Functions of Government

Lectures 17 and 18

Connolly and Munro (1999): Chp 24
Griffiths and Wall (2007): Chp 29
Stiglitz (2000): Chp 26
Outline

• The assignment problem
  – The case for central govt
  – The case for local govt
  – In practice, multi-level govt

• Rules for assignment

• UK: a unitary state

• EU: a type of federalist state
In favour of Central Govt

• Pareto gains from higher level govt

• 1. Economies of scale
  – Shared fixed costs eg tax collection and civil service
  – Intermittent demand eg judicial system

• 2. Spillover effects
  – Direct cost and benefit spillovers (eg pollution and free-rider problem)
  – Strategic substitute eg defence (public goods and non-excludable)
  – Strategic complements eg education
  – Indirect spillovers: inter-related policies

• 3. Co-ordination
  – Policy harmonisation eg transport system, product and safety regulation, legal and trade
In favour of Local Govt

• Pareto gains from regional units of govt

• 1. Local information
  – Knowledge of costs and benefits of local public goods (non-rival goods)
  – Uniform information v local information: Figure 1
  – **Tiebout Theorem**: under certain conditions local provision of public goods is Pareto-efficient.

• 2. Public choice
  – Centralisation and bureaucracy
  – Decentralisation and ↓ expenditure

• 3. Autonomy
  – Voluntary provision and community

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Figure 1  **A decentralised outcome**
In favour of Multi-level Govt

• In practice, most countries have several tiers of govt
  – UK: 2+ tiers

• Optimal decision depends on type of public good
  – National level eg defence
  – Local or state level eg education
  – Other areas of expenditure are subject to variation
    ⇒ Separate jurisdictions v economies of scope in govt
  – Decentralisation and incomplete contracts?

• The Assignment Problem
  – The design of govt: which tier will deal with what function?
  – Trade-off: spillovers v local tastes/preferences
  – Issue of separability
How to Assign the Functions of Govt?

• Rules for Assignment of Taxes
  – Mobile factors: CG and a progressive, re-distributive taxation
  – Immobile factors: local taxes or user fees
  – Equity: CG to oversee re-distribution of uneven resources

• The Assignment problem and Institutions
  – A unitary state (UK, France)
    CG decides nr of lower tiers, geographical jurisdictions, decentralised power
  – A federal state (US, EU, Germany, Australia)
    CG is constrained: tiers of govt are constitutionally fixed, requires agreement, state functions

• Political decision-making
  – Sovereignty v autonomy debate
Assignment in the UK

- **Unitary nature of the state**
  - Allowed change in decision-making structures of local govt

- **1. Greater London Authority and Mayor of London**
  - Strategic economic policy; transport policy

- **2. Compulsive competitive tendering v best value**
  - Cost of service v quality, improvement and consultation

- **3. Directly elected regional assemblies**

- **4. Social policy initiatives: key features**
  - Role of local authorities
  - Partnership and collaboration across public, private and voluntary sectors
  - Audit and inspection of quality and standards
  - Devolved responsibilities
The EU and Federalism

• EU Institutions
  – The European Commission: external rep; initiate & enforce legislation; mediator
  – The Council of Ministers: agree legislation by QMV
  – The European Parliament: co-decision making powers
  – The European Court of Justice: supreme court

• EU v ‘typical’ Federalism
  – Small EU budget constrains transfers & re-distribution of income
  – Welfare concern of citizens
  – Imperfect information sharing

