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Comment on the Financial Relationship Between Central and Local Government in the Netherlands

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MEASURING LOCAL GOVERNMENT EXPENDITURE NEEDS:

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COMMENTS

by

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Messrs. Bierens and Uhl have explored an interesting and important policy concern in local government finance, the determinants of local government employment levels. Their analysis is innovative and useful in their attempt to proxy public output with various physical measures, usually employment, in their separation of "delivery" from administrative employment, and in their explanation of intercity employment differences with measures of both community characteristics and resident characteristics. Three aspects of their analysis, however, would seem to call for further study and model development: a) the consistency of these results with a properly specified demand model; b) the use of a cross-section model for forecasting; and c) the need to establish a better linkage between employment involved directly in service delivery and administrative employment.

The absence of a well developed theoretical model limits the usefulness of this empirical analysis. Similar work on State and Local government employment in the United States has specified employment demand functions and estimated wage and income elasticities of demand in addition to the effects of preference and need indicators.[1] An important and consistent finding in this research is a low price elasticity of demand for public employees. The Bierens-Uhl analysis, a purely statistical study, specifies neither a price nor an income term. Hence it would seem incapable of picking up the employment response to changing wage rates, inflation, a changing level or structure of government grants, or increased community income.

A well defined model may have led the authors closer to the relationship between local government employment and local government expenditures. As it is, they make no attempt to combine the results of their estimated equations for employment and selected non-labor expenditure

1. See, for example, Ronald Ehrenberg "The Demand for State and Local Government Employees" American Economic Review 63, No.3, (June 1973): 366-79; and Roy Bahl, Richard Gustely and Michael Wasylenko "The Determinants of Local Government Police Expenditures: A Public Employment Approach" National Tax Journal 31, No.3, 1978.

A second problem with this approach is the suggestion that it may be used for forecasting and projections. As a cross-section analysis, the results explain why employment levels differ among local governments at any one point in time. The factors which explain such differences may tell us little about what determines changes in local authority staffing. Moreover, certain of the important determinants of the temporal behavior of employment are by definition excluded from cross-section analysis, e.g., inflation, changes in government grant and subsidy policies, and the possibility that the local government employment response to population growth is lagged. Cross-section analysis also precludes study of the responses of local authorities to population decline.

A more fundamental problem with using a cross-section analysis for this purpose is the sense in which the estimated regression equation implies some sort of "norm" to which all local authorities should aspire. Indeed, the estimated equation is nothing more than a description of the average behavior of governments in the sample, and even then, this kind of average is influenced substantially by governments which are outliers in terms of their characteristics. Unless the residuals in this analysis are quite small, it is difficult to know how one would interpret a projected or forecasted employment level for any particular local authority.[1]

A further problem with using this analysis for projections is the need to have forecasted values for many independent variables. Given the very great difficulty in projecting variables such as energy usage, commuting patterns, and even population growth (even with a sophisticated submodel), the forecast employment levels will involve considerable guesswork and the projections will be much less systematically arrived at than is implied here.

A third area where the Bierens-Uhl study could be extended is in studying the relationship between the level of staffing necessary for direct service provision and that required for administration. Their breakout of the two kinds of employment is important and useful but they do not attempt to establish a linkage. Such a linkage could hold important policy implications. For example, if administrative employees are both higher paid and a growing proportion of total employment in growing cities, then city employment structures will move toward a higher paid mix as population grows.

Nothing in these comments should take away from the value of cross-section studies of local finance. There is much to be learned from understanding why cities differ in their patterns of fiscal response. Still, great care must be taken to promise no more, by way of conclusions, than the underlying theory and data will allow.

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1. The authors do not present residuals or adjusted coefficients of variation.