

Final

GOVERNMENTAL COOPERATION -- A PERPLEXING CHALLENGE

Werner Z. Hirsch

University of California, Los Angeles\*

Glad as I am to be with you, and flattered by your invitation, what worried me as I prepared these remarks is the present chaotic state of opinion which makes solutions for local governments difficult. Even the most experienced and serious people concerned with the issues seem to have irreconcilable differences of approach. There is no agreement -- there never has been -- about why local governments have such difficulties in being efficient and responsive to the interests of their constituents, and in financing their activities. How then can there be agreement on steps to ameliorate these problems? Is the curse found in the environment within which local government must perform its responsibilities, or is it that local governments are improperly organized, too highly unionized, or poorly managed, or are their managers interfered with by self-serving politicians who sacrifice efficiency to distributional considerations?

Are Portland or Multnomah County improperly organized and, if so, what forms of cooperation are called for? How can I be expected to say anything with which you all will agree, let alone offer thoughts that deserve your serious consideration? So my hope is not to displease too many of you and not to leave all of you frustrated by the complexity of the problems and the lack of consensus about appropriate policies, but to offer some modest insights.

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My task, at the same time, is seriously influenced by Measure #5 which forces Oregon to reexamine its local government sector. Yet you have made it somewhat easier when you selected as thrust of the conference a search for new institutional arrangements of local governments. As we embark on this journey, I am reminded of a statement by Isaiah Berlin, "When institutions become too set... order becomes oppression and worship of it self-stultifying; sooner or later it is broken through by the almost physiological desire to live, move, create, by the need for novelty and change"<sup>1</sup> and later on he reminds us, "that institutions are made not only by, but also for, men, and when they no longer serve him they must go".<sup>2</sup>

A brief review of America's public institutions' history is in order. Let us recall the time when perhaps the most exciting ideas in North America centered on novel and innovative forms of government. The founding fathers were convinced that they could most effectively create and nurture a more perfect society through the design of its governments. The American Declaration of Independence and the Constitution of the United States both reflect the idea that by designing the right form of governance we could create prosperity and happiness. This idea, that a society, if only it could find the right form of government, could become and do almost anything it dreamed of peaked around 1800. By 1865, the shape of American federalism, first probed and pushed by Hamilton, Jefferson and Marshall and the American Civil War, and having resolved further key questions about state and federal powers, ushered in an age of relative stability, at least for a time. In the 1930s, Franklin D. Roosevelt and his New Deal redefined

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<sup>1</sup> Isaiah Berlin, "The Crooked Timber of Humanity, (New York: Knopf, 1991) p. 196.

<sup>2</sup> Ibid., p. 199.

relationships between state and federal governments; and at the end of World War II, intellectuals (however, with little support from politicians and the populace) agitated for revamping local governments through massive metropolitan consolidation. Not much came of these efforts, and the number of large metropolitan governments can be counted on two hands.<sup>3</sup> Then beginning in the mid 70s, the cry that "small is beautiful" could be heard throughout the land. Attempts to reassign more power to local governments, and particularly to foster small governments, were one result.

So much for a brief historical perspective. I very much like the title of your conference which focuses on governmental cooperation. The challenge is to comprehend the vast variety of possible cooperative arrangements, to identify some of the more appealing ones and to evaluate their merits when applying them to specific local government tasks and activities. In preparing a list of ways in which local governments can cooperate, we must mainly distinguish cooperation between municipalities, municipalities and counties, counties and special districts, as well as between cities and special districts. Moreover, and this will be one of my major points, we must recognize that there is room for cooperation among these local governments as well as cooperation between any of them and local firms. Governments can contract out select services. Thus, it would be a colossal

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<sup>3</sup>The first major city-county consolidation took place in Dade County, Florida, in 1957. Further consolidation has taken place in Baton Rouge, Nashville-Davidson County, Jacksonville-Duval County, and Indianapolis and the surrounding Marion County. The Toronto Metro is often pointed to as the shining example of consolidation in Canada. It was established not by the vote of the people but by the provincial government of Ontario. There has always been some dissatisfaction with regional government. The *Toronto Globe and Mail* stated in 1981, "Regional government was introduced in Ontario in 1968 with the promise of improving the efficiency of the municipal system and cutting costs. But the controversial changes never measured up to the promises as new bureaucracies sprouted, taxes rose and some taxpayers complained of receiving poor service." (Robert Matas, "Regional Government Woes," *Toronto Globe and Mail*, 11 March 1981, p. 4.)

