THE INSTITUTIONAL FRAMEWORK OF COMMUNITY FORMATION: THE LAW AND ECONOMICS OF MUNICIPAL INCORPORATION IN CALIFORNIA

by

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CHAPTER I

INTRODUCTION

Urbanization has been a prominent characteristic of the past half century in America. One facet of this urbanization has been the growth of new municipalities around the existing central cities. Of the 18,517 municipalities in the United States in early 1972, 5,467 or approximately 30 percent were located within Standard Metropolitan Statistical Areas,[1] with a total population of more than 100 million. The apparent inability of these metropolitan areas to meet adequately the residents' demands for public goods and services has been frequently referenced, and it has been labeled the "urban crisis." The proliferation of satellite communities around the metropolitan fringe and the concomitant fragmentation and overlapping of services has been suggested as a root cause of many of the problems of urban areas, and has stimulated much research into the optimal structure of governmental units. This research has largely concentrated on such factors as the cost structure of public goods under various city sizes, the distributional aspects of public goods as city size varies, and the production efficiencies and diseconomies generated by differing levels of consumption.[2]

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[1] U. S. Bureau of the Census, Governmental Organization, vol. I (Washington: Superintendent of Documents, 1972), pp. 2-21.

[2] For example, see: Werner A. Hirsch, "The Supply of Urban Public Services," Issues in Urban Economics, ed. by Harvey S. Perloff

The economic analysis of local government, then, has focused on the notion of an "optimal organization of cities." Within this framework, the research approach is generally one that looks at the solution which has emerged from institutional and historical factors, and focuses on altering the resultant outcome. An alternative method of investigation is to focus attention on the institutional and political relationships that interacted to produce the observed phenomenon, and to investigate how changes in those arrangements may alter the resultant outcome.

Very few investigations into the urbanization of the U. S. population have focused on the institutional structure under which cities come into existence. This study will contain an economic analysis of the legal institutions that govern the creation and dissolution of municipal corporations. The research explores the extent to which these laws determine the size and complexity of the existing pattern of cities, and examines alternative hypotheses concerning the impact of changing the number of governmental units within a given area.

The pattern of cities and towns that emerges over time will, to some extent, be the result of the interaction between the institutional framework contained in the states' incorporation statutes and the demand of individuals within a geographic area for a specific bundle of

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Lowden Wingo, Jr. (Baltimore: Johns Hopkins Press, 1968), and "Determinants of Public Education Expenditures," National Tax Journal, XIII (March, 1960), 29-40; Harry J. Schmandt and G. Ross Stephens, "Measuring Municipal Output," National Tax Journal, XIII (December, 1960), 369-75; Walter Isard and Robert E. Couglin, Municipal Costs and Revenues Resulting from Community Growth (Wellesley, MA: Chandler-Davis Publishing Company, 1957).

goods and services. A legal climate that is conducive to the promotion of voluntary associations of individuals will have a quite different impact on the emergent pattern of governmental units than a legal climate that is hostile to new community formation. Municipal corporations are generally formed in response to the demands of individuals for a mechanism to avail themselves of public goods or services which are not being adequately provided by the existing governmental structure. Prior to investigating the impact of specific statutory provisions regarding incorporation, it will be useful to discuss briefly the historical and legal status of municipal corporations and the general methods of incorporation within the United States.

Legal Status of U. S. Municipal Corporations

The formation of individuals into fiscal clubs containing some of the powers and privileges traditionally associated with local government has been a notable phenomenon of civilization. In this country, the historical antecedents of community formation were the chartered cities of Europe and England, which derived their powers and privileges from special grants given by the Crown. During the colonial era of the United States, there existed slightly more than a dozen corporate entities in the several colonies, each of which owed its origin to a charter issued by the governor, acting under a grant of authority from the British Crown.[1] The transition from colonial to

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[1]For an excellent historical review of colonial city structure, see H. L. McBain, "The Legal Status of the American Colonial City," Political Science Quarterly, XL (1925), 177ff.

state rule had little effect on the municipal corporations. The federal constitution made no mention of cities; therefore, the power to create and control incorporations belonged to the state governments and became vested in their legislatures. Legal theory has held that there exists no inherent right to self-government, and that municipal governments are dependent upon the state and are subservient to the will of the state legislature. The accepted principle of the local-state legal relationship is illustrated by Judge John F. Dillon's 1868 description:

> The true view is this: Municipal corporations owe their origin to, and derive their powers and rights wholly from, the legislature. It breathes into them the breath of life, without which they cannot exist. As it creates, so it may destroy. If it may destroy, it may abridge and control. Unless there is some constitutional limitation on the right, the legislature might, by a single act, if we can suppose it capable of so great a folly and so great a wrong, sweep from existence all the municipal corporations in the State, and the corporation could not prevent it. We know of no limitations of this right so far as the corporations themselves are concerned. They are, so to phrase it, the mere tenants at will of the legislature.[1]

The courts have taken a narrow view of the powers of municipalities to act independently of express grants from the legislature. The definition of municipal power developed by Judge Dillon in the mid-1900s has come to be known as "Dillon's Law," or the "creature theory" of municipal government. This is one of the controlling principles in regard to the legal status of cities in the United States today.

> It is a general and undisputed proposition of law that a municipal corporation possesses and can exercise the following powers and no others: First, those granted in words; second, those necessarily or fairly implied in or

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[1] City of Clinton v. Cedar Rapids and Missouri River Railroad Co., 24 Iowa 455,475 (1868).

> incident to the powers expressly granted; third, those essential to the accomplishment of the declared objects and purposes of the corporation,--not simply convenient, but indispensable. Any fair, reasonable, substantial doubt concerning the existence of power is resolved by the courts against the corporation, and the power is denied.[1]

Typical of decisions rendered under this rule is Dortch v. Lugar.[2] In this case, despite the existence of a state constitutional provision declaring that the right to alter and reform the government is inherent in the people,[3] the Indiana Supreme Court upheld a legislatively-imposed consolidation of the governments of Indianapolis and Marion County.[4] The court maintained that

> Subordinate divisions of the government are but parts of the state government as a whole. The state, by its legislature, may abolish, consolidate, combine, eliminate, or create new governmental corporations, or authorize such alterations to govern those who live in a given area. There is no constitutional guarantee for the continued existence of a governmental subdivision of the state. They are all creatures of the legislature.[5]

The United States Supreme Court has repeatedly held that state legislatures are supreme over local governments, so far as the federal constitution is concerned. In City of Trenton v. State of New Jersey,[6] the Supreme Court declared that there was no basis for a municipality evoking such constitutional restraints as the due process clause against the state; and in City of Newark v. State of New Jersey,[7] the

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[1] John F. Dillon, Commentaries on the Law of Municipal Corporations, (5th ed.; Boston: Little, Brown & Co., 1911), vol. I, pp. 448-50.

