to A. Competition of communities offers not obstacles but opportunities to various communities to choose the types and scales of governmental functions they wish. The proviso that all family incomes are equal has a vast influence on this argument, of course, and we turn now to income redistribution as a goal.

THE DISTRIBUTION OF INCOME

If all families had equal (real) income, would there be any need for local governmental units? Why could not each city be a private corporation, supplying at a price the services its dwellers demanded? With many, many such corporations, competition would prevent monopolistic pricing, and schooling and police and fire protection would be sold at a price including a fair rate of return on investment. This scheme would obviously be inappropriate where the service must be a monopoly (like national defense) and probably also where the community size was so large (due to the economic advantages of size) that the communities were too few to rely upon competition, but let us put these instances aside. We are not seeking to prove that there should be no government, but rather to find the logic of government at the multiunit governmental level.

A basic deficiency in this private enterprise organization of social life, we would all agree, is that it allows excessive freedom to the individual. It would allow parents to horsewhip children, and it would create communities populated chiefly with drunkards and drug addicts—although thieves would presumably prefer to live among honest men (even with their policemen) than only with other thieves. Public opinion would curb many undesirable personal actions, but the society would wish to compel observance of its basic values. As a result, we must recognize the need for political units large enough so their numbers include enough normal people to insure the imposition of the society's basic moral standards on local communities. Our States—with 1 or 2 possible western exceptions—meet this condition of statistical large numbers.

The second basic weakness—some will call it a strength—of the private enterprise organization of local government is that it would not permit price discrimination; it does not have the ability to redistribute income. The purely competitive organization of local services would

make it impossible for a local government to obtain money from the rich to pay for the education of the children of the poor, except to the extent that the rich voluntarily assumed this burden.

How can local governments cope with this problem? If 99 communities tax the rich to aid the poor, the rich may congregate in the hundredth community, so this uncooperative community sets the tune. Here competition does not perform with its usual excellence, for competition is the system calculated to organize only voluntary activity.

What is the correct amount of redistribution of income in light of the society's desires? It is more than the unrestricted competition of tax-free colonies of the rich would allow, but less than the most aggressively egalitarian community would desire. The decision must be in some sense a national decision, for the proper amount of redistribution, even if rich and poor were chained to their communities, could not depend upon the accidents of income composition of a particular community. And once this level of redistribution is set, no one community may complain if its rich citizens migrate when it seeks to go above this level of distribution unless the society is prepared to let the most egalitarian community set the scale of income redistribution.

Since redistribution is intrinsically a national policy, it should not be restricted to a community level; a community consisting only of poor people should receive the desired minimum social services. Hence, in pure principle, the Federal Government should collect the progressive levies and redistribute them (in whole or in part) to local units with each unit receiving an amount governed by the number of its poor and the degree of their poverty.

Given this system of tax revenue redistribution, the local governments could still be allowed to perform any function which they were competent to perform efficiently. One community might choose to spend more on schools and less on hospitals than another, but this is surely an area of legitimate freedom; there is no "correct" distribution of expenditures among such functions.

In a society which has no serious program of income redistribution (even as a means to the attainment of minimum goals), local governments would face no basic revenue problems because of competition.¹ It is in keeping with this argument that a century ago almost all functions were local and the problem of competition for the tax base was negligible. With an appropriate fiscal system we could restore these revenue considerations to a position of unimportance even in an era of extensive income redistribution. There still remains the question of whether the local governments could efficiently perform the enlarged range of functions that modern governments have assumed. We turn now to this question.

THE ECONOMIES OF SCALE

How large must a governmental unit be to perform efficiently the activities which the public wishes governments to perform? This is an area which deserves much more attention than it appears to have received, and the following remarks are highly tentative.

¹ Perhaps a qualification should be entered with respect to the growth of taxable wealth that escapes a general property tax. In England the desire of property owners to ease their tax burdens was a force in the emasculation of local government; see E. Cannan, *The History of Local Rates in England*, second edition, 1912, ch. VI.