mistake to consider wholesale metropolitan consolidation as the only possible cooperation alternative. It is the most complete, and thereby the most extreme form of cooperation. Lesser forms would consolidate one of two specific functions or, after separating government into two tiers, consolidate one of them; and perhaps the most limited form would involve voluntary cooperative purchase of supplies and/or labor. (The latter is the case when one government contracts with another under the Lakewood plan, about which I will have to say more later.)

There clearly exists a wide typology of cooperative arrangements. For evaluating their merits, I propose to offer a set of criteria which might prove useful. Economists discuss these criteria as part of the theory of optimal government size. Professor Jerome Rothenberg of MIT, about 20 years ago, suggested four criteria to evaluate optimum government size -- economies of scale, internalization of externalities, attainment of redistributive goals, and responsiveness of government to individual preferences.<sup>4</sup>

I will briefly review these four criteria -- scale economies, in simple terms, means that as service output increases, usually because of a larger size of government, cost savings occur. Accordingly, the cost of delivering a unit of public services e.g., a cubic foot of water, declines as more water is delivered. Scale economies are particularly common in services benefiting from vertical integration such as electricity generation and distribution, water production and distribution, and sewage treatment. They tend to amount to 10 to 15% of all urban public services. Most local

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<sup>4</sup>Jerome Rothenberg, "Local Decentralization and the Theory of Optimal Government," in The Analysis of Public Output, ed. J. Margolis [New York: National Bureau of Economic Research, Columbia University Press, 1970], pp. 31-59.

services, however, are horizontally integrated, where a number of venues produce essentially the same service under the guidance of a unified policy. Such public service as police and fire protection, education (separately for each education level), hospitals, and refuse collection are fine examples of horizontally integrated services which account for perhaps 80-85% of urban government services.

Empirical research reveals that metropolitan consolidation is unlikely to produce major scale economies unless the existing scale of operation is quite small or vertically integrated services are involved. Horizontally integrated municipal services are not likely to incur scale economies unless they begin serving more than 100,000 citizens. Thus, unless governments are small, they gain relatively few scale economies in relation to police protection, primary and secondary education, and refuse collection. In relation to fire protection, we found very minor scale economies. At the same time, we identified major scale economies in relation to water, electricity and sewage.

Let us turn next to the second criterion -- internalization of externalities. Externalities occur when people and firms interacting with one another inflict costs for which they do not pay. It should be clear that the larger the jurisdiction, the more of the externalities generated by any of its parts can be internalized. However, you do not need consolidation in order to arrange for the internalization of externalities. Instead, a variety of agreements can be entered into or courts might be relied upon to act as externality adjusters.

Concerning the third criterion, the residents of Multnomah county, or for that matter any other jurisdiction, may have specific redistributive goals. For example, they may want to improve the lot of an impoverished

geographical enclave. Clearly, if this enclave is part of a larger and relatively well-to-do jurisdiction, the impoverished enclave will have greater financial resources than if it were an independent jurisdiction. However, there are alternative steps that can be taken to attain the same redistributive objective. One example is state or federal subsidies to impoverished people or areas.

Finally, there is the issue of the responsiveness of government to individual preferences. Its absence can be inconsistent not only with the basic tenets of a democracy, but can also lead to alienation and possibly even to violent consequences. It is clearly easier for citizens to participate in small than very large governments, a conviction which has been the driving force of the "Small Is Beautiful" movement.