• EU v Nation State
  – Policy of subsidiarity
## EU Revenue

<table>
<thead>
<tr>
<th>Source</th>
<th>1998</th>
<th>(%)</th>
<th>2000</th>
<th>(%)</th>
<th>2006</th>
<th>(%)</th>
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<tbody>
<tr>
<td>TOR</td>
<td>13,743.2</td>
<td>(16.7)</td>
<td>14,564.9</td>
<td>(16.4)</td>
<td>14,225.1</td>
<td>(12.9)</td>
</tr>
<tr>
<td>VAT</td>
<td>32,752.8</td>
<td>(39.7)</td>
<td>32,554.6</td>
<td>(36.7)</td>
<td>15,884.3</td>
<td>(14.3)</td>
</tr>
<tr>
<td>GNP</td>
<td>35,985.2</td>
<td>(43.6)</td>
<td>41,593.4</td>
<td>(46.9)</td>
<td>80,562.5</td>
<td>(72.8)</td>
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<tr>
<td><strong>Total ‘own resources’</strong></td>
<td><strong>82,481.1</strong></td>
<td><strong>(100.0)</strong></td>
<td><strong>88,712.9</strong></td>
<td><strong>(100.0)</strong></td>
<td><strong>110,671.9</strong></td>
<td><strong>(100.0)</strong></td>
</tr>
<tr>
<td>Other revenue</td>
<td>1,628.0</td>
<td></td>
<td>674.0</td>
<td></td>
<td>1,297.6</td>
<td></td>
</tr>
<tr>
<td><strong>Total revenue</strong></td>
<td><strong>84,109.1</strong></td>
<td></td>
<td><strong>89,386.9</strong></td>
<td></td>
<td><strong>111,969.5</strong></td>
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</tbody>
</table>


### Table 1 Sources of Revenue for the EU budget (€m and %)
## EU Expenditure

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<tbody>
<tr>
<td><strong>Agriculture</strong></td>
<td>40,937.0</td>
<td>40,993.9</td>
<td>45,377</td>
<td>50,991.0</td>
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<td>EAGGF guarantee</td>
<td>40,937.0</td>
<td>36,889.0</td>
<td>40,761</td>
<td>43,279.7</td>
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<tr>
<td>Rural Development (RDP)</td>
<td>–</td>
<td>4,104.9</td>
<td>4,616</td>
<td>7,711.3</td>
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<tr>
<td><strong>Structural operations</strong></td>
<td>28,594.7</td>
<td>32,678.0</td>
<td>32,998</td>
<td>35,639.6</td>
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<tr>
<td>Structural Funds</td>
<td>23,084.4</td>
<td>28,105.0</td>
<td>30,316</td>
<td>32,134.1</td>
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<td>Community Initiatives</td>
<td>2,558.8</td>
<td>1,743.0</td>
<td>–</td>
<td>–</td>
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<tr>
<td>Cohesion Fund</td>
<td>2,648.8</td>
<td>2,659.0</td>
<td>2,682</td>
<td>3,505.5</td>
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<tr>
<td>Others</td>
<td>302.7</td>
<td>325.0</td>
<td>–</td>
<td>–</td>
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<td>Internal policies</td>
<td>4,678.5</td>
<td>6,027.0</td>
<td>6,793</td>
<td>8,889.2</td>
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<td>External policies</td>
<td>4,528.5</td>
<td>4,805.1</td>
<td>4,895</td>
<td>5,369.0</td>
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<tr>
<td>Administration</td>
<td>4,353.4</td>
<td>4,703.7</td>
<td>5,225</td>
<td>6,656.4</td>
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<td>Other</td>
<td>437.0</td>
<td>4,072.7</td>
<td>3,754</td>
<td>4,424.3</td>
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<tr>
<td><strong>Total</strong></td>
<td>83,529.2</td>
<td>93,280.4</td>
<td>99,042</td>
<td>111,969.6</td>
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</tbody>
</table>

Source: As for Table 29.2.

### Table 2  Budgetary Expenditure of the European Community (€m)
Summary

• CG and spillovers v local govt and local tastes

• Tax assignment
  – Central govt tax and factor mobility
  – Local govt tax and factor immobility

• UK: multi-level governance

• EU: a political and economic entity
  – Driven by 4 freedoms (not spillovers)

• Assignment in the EU: policy of subsidiarity
  – Assign functions to the centre only if inadequate nationally