[2] 266 N.E.2d 25 Ind (1971). [3] Indiana Constitution, Article I,§1.

[4] 266 N.E.2d 25 Ind (1971). [5] Ibid.

[6] 262 U. S. 182, 43 S. Ct. 534 (1923).

[7] 262 U. S. 192, 43 S. Ct. 539 (1923).

court ruled that the equal protection clause of the fourteenth amendment was not intended to limit state control over its subdivisions. In Williams v. Mayor and City Council of Baltimore,[1] Mr. Justice Cardoza stated flatly that a municipal corporation "has no privileges or immunities under the federal constitution which it may invoke in opposition to the will of its creator." Legally, therefore, the status of cities is relatively uniform; the legislatures retain the rights to control municipal formation without regard to due process or equal protection clauses, except in those areas where specific constitutional limitations exist.

The one notable exception to this interpretation of legislative power over formation and dissolution of municipalities occurred in California in 1972. The Supreme Court of California struck down a remonstrance statute contained in the municipal incorporation procedure of the state on the grounds that it violated the equal protection clause of both the California and the U. S. Constitution.[2] The remonstrance statute had allowed the owners of 51 percent of the assessed property value of a proposed municipality to halt the incorporation proceedings by presenting a petition to the Board of Supervisors stating their desire for the area to remain unincorporated. The impact of the California court's decision may be to force a reexamination of all other state statutes for incorporation, disincorporation, consolidation, and annexation that weigh the votes of individuals unequally.

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[1] 289 U. S. 36, 40, 53 S. Ct. 431,432 (1933).

[2] Curtis v. Board of Supervisors, 7 Cal. 3rd 942, 501, P. 2nd 537, 104 Cal. Rptr. 297 (1972).

Forms of Incorporation

The legal procedure whereby a municipal corporation is brought into existence is termed "incorporation." The three most common incorporation procedures are (1) legislative special acts, (2) organization under general laws, including optional provisions in some states, and (3) adoption of a home-rule charter. Until the 1850s, municipal corporations were usually created by special legislative acts, each applicable to a specific unit of government with the legislature setting out the boundaries, the corporate name, and the powers and privileges of the city. In order to accomplish even minor changes in their charter, the cities had to petition the legislature for the change. The legislatures could and did draft laws that reflected their own preferences in incorporation matters, and which were generally regarded as solely internal to the fiscal clubs. The disparity of treatment of municipalities, and the attendant abuses of legislative interference in local affairs, led to the adoption of state constitutional prohibitions against special legislative acts. Many states mandated their legislatures to provide a system of general laws to govern the incorporation and organization of fiscal clubs. A few states continue to utilize special acts for incorporation, but they are in the minority. A detailed discussion of state-by-state incorporation procedures is contained in Chapter II.

There is a system of general incorporation laws in use in most states today which delineates the criteria that must be met to qualify for incorporation. The courts have held that legislatures may institute varying criteria such as different classification levels for municipal

corporations within the state, as long as such classifications are based on some difference in situation or condition.[1] Generally, the first step under a general incorporation law is to request incorporation by filing a petition with the designated agency. The petition must contain such things as the proposed boundary, the corporate name, and the signatures of a stated percentage of the area's residents. Following public notice of the petition for incorporation being officially filed and accepted, and a designated length of time to allow for objections to be filed, an election or a hearing, or both, may be required to determine whether the area will be allowed to incorporate. Some states have designated specific unincorporated territories, usually urban areas, as "unique" and subject to additional requirements for incorporation under the general law statutes.

In addition to general laws regulating community formation, legislatures in several states have initiated optional charter laws that allow the members of the club a greater degree of discretion over the type of government they may form, such as city manager, commission, and mayor-council. Under this procedure, the legislature establishes several models for the government of cities and towns which allow the municipalities a choice of alternative administrative structures based on the preferences of the electorate. As a method of meeting the particular needs of the different localities, cities are given the choice of several optional features and various optional charters that allow for different forms of municipal government.

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[1] Northwestern University v. Wilmette, 230 Ill. 80,82 NE 615 (1907).

More than half of the states provide for some degree of local self-government by municipalities, either by constitutional provisions or through legislative action. Municipal home-rule in the legal sense means charter-making. In a more popular sense, however, it has come to mean local self-government: the right of the individuals in a particular fiscal club to conduct their own affairs as they choose--free from state legislative interference on matters of local concern. Home-rule charters, unless prohibited by constitutional or legislative restraints, can include any provisions desired by the electorate. Missouri was the first state to grant home-rule status to a city, St. Louis, in 1875. Under municipal home-rule, the city is still subject to legislative control; the scope of legislative interference, however, is severely restricted.

Overview of the Study

The next chapter presents a brief contrast of the research agenda pursued by the objective cost and the subjective cost traditions. The first section will present a brief description of the central themes and approaches to the organization of local government as found in the objective cost tradition. Then a contrasting approach, based on the subjective cost tradition, is presented, and finally the chapter presents a brief discussion of where the institutional focus fits into the analytical agenda of local government research.

Chapter III contains a detailed survey of the institutional framework, legislative and judicial, established to control the formation of communities throughout the United States. An understanding

of the statutes that regulate the rights of individuals to band together to form a multipurpose club is necessary for development of a method for analyzing the welfare consequences of alternative rules. The statutes will be analyzed from a property rights perspective, that is, what is the assignment of right to the parties involved in the incorporation process. The prohibitions on incorporation in urban areas, and the inequality of weight assigned to votes of individual parties to the proceedings, will be examined in detail.

Chapter IV presents an examination of the statutes governing the incorporation procedure in the state of California. The California legislature in 1963 radically altered the municipal incorporation process with the intent of establishing a logical and orderly pattern of local government units. The powers and structure of the Local Agency Formation Committees, which were created by the change, is presented in detail, and contrasted with the legal structure prior to 1963. Attention is focused on the degree of discretionary control the new law grants to the existing cities and counties. An examination of the rights of individuals to initiate the incorporation process in California is also presented.