I would hope that judicious use of these four criteria would help you determine the desirability of alternative cooperative efforts. I wish I knew more about the state of Oregon, the city of Portland and the relevant Oregon counties in order to speculate about specific situations. I am aware you have a Metropolitan Service District. In deference to my ignorance, let me reflect on my beat. I think the four criteria would lead to the conclusion that a consolidation of the Los Angeles Police Department with the Sheriff's Office of Los Angeles County would be on balance counter-productive. Each of the two may already be too large. On the other hand, having a single planning commission and a single zoning board for a handful of adjacent cities, e.g., Beverly Hills, Santa Monica, Culver City, Malibu and West Hollywood, could lead to salubrious results. Such an effort would likely lead to scale economies as well as reduce externalities. In Los Angeles some functions have been consolidated, in my view correctly. Thus Los Angeles County for all jurisdictions assesses property, collects

property taxes, administers most elections and the superior court system, provides health care and social services, runs the jail, and supervises parole and probation services. The City of Los Angeles even owns virtually all airports in the entire Los Angeles basin, including Ontario airport in Orange County, and for the life of me, I cannot find a reason for it.

But note that Los Angeles County is many times more populous than its largest city, i.e., the city of Los Angeles which has more than 3 million inhabitants. More than a third of the county's population lives in unincorporated areas. Serving these residents alone would be a task that justifies the county's existence. This is very different from Multnomah county whose 1990 population was less than 600,000, yet more than 86% of its population lives in 2 cities -- Portland and Gresham. Could Los Angeles County be abolished? No!! Could Multnomah County be abolished? How am I, the outsider, to know? But it clearly deserves consideration.

There is a venerable theory (which I hereby invent) according to which it would be a great mistake to finger regional governmental cooperation as the sole strategy for producing more efficient and responsible local governments. An alternative strategy might focus on steps to create more competitive conditions for the selection of local government services as well as labor and material inputs. Should contracting out -- a form of privatization -- be the engine by which this task is to be accomplished, local government by contracting with large private firms (or even other governments) could indirectly benefit from scale economies. They could also do so by contracting with another government. This arrangement is often referred to as the Lakewood Plan, since it was first put to use when the newly incorporated city of Lakewood in Los Angeles County contracted with other governments for a variety of services. For example, the Sheriff's

department provided police protection, a service about 30 cities contract with the Sheriff. Whether contracts are sought from private firms or governments, the same positive effects can accrue. When there are more than only one potential supplier, seeking bids from them can create a competitive environment. Public employees fearing successful outside bids often will be inclined to make extra efforts on their jobs, i.e., be more productive, in order to prevent contracting.

Before going much further, I would like to alert you to some likely clashes between the two policy options. Cooperative government efforts which are intended to yield benefits from scale economies tend to enhance government's monopoly and monopsony powers. Such a move is diametrically opposed to the creation of competitive market conditions. Ultimately, therefore, some balancing might be needed.

Creating competitive conditions and forging arrangements for citizens to benefit from them can be fostered by privatization in general and contracting out in particular. The ability to choose among suppliers of services and to assure the accountability of public servants can have beneficial effects.

Let me hasten to point out that not all local government services lend themselves to contracting out. Effective contracting requires that efficiency gains -- not merely cost reductions -- are likely; that an agreed upon quality of service will be delivered because accountability for such an outcome is assured; and that agreed upon distributional results can be expected. Note that if these three conditions are met and a service is contracted out, governments can often also gain not inconsequential tax payments from the private contractor. My research indicates that, for example, electric utilities and waste disposal companies, both performing



services that can be contracted out, paid taxes in 1987-88 equivalent to 7-19% of their total operating revenue. Admittedly only a part of it goes to the same government that contracts out the service.

I would like to turn briefly to Oregon, whose cities have been leaders in contracting out. Based on replies to questionnaires sent to cities in Oregon and Washington and counties in Oregon, Washington and Idaho late in 1990, municipalities with populations in excess of 25,000 in Oregon engaged in contracting out at a rate of more than 2 1/2 times that of Washington's municipalities. For example, we found that 63% of Oregon's municipalities contracted out for some security services, 50% for the management and operation of certain facilities, and a further 50% for recreation services, road services, and vehicle maintenance and repair, respectively. Altogether 43% of Oregon's cities with populations in excess of 25,000 contracted out for one or more of the eight local services which are most commonly privatized. This figure compares with 17% for the state of Washington.