There are a set of functions which are intrinsically national because they are indivisible. The greatest of these is national defense, and it would be ill-served if each State or local unit were to undertake the defense of its own area. One may cite also foreign relations, the national governmental machinery, and the control of relationships among lower governmental levels.

In addition to such traditional functions, one may list certain functions which are or can be performed at a local level but which must be coordinated to achieve efficiency in their design. The transportation systems of localities must take some account also of the needs of long-distance transportation. The radio and television stations of various localities must not jam one another. These are functions which in the economist's language, have large external economies or diseconomies accruing to the areas which do not participate in their execution, so it is essential that they be formulated (although not necessarily administered) on a larger area than the local government.

We should reserve for the Federal Government those functions which are much more efficiently discharged on the largest scale. When local performance involves large duplication, it is inefficient. Thus it seems undesirable to have 48 estimates of wholesale prices since the price movements in most regions will be parallel; on the other hand, the calculation of cost-of-living indexes might suitably be removed from the BLS to the States.

The optimum scale of performance has tacitly become identified with the National, or at least the State, scale almost without examining the nature of the governmental functions under discussion. This seems most surprising to the student of industrial organization; he is accustomed to finding that the activity in an industry with a complex technology is usually efficiently conducted by a firm smaller by almost any measure than the government of a town of 25,000. Is there some special characteristic of governmental functions that makes large units necessary to efficiency?

Only one characteristic seems a possible candidate for this role: the great variety of functions performed by even the small governmental units. The lack of specialization is pronounced even though political scientists complain of a multiplicity of overlapping local units (many of which were established to evade tax or debt limits on local units). Some of these functions can be performed efficiently on a very small scale. Many of the most distinguished private schools and colleges are much smaller than the school system of a town of 5,000 people. Others are more varied. A police department can efficiently control local traffic on a small scale; in one sense it must be worldwide to have an efficient "missing persons" bureau.

But this variety of function is not really unusual. Every enterprise must use goods and services, or produce goods or services, which must be produced or sold on a much wider scale than the enterprise itself can undertake. Even a huge department store is not large enough to make its own delivery trucks, or to print the newspapers in which it advertises. Just as cooperation in these matters is brought about by the price system, so cooperation among governmental units has been developed—and could be carried much further—to avoid the determination and execution of all public functions by that governmental unit which is most efficient in conducting the function with the largest scale of operation.

It happens, as we have already noticed, that one function of paramount importance must be conducted on a very large scale: the collection of revenues designed to redistribute income. Much centralization, in fact probably most centralization, has been a consequence of this situation. A central government is loathe to make grants without exercising a degree of control over the local units which disburse the funds. No degree of control less than 100 percent, however, is sufficient to guarantee local performance exactly as the central authorities wish it, and there is no obstacle except tradition to slow down their gradual extension of controls.

The case for imposing controls over the smaller units receiving grants, however, is far from general. The central disbursing authority has no monopoly of wisdom. The State boards of education have imposed a series of certification requirements on local teachers, for example, that have done much to lower the quality of elementary education in the United States. When central governments have superior civil servants, as they often do, the cause lies more often in their control of finance and authority than in the advantages of centralization. It may be true that when most administrative units are small the ablest men cannot conduct affairs on the largest scale, but this seems an odd consideration to give weight in setting the functions of local governments in a democracy. More often the complexity of the tasks at the national level has reached such levels that not the ablest men can control them efficiently.

If grants were given to local governments without supervision, there would be some instances of gross neglect or venality and more variety in the quality of the performance of public functions. We should also expect to find that much of this variety was eminently sensible, and that many types of experimentation would constantly be embarked upon by the more venturesome and the more foolish communities—with large social benefits from both the successes and the failures.

If we give each governmental activity to the smallest governmental unit which can efficiently perform it, there will be a vast resurgence and revitalization of local government in America. A vast reservoir of ability and imagination can be found in the increasing leisure time of the population, and both public functions and private citizens would benefit from the increased participation of citizens in political life. An eminent and powerful structure of local government is a basic ingredient of a society which seeks to give to the individual the fullest possible freedom and responsibility.