Chapter V develops a conceptual framework with which to examine the actual consequences of the change in the legal structure governing the formation of new communities in California. There are two primary themes regarding entry restriction found in the literature on local government formation. One perspective views entry restrictions as efficiency enhancing, as small inefficient units of government are prevented from forming. An alternative perspective suggests that

existing governments seek entry restriction so that they can gain monopoly profits. The predictions as to the budgetary consequences of increased entry restrictions are investigated from each perspective.

Chapter VI will present some empirical evidence as to the impact of the legislation on the local government industry in California. The two areas that will be explored are the organizational and budgetary consequences of the new law. A model will be developed to explain the impact of demographic, economic, and institutional factors on the organization of new municipal corporations. Also contained in Chapter VI is an examination of public expenditure data for the period 1962 to 1972. The cost of public service provision will be investigated in the light of the legislative change. Increased efficiency and per-unit cost reductions were the promised results of decreasing the ease of community formation. Existing cities would then be a sufficient size to generate economies of scale in public goods provision. The public expenditure data will allow the testing of the efficiency hypothesis against alternative hypotheses to see which more fully explains the observed phenomenon.

Finally, Chapter VII will summarize the legal framework pertaining to community formation in the United States and the consequence of the various rules on the efficient provision of public goods. The trend toward increasing the transactions costs for individuals to form new communities, as well as the movement toward appointed bodies to control the incorporation process, will be analyzed in terms of the California experience.

CHAPTER II

COST THEORY AND ALTERNATIVE APPROACHES TO THE STRUCTURE OF LOCAL GOVERNMENT

Substantial analytical effort has been invested in recent years in the development of definitions of the optimal characteristics or pattern of a system of local government.[1] These models have been

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[1]For examples of this approach, see: M. J. Boskin, "Local Government Tax and Product Competition and the Optimal Provision of Public Goods," Journal of Political Economy, LXXXI (January/February, 1973), 203-10; Mark V. Pauly, "Optimality, 'Public Goods,' and Local Governments: A General Theoretical Analysis," Journal of Political Economy, LXXVIII (May/June, 1970), 572-85; Allan Williams, "The Optimal Provision of Public Goods in a System of Local Government," Journal of Political Economy, LXXIV (February, 1966), 19-33; Martin McQuire, "Group Segregation and Optimal Jurisdictions," Journal of Political Economy, LXXXII (January/February, 1974), 112-32; M. S. Koleda, "A Public Good Model of Government Consolidation," Urban Studies, VIII (June, 1971), 103-10; William C. Brainard and F. Trenery Dolbear, Jr., "The Possibility of Oversupply of Local 'Public' Goods: A Critical Note," Journal of Political Economy, LXXV (February, 1967), 91-92; Geoffrey Brennan, "The Optimal Provision of Public Goods: A Comment," Journal of Political Economy, LXXVII (March/April, 1969), 237-41; Edwin Von Boventer, "Optimal Spatial Structure and Regional Development," Kyklos, XXIII (1970), 903-24; Robert L. Bish and Patrick D. O'Donoghue, "A Neglected Issue in Public Goods Theory: The Monopsony Problem," Journal of Political Economy, LXXVIII (November/December, 1970), 1367-71; Larry D. Singell, "Optimum City Size: Some Thoughts on Theory and Policy," Land Economics, I (August, 1975), 207-12; and John P. Blair, "Optimum City Size: Some Thoughts on Theory and Policy: Comment," Land Economics, I (August, 1975), 284-86.

There is a related body of literature that deals with various aspects of city size and the pattern of urban land use. For examples of this approach to optimum city size, see: Peter Stone, "The Economics of the Form and Organization of Cities," Urban Studies, IX (October, 1972), 329-46; Edwin Von Boventer, "City Size Systems: Theoretical Issues, Empirical Regularities and Planning Guides," Urban Studies, X (June, 1973), 145-62; and Harry W. Richardson, "Optimality in City Size, Systems of Cities, and Urban Policy," Urban Studies, IX (February, 1972), 29-48.

developed with the intention of providing insight into the relationship between alternative structures of local government and the optimal allocation of resources. The analytical framework common to these studies is that of postulating supply conditions and utility functions, and from these deriving propostions about optimality. The research agenda has dealt with questions of the presence and/or absence of scale economies in public goods production, the shape of individual utility functions with respect to specific types of goods produced collectively, and the impact of external effects on the public goods bundle produced at the local level of government. Characteristic of this research is that the models are constructed within a framework where the researcher knows by assumption all the necessary conditions required to generate an optimal solution. The investigator constructs the analysis as if individual preferences and production conditions are given; thus, the analytic process involves a "cranking-out of a solution."

Critics of this mode of analysis argue that an outside observer can never determine the relevant mental circumstances of the participants of the process; therefore, it is not possible to select an optimal solution.[1] An alternative perspective to the study of the most efficient pattern of local government can be found in how the question of efficiency is approached in the analysis of private sector performance. An analogous area of economic inquiry has been into the question of the optimal scale of plants and the existence of intraplant

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[1]For an excellent presentation of this viewpoint, see: F. A. Hayek, Individualism and Economic Order (Chicago: University of Chicago Press, 1948).

scale economies. The approach to this problem has been based on an analysis of what plant size over time has gained most in terms of its relative contribution to the industry's value-added. The determination of the optimal size plant has been based on whether a given scale of operations survives in the light of competition.[1] The approach is not for an external observer to compute optimality, but rather to focus attention on the question of under what institutional characteristics optimal firm size will be synonymous with survivability.

The survivor technique is not directly applicable to the question of the optimal pattern of local governments, for the survival of units does not directly depend upon the scale of operations of the governmental unit. The survival of a governmental unit is determined only in part by the decisions of individuals to work, reside, and invest in the given jurisdiction. The importance of the principle of survivorship lies not in the direct applicability of the conclusions of the analysis to the question of optimality of local governments, but rather lies in the analytical perspective brought to bear on the properties of alternative patterns of local government.

These alternative approaches to the study of the structure of the local government market imply very different research agendas. The view that suggests an external observer can determine an optimal pattern of cities focuses attention on the specification of supply functions of

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[1] For examples of this mode of analysis, see: George J. Stigler, "The Economies of Scale," Journal of Law and Economics, I (October, 1958), 56ff; William G. Shepherd, "What Does the Survivor Technique Show About Economies of Scale?", Southern Economic Journal, XLVI (July, 1967), 113-22, and Market Power and Economic Welfare (New York: Random House, 1970).

government and preference mappings of individuals. The perspective which suggests that individuals cannot choose optimal solutions, but only institutional rules, focuses attention on the specific rules, regulations, and other characteristics of the process by which municipalities are created, expand or contract, merge, or disappear. The perspective that will be pursued in this analysis is one of investigating the institutional characteristics of the local government market as it exists, and concentrating attention on the particular patterns of government that are observed under alternative institutional arrangements.