Oregon's counties with populations in excess of 50,000 exhibited a somewhat lesser interest in contracting out than did Washington's and Idaho's counties. 33% of the latter contracted out for one or more of the eight most commonly privatized services, while Oregon's counties accounted only for 21%. Nevertheless, 60% of Oregon's counties contracted for road services, 50% for solid waste collection and 30% for the management and operations of select facilities.<sup>5</sup>

These empirical findings should not be surprising. The services which were contracted out meet the contracting conditions mentioned earlier. Contracting out was likely because it could occur under competitive

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<sup>5</sup>Werner Z. Hirsch Local Governments Putting A Contract Out On Cost [University of California, Los Angeles, Department of Economics, May 1991], working paper number 621, 13pp.

conditions, producing efficiency gains, while output measurement was possible and therefore accountability an attainable objective. I cannot evaluate the redistributive dimensions which must have been considered. What is also interesting is that organized labor which often will seek to frustrate contracting out initiatives because of self-interest, did not do so in Oregon's municipalities.

Let me summarize what our empirical investigation found -- services most frequently contracted out in the Northwest are solid waste collection, road services, vehicle maintenance and repair, management and authorization services, parks, recreation services and security services.

Clashes between certain types of cooperation among local governments and privatization efforts can be ameliorated and kept to a minimum by carefully selecting contract arrangements. Rather than contracting out all activities of a particular jurisdiction, e.g., an entire elementary school district, one or more districts could contract for janitorial services, counselling or building repair and maintenance. Courts could contract for stenographic services, and tax collectors for word-processing and computer services. Such horizontally directed contracting of specific service inputs which promises efficient and accountable discharge of responsibility can combine the best of all worlds. There will be competition between firms seeking the contract, and the cooperating governments will enjoy heightened bargaining power to reap gains from an enlarged scale of operation.

Before concluding my remarks I would like to congratulate you for undertaking such a serious search of opportunities to improve government. But I should also tell you that you are not alone in this effort. I would like to share with you what I have learned recently about a concerted and well-thought out effort in the United Kingdom. Thus, you are in good

company. Specifically, in July of this year John Major, Britain's Prime Minister, issued a "Citizens Charter", according to which local governments will be given a "charter mark" where their services are deemed to be up to scratch. Improved efficiency and quality service is expected to come about because of two main pressures -- competition and privatization on the one hand and targets and monitoring on the other hand. The second class of pressures are to be exerted by the setting of tough targets and the publication of details of performance of each local government. Examples of targets are fixed appointment times in the health services and target response time from police and fire departments. Perhaps it would be worthwhile to experiment with some awards and penalties in addition to merely publicizing performance. For example, patients who are forced to wait longer than the guaranteed maximums for hospital waiting times could be awarded a fee reduction or assured a greatly reduced waiting time for their next visit.

The philosophy underlying these proposals is summarized as follows -- "whenever the client can exercise a choice, the most effective form of redress is the right of exit: the decision not to accept the service provided and to go somewhere else".<sup>6</sup>

Let me conclude by reminding you that effective and responsive local governments are essential to a vibrant democracy, where according to John Ruskin, "the government rests directly with its citizens". Ever since the federal government has resolutely reduced its role in the domestic arena, Americans have been forced to rely ever more on their local governments, and a taxpayers' revolt which started in the early eighties has made it

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<sup>6</sup>Reprinted in "Taking on the Public Sector," The Economist (July 27, 1991), p. 54.

excruciatingly difficult for these governments to respond. The challenge that faces citizens and their officials in assisting local government become more efficient and responsive to the demands of their constituents so that it can meet their heightened responsibilities has never been greater. This task is even more demanding in Oregon, because of Measure #5, a ticking time bomb. This measure, no doubt, is a nuisance to many officials in Oregon. Yet it is also a challenge and if properly responded to could become a blessing in disguise.

I have the strong feeling that this community, assisted by such groups as the one assembled here today, Portland Future Focus and the university leadership sponsoring this conference have the resolve and the capacity to meet these challenges and that they are well on their way to doing so.

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PROJECT DIRECTOR

*Lester R. Brown*

*Christopher Flavin*

*Hilary F. French*

ASSOCIATE PROJECT  
DIRECTORS

*Christopher Flavin*

*Sandra Postel*

*Jodi Jacobson*

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*Sandra Postel*

*Michael Renner*

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*Linda Starke*

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SENIOR RESEARCHERS

*Lester R. Brown*

*Alan Durning*

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