The purpose of this chapter will be to present a brief description of these alternative perspectives concerning local government structure. The discussion will focus on the articulation of demands to the governmental unit and the production or supply decisions by that unit as viewed from the optimality and the institutional perspectives. The last section of this chapter will discuss where the institutional focus fits into the analytical agenda of local government research.

Objective Cost Paradigm and Local Public Economy

Research into the organization of government in metropolitan areas has usually focused on such variables as the number of municipalities and other forms of local government, the size (both population and area) of each of these decisionmaking units, and the various kinds of functions performed by each unit.[1] Within this

[1] For a statement of why these factors are considered important, see: Modernizing Local Government (New York: Committee for Economic Development, July, 1966).

setting, the various optimality models have investigated the most efficient size and scope of government for articulating individual demands. In addition, efforts have been devoted to a determination of the relationship between the costs of public goods provision and the size of the governmental entity. The ability of government to achieve a consensus with respect to the public goods bundle provided and the manner of provision can be analyzed with the aid of familiar demand and supply concepts.[1]

Supply-side considerations

One major focus of interest is the supply side of the public goods market, with much of the analysis dealing with the relationship between the size of the governmental unit and the cost of producing the collective consumption good. The research has primarily dealt with investigations into the presence or absence of economies of scale in the production of public goods and services. If public output is produced under substantial scale economies, then a system of many very small jurisdictional units will incur substantially higher costs of producing collective consumption goods than will a system of a few large units. Should public goods output be characterized by economies of large-scale production, then the costs of government could be substantially reduced by a decrease in the number of units via consolidation and merger.

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[1]The classification of research into local government on the basis of supply- and demand-side considerations is found in: Robert L. Bish, The Public Economy of Metropolitan Areas (Chicago: Markham Publishing Co., 1971).

A number of empirical studies attempting to measure scale economies in the public sector have encountered substantial difficulties in developing any consistent measure of output.[1] A review of these studies indicates that very small local government units are likely to encounter higher production costs for particular public functions, but that any scale economies achieved from larger jurisdictions are rapidly offset due to scale diseconomies in other functions. The relative unimportance of scale economies in the public sector as compared to the private sector is explained by Hirsch on the grounds that most local governmental services require relatively close geographic proximity of service units to service recipients.[2]

An important assumption of the supply-side studies into the relationship between the shape of the cost function for public goods and the optimal size of the political unit is that these studies are based on the premise that the local governmental unit that articulates the demand must also be the production unit. Two exceptions are important to note with respect to this assumption. Local governmental

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[1]For examples of this type of research, see: John Riew, "Economies of Scale in HIgh School Operation," Review of Economics and Statistics, XLVIII (August, 1966), 280-87; Harold A. Cohen, "Variations in the Cost Among Hospitals of Different Sizes," Southern Economic Journal, XXXIII (January, 1967), 355-66; Werner Hirsch, "Cost Functions of an Urban Government Service: Refuse Collection," Review of Economics and Statistics, XLVII (February, 1965), 87-92; Nels W. Hanson, "Economy of Scale As a Cost Factor in Financing Public Schools," National Tax Journal, XVII (March, 1966), 92-95; and Harvey Shapiro, "Economies of Scale and Local Government Finance," Land Economics, XXXIV (May, 1963), 175-86.

[2]Werner Z. Hirsch, "Local versus Areawide Urban Government Services," National Tax Journal, XVII (December, 1964), 331-39, and "Supply of Urban Public Services."

units typically provide the resident with a variety of public goods and services. If only one or a few public services are subject to scale economies, then special district jurisdictions can be established with boundaries extensive enough to exhaust the economies. This alternative production arrangement would lead to an increase in the number of local governmental units, a conclusion which is contrary to the agglomeration tendencies suggested by much of this research. Secondly, in states where service contracting is permitted, a particular public service that is subject to scale economies can be produced by one governmental unit and sold to the residents of other jurisdictions. The essential point is that once it is possible to separate the production decision from the demand unit, economies of scale are not an acceptable criterion for use in determining the optimum size of political units to serve the public goods sharing group.[1]

Demand-side considerations

The demand for public goods depends on tastes, family status, income, and a myriad of other variables. A number of optimality models have been constructed with the aim of determining the size and scope of the political unit that can most effectively accommodate the varying demands of individuals for public goods and services.[2] The research

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[1]For a detailed discussion of this point, see: Robert L. Bish and Vincent Ostrom, Understanding Urban Government (Washington: American Enterprise Institute for Public Policy Research, 1973), esp. Ch. 3, pp. 17-33.

[2]For a representation of research with the focus on the demand-side factors, see: Jerome Rothenberg, "Local Decentralization and the Theory of Optimal Government," in The Analysis of Public Output, ed. by Julius Margolis (New York: Columbia University Press, 1970), pp. 31-64.

has focused on the ability of the unit to satisfy the divergent preferences of individuals both within a given jurisdiction, as well as the impact public goods provision has on the individuals who reside outside the boundaries of the city. Attention has been focused on (1) the ability of the local government unit to respond to the varied preferences of its residents, and (2) the impact of public goods spillovers on noncity residents.

One feature of the collective decisionmaking process that distinguishes it sharply from decisionmaking in the private market is that when a good is provided collectively, all members of the community must adjust to the same level of output. When all members of the society are identical with respect to their evaluation of the public good, neither the decision rule nor the tax mechanism affects the final outcome, provided only that the tax is general and nondiscriminatory.[1] When it is necessary to combine individual demands for the collective good that are diverse and varied, then the decision rules and the tax institutions influence the outcome.

An example of the varying ability of the political structure to effectively articulate the diverse preferences of the society can be illustrated by contrasting the level of public goods output under alternative institutional settings. Assume that there are three equal-sized neighborhoods, all in the same political unit of government, and that these neighborhoods are identical in all respects except in their

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[1]For a detailed discussion of these issues as they relate to the individual decisionmaker, see: James M. Buchanan, Public Finance in Democratic Process (Chapel Hill: University of North Carolina Press, 1967), esp. Chs. 9 and 11.

evaluation of their demand for a single public good, neighborhood playgrounds. One neighborhood has a relatively high demand for playgrounds, one neighborhood a relatively low demand, with the other area's demand falling between the two neighborhoods. Since the neighborhoods are assumed to be within the same political subdivision, and are assumed identical in all respects relevant to the levy of any general tax, any such tax will impose the same tax price on each resident, irrespective of neighborhood. For simplicity, we shall assume that the cost per unit of output remains constant over relevant quantities. The neighborhood demand curves are shown in Figure 2.1, along with the preferred output level for each area. Should demand be aggregated within the same political subdivision, the probable level of provision of neighborhood parks would be the median level preferred by Neighborhood B. This outcome would satisfy fully only the area whose preferences lie between the two neighborhood extremes. Only the residents of Neighborhood B would be "on their demand curve" for the collectively-supplied good. Individuals in the low-demand neighborhood will feel they are paying for goods they do not want, and residents in Neighborhood C would be willing to pay more to get more of the public good.

An alternative institutional setting is one where each neighborhood is an independent political unit, so that each can articulate their preferred demands for the publicly provided good. The position of Neighborhood B would remain unchanged. Neighborhood A would decrease provision to OX_A, while Neighborhood C would increase provision to OX_C. These two neighborhoods would find themselves better off; thus,

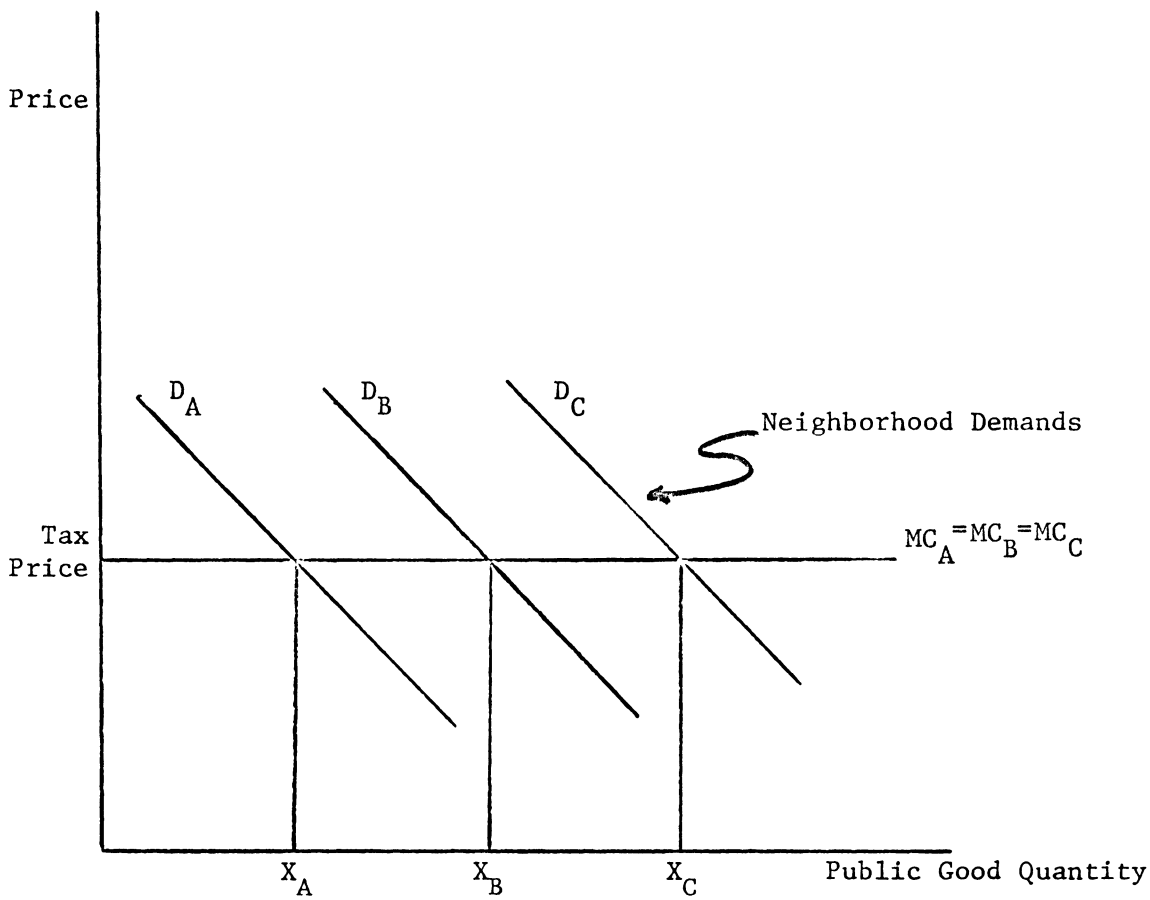

Fig. 2.1. Demand curves of three neighborhoods with unequal evaluations for a single collective consumption good

there is a clear welfare gain from the alternation of the institutional setting. It is important to note that this welfare gain is exclusively distributional, and stems from the fact that Neighborhoods A and C are no longer required to consume uniform quantities of the good upon which they place differing evaluations at the margin.[1]

Distributional efficiency in the provision of the public good can be achieved by collecting together in a single government the people who want to receive, and pay for, a certain level of public goods. Consensus suggests the desirability of small and homogeneous jurisdictions.[2] The distributional inefficiencies will result, regardless of the decision rule adopted in the uniform provision case. When each community can articulate its own preferences, the high- and low-demand communities are made better off, and the median community is unaffected. Recent empirical research into the magnitude of the welfare loss generated from uniform provision of public goods suggests that the distributional inefficiencies are quite substantial. Estimates developed for northeastern New Jersey indicate a welfare loss in excess of 30 percent of public educational expenditures by moving away from a

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[1]The distributional aspects of uniform provision of private goods are investigated by James M. Buchanan, "Notes for an Economic Theory of Socialism," Public Choice, VIII (Spring, 1970), 30-43.

[2]The notion that small governmental units are better able to articulate individuals' demands is discussed in: Charles M. Tiebout, "A Pure Theory of Local Expenditure," Journal of Political Economy, LXIV (October, 1956), 416-24. For a detailed examination of the impact of mobility on the per capita cost of provision, see: James M. Buchanan and Charles J. Goetz, "Efficiency Limits of Fiscal Mobility: An Assessment of the Tiebout Model," Journal of Public Finance, I (Spring, 1972), 24-43.

system of many independent producers to a system of consolidated uniform provision.[1]

The second aspect of the demand-side considerations that have been dealt with at length focus on the effects of external economies on the output decisions of local governmental units. Spillins and spillouts are those external effects that are imposed and unavoidable or freely given and unearned by receivers. Efficiency considerations arise out of externalities among, not within, governmental units. When the population affected by any policy of a political jurisdiction is larger than that jurisdiction's constituency, spillovers are generated. Alternatively, when the actions of nonresidents can influence the operation of a jurisdiction, then the local community is subjected to spillins. The focal point of much of the optimality research has been what effect, if any, the presence or absence of externalities will have on the public goods bundle provided by units of local government. The issue revolves around whether the conditions for allocative efficiency are realized in the presence of external effects.

An understanding of the issues that have informed the optimality research efforts into the efficiency of public output levels in the face of externalities can be gleaned from an examination of a very elementary model of community interaction. This simple model abstracts from the

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[1]The New Jersey estimates were developed by: D. F. Bradford and W. E. Oates, "Suburban Exploitation of the Central Cities and Governmental Structure," in Redistribution through Public Choice, ed. by Harold M. Hochman and George E. Peterson (New York: Columbia University Press, 1974), pp. 43-90; and for a discussion of the related problem of what level of government can best provide certain collective goods, see: Yoram Barzel, "Two Propositions on the Optimum Level of Producing Collective Goods," Public Choice, VI (Spring, 1969), 31-37.

complexities of the public good decisionmaking process in order to concentrate on the effect of external economies. For the sake of simplicity, assume that only two communities exist, A and B, and that they are populated by equally endowed, identically preferenced individuals.[1] This assumption allows us to treat the two communities as if they were two individuals. We will assume that only two goods are available for production; one good, figs, is purely private, and the other good, mosquito eradication, is purely public in the Samuelsonian sense.[2] The cost of mosquito eradication is assumed to be constant over the relevant range of quantity, and the income-effect feedbacks on individual marginal evaluations of the public good will be neglected. Under these simplifying conditions, it is possible to evaluate the outcome of the interaction of the two communities in the production of their preferred public-private good mix. Figure 2.2 presents the marginal evaluation schedule for mosquite eradication, measured in terms of figs, for the two communities. Given the assumptions of the model, one schedule represents the evaluation of both communities.

Initially, we can look at the case where each community engages in insect eradication without respect to the public expenditure of the

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[1]The model presented here has been drawn heavily from the analytical agenda presented by James M. Buchanan, The Demand and Supply of Public Goods (Chicago: Rand McNally and Co., 1968), and Pauly, "Optimality, 'Public Goods,' and Local Governments."

[2]Paul A. Samuelson, "The Pure Theory of Public Expenditure," Review of Economics and Statistics, XXXVI (November, 1954), 387-89, and "Diagrammatic Exposition of a Theory of Public Expenditure," Review of Economics and Statistics, XXXVII (November, 1955), 350-56.

other community. In this case, each community would find itself with twice as much of the public good as desired (the level denoted as Q_{max} in Figure 2.2). Under these conditions, we could expect that each community would cease production of the public good, each attempting to achieve the "free rider" position. By a series of actions and reactions, each community will seek to adjust its production of the public good to the anticipated amount that the other community will produce.

A slight modification of the initial case of simultaneous behavior can be used to demonstrate that the level of public good produced in the limit will be undertaken by only one community, with the other community compensating for the additional units produced. Suppose that Community A realizes the nature of the interdependency of public goods production before Community B; then in this case Community B will undertake its desired level of mosquito eradication and find that it has exactly the public good-private goods mix it desires (the level Q_{min} in Figure 2.2). Community A is not producing any mosquito eradication, and is enjoying the same level, Q_{min}, via spillovers. The question now is: does the existence of spillovers lead to an independent adjustment equilibrium position for the two communities that is characterized by allocative efficiency? The criterion developed by Samuelson and others for public goods optimality is that the summed marginal rate of substitution between the public good and the private good should be equal to the marginal rate of transformation, or marginal cost. The situation depicted by Figure 2.2 is clearly nonoptimal, the summed marginal evaluations of the two communities is greater than the marginal cost. Will this situation lead to an

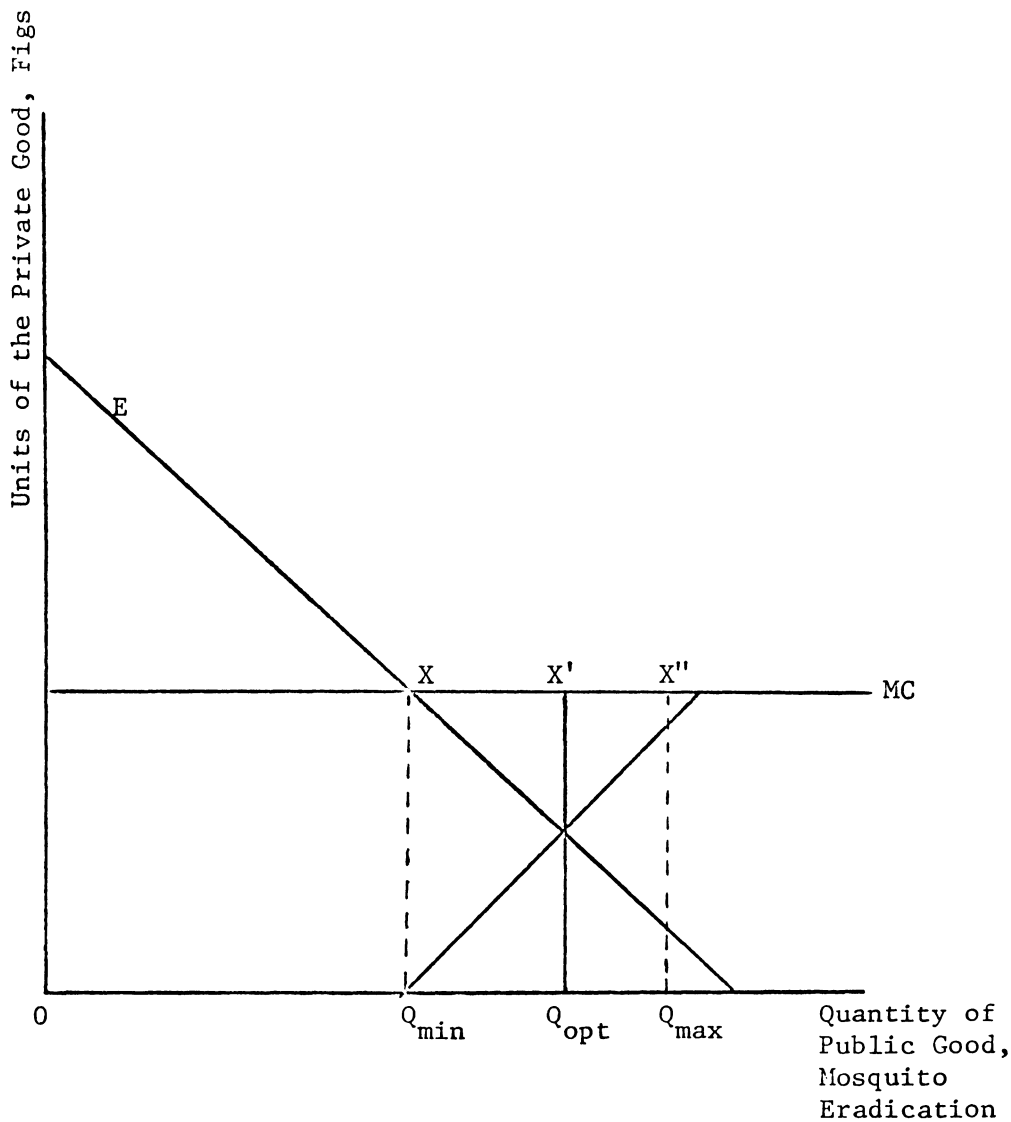

Fig. 2.2. Independent and combined adjustment for two identical communities with respect to the production of a pure public good

increase in the level of public good produced? If trade is prevented between the two communities and strategic behavior absent, then the independent adjustment equilibrium will be stable and the conditions for allocative efficiency will not be generated. The level of mosquito eradication will be less than optimal.

If the institutional framework exists where a redistribution of income via trade between the two communities is possible, then it is easy to demonstrate that the conditions for allocative efficiency will be generated. This process would involve a private-goods transfer from one community to the other. For example, it is possible to derive a schedule of private-goods transfer that Community A would be willing to give to Community B for the production of additional units of the public good. As long as the amount offered by A exceeds or equals the differential between the marginal evaluation and the marginal cost for Community B, B will be willing to expand its production of the public good. The necessary amount B must receive or, alternatively, the amount A is willing to pay is represented by line S in Figure 2.2. The public good level produced under this transfer mechanism can be shown to achieve allocative efficiency. The summed marginal rates of substitution ($2ZQ_{opt}$) equal the marginal cost of producing the equilibrium level of mosquito eradication ($X'Q_{opt}$). This solution emerges as a result of trade, with zero transactions costs, for the two communities.[1]

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[1]The uniqueness of the solution is, of course, a result of the use of marginal evaluation schedules and the absence of income effects which removes the interdependencies of bilateral monopoly. This procedure facilitates a discussion of the exploitation of gains from trade, without analyzing or predicting the particular terms of trade. For a review of the literature on the possibilities of trade in the

There are many additional aspects of the problem of externalities in a system of local government which this simple model has not explored. Production outcomes will vary depending upon a variety of important factors that were not dealt with in this analysis, such as the characteristics of the good produced by a given community, which can range from purely private to purely public; the effect of differing productive endowments between communities; as well as the impact of diverse preferences for the collective consumption good. Further, the presence of externalities may arise in the consumption of the good rather than in the production, and the presence of high transactions costs may be an effective barrier to mutually advantageous trade.[1] The above presentation is not intended to be an inclusive summary of the optimality research, but rather is presented to give the reader some notion of the types of issues contained in the research agenda.

The Subjective Cost Paradigm and the Pattern of Local Government

The focal point of the optimality models is that there exists the ability to impose a solution on society that will generate the most

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public sector, see: Herbert J. Kiesling, "Public Goods and the Possibilities for Trade," Canadian Journal of Economics, VII (August, 1974), 403-17; Michael Connolly, "Trade in Public Goods: A Diagrammatic Analysis," Quarterly Journal of Economics, LXXXVI (February, 1972), 61-78; and Richard E. Wagner, The Fiscal Organization of American Federalism (Chicago: Markham Publishing Co., 1971).

[1]For a discussion of the mechanisms that might be employed to attain optimality through a system of transfers and grants, see: George F. Break, Intergovernmental Fiscal Relations in the United States (Washington: The Brookings Institution, 1967). For a discussion of the spillover considerations from a legalistic perspective and what can be

efficient allocation of resources. The important point of divergence between the present research agenda and the characteristics of the optimality research is their underlying assumption that it is possible to know the necessary information to impose an optimal outcome. Regardless of the implication of optimality models, it is not possible to impose optimality conditions and outcomes, or to choose the most efficient allocation of resources. What can be chosen by the participants are alternative institutional frameworks in the form of rules, regulations, and other legal constraints that will structure the process of resource allocation in the public sector. The analysis of alternative institutional frameworks is possible, with an eye toward predicting how differing constraints alter the behavior patterns of the individual. This conception of the research agenda does not eliminate the notion of efficiency, quite the opposite is true.

> The motivation for individuals to engage in trade, the source of the propensity [to truck, barter, and exchange one thing for another], is surely that of "efficiency," defined in the personal sense of moving from less preferred to more preferred positions, and doing so under mutually acceptable terms. An "inefficient" institution, one that produces largely "inefficient" results, cannot, by the nature of man, survive until and unless coercion is introduced to prevent the emergence of alternative arrangements.[1]

A contrast of the two research approaches is provided by an examination of an area of similar economic inquiry. The analogue of the procedure to determine the optimal city size by investigating cost

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considered a common consolidation solution, see: Daniel R. Mandelker, "Standards for Municipal Incorporations on the Urban Fringe," Texas Law Review, XXXVI (February, 1958), 271-98.

[1]James M. Buchanan, "What Should Economists Do?", Southern Economic Journal, XXX (January, 1964), 217.

conditions is found in the vast volume of research into the determination of the optimal firm size in the private sector.[1] In research to determine the most efficient city size, the researcher assumes that all relevant production information and technological constraints are available as a basis for his calculations. As Stigler so forcefully pointed out with respect to technological studies of costs of different sizes of plants, these research efforts

> . . . do not tell us the optimum size of firm in Industry A in 1958 but rather the optimum size of new plants in the industry, on the assumption that the industry starts de novo or that only a small increment of investment is being made. . . . All judgements on economies of scale [and optimal firm size] have always been based directly upon, or at least verified by recourse to, the experience of survivorship.[2]

To clarify how the notion of survivorship applies to the local government market, let us look at a hypothetical example. Assume that governmental units must produce the services that they provide

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[1]There exists an extensive body of research into the optimal firm size for a number of specific industries. For a general discussion of the issues addressed, see: William J. Baumol, "On the Theory of Expansion of the Firm," American Economic Review, LII (December, 1962), 1078-87; Harvey Leibenstein, "Allocation Efficiency vs. 'X-Efficiency'," American Economic Review, LVI (June, 1966), 392-415; Marshall Hall and Leonard W. Weiss, "Firm Size and Profitability," Review of Economics and Statistics, XLIX (August, 1967), 319-31; Norman R. Collins and Lee R. Preston, "The Size Structure of the Largest Industrial Firms, 1909-1958," American Economic Review, LI (December, 1961), 986-1011; Wilford J. Eiteman, "Factors Determining the Location of the Least Cost Point," American Economic Review, XXXVII (December, 1947), 910-18; F. M. Scherer, Industrial Market Structure and Economic Performance (Chicago: Rand McNally and Co., 1970); and D. K. Round, "Optimal Plant Size in Australian Industries," Australian Economic Papers, XIV (June, 1975), 14-34.

[2]Stigler, "Economies of Scale," 56.

residents,[1] and that some economist is employed to determine the optimal city size, optimal in the sense of minimizing production costs.[2] After extensive calculations, it is determined that the optimum city size for the production of the public good is 20,000 people with the per capita tax burden being $100. It is estimated that cities of other sizes will be faced with higher costs as they fall outside the minimum

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[1]When units of local government are constrained by the institutional environment to produce the public goods that they provide for the residents of their jurisdictions, as is the case in many states, the possibility arises that fragmentation of the local government market will lead to incomplete or no provision of certain goods. When contracting is possible, and transactions costs are low, this possibility will be minimized. The essential point to note is that the nature of the institutional framework of the local government market facilitates or retards the ability of governments to engage in mutually advantageous trade.

[2]The minimization of production costs is only one of a number of criteria employed in the discussions of the optimal distribution of cities in space. For example, studies have focused on the optimal city size and pattern with respect to the minimization of the per capita costs of public goods [Werner Hirsch, "Expenditure Implications of Metropolitan Growth and Consolidation," Review of Economics and Statistics, XLI (August, 1959), 232-41], or the size that maximizes the difference between agglomeration economies and the costs of urban services plus agglomeration diseconomies [Von Boventer, "Optimal Spatial Structure"], or the pattern that minimizes the costs of factors to manufacturing industries [Alan W. Evans, "A Pure Theory of City Size in an Industrial Economy," Urban Studies, IX (February, 1972), 49-78], or other factors [William F. Level, "A Markov Approach to the Optimal Size of Cities in England and Wales," Urban Studies, X (October, 1973), 353-65]. In addition, some criteria for the evaluation of change in the structure of cities as it differs from some norm are generally implied. For a discussion of this implied criterion for evaluating change, see: Roland N. McKean, "An Outsider Looks at Urban Economics," Urban Studies, X (February, 1973), 19-37. On the applicability of optimality criteria in the absence of an institutional framework, see: James M. Buchanan, "The Relevance of Pareto Optimality," Journal of Conflict Resolution, VI (December, 1962), 341-54; and Blaine Roberts, "An Extension of Optimality Criteria: An Axiomatic Approach to Institutional Choice," Journal of Political Economy, LXXXI (March/April, 1973), 386-400.

cost range. Suppose that most cities in this setting are observed to be half as large, and that those cities with 20,000 people are rapidly decreasing in size. On the basis of this empirical evidence as to the dominant city size, the calculations of the economist, an external observer, are called into question. Can 20,000 people be accepted as the optimal size city in the fact of the contradictory empirical evidence? Clearly not: an optimum size that cannot survive in rivalry with other city sizes is a contradiction, and some error must have been made in the method of counting costs. Factors have been omitted that are at least as valuable to the individuals as the calculated decrease in production cost through larger city size.

The optimal size of the public goods sharing group can be determined only by observing the city size that emerges under alternative sets of institutional constraints. A choice of community residency for the individual involves more factors than simply the tax bill from the production of a public good. The essential point is that the only way optimality can be concluded is to observe the enterprise that emerges as a result of withstanding the test of competition from alternative forms of enterprise.[1] The institutional framework that is

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[1]The notion of determining the optimal size of an enterprise on the basis of the one that survives in free competition was proposed long ago by John Stuart Mill.

> "Whether or not the advantages obtained by operating on a large-scale preponderate in any particular case over the more watchful attention, and greater regard to minor gains and losses, usually found in small establishments, can be ascertained, in a state of free competition, by an unfailing test. Whenever there are large and small establishments in the same business, that one of the two which in existing circumstances carries on the

conducive to promoting such a result is the one of free entry in the private sector and free contracting in the public sector.[1]

Institutional framework and local government research agenda

The set of rules, regulations, and other institutional characteristics that government the creation of alternative patterns of local public goods sharing groups would, of necessity, include mechanisms for the adjustment of boundaries of existing units, as well as procedures for creating new governmental entities. To see where the institutional approach fits into the analytical agenda pursued by most

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production at the greater advantage will be able to undersell the other." [John Stuart Mill, Principles of Political Economy, vol I (3rd ed.; London: John W. Parker and Son, 1852), p. 166.]

This notion was developed in another context, the framework focusing on the direct relationship between cost and the act of choice. See: James M. Buchanan, Cost and Choice (Chicago: Markham Publishing Co., 1969), esp. Ch. III.

[1]The concept of "free contracting" is not self-defining, just as "free entry" is not self-defining. Free contracting is not a precise, unambiguous notion, but rather refers to the various contractual obligations and relations among the participants. The central point is that attention needs to be shifted to an explanation of these particular institutions and contractual relations, and away from the simple optimality models. As used here, free contracting is meant to imply the possibility of partial or outright transfers of rights with the terms stipulated in the structure of the contract as to time period, method of payment, etc. For a discussion of the factors that determine the types of contracts formed, see: Steven N. S. Cheung, "Transaction Costs, Risk Aversion, and the Choice of Contractual Arrangements," Journal of Law and Economics, XII (April, 1969), 23-42. For a discussion of the manner in which institutional constraints may alter the structure of contractual agreements so that the requisite marginal equalities for efficient resource utilization cannot be met, see: Steven N. S. Cheung, "The Structure of a Contract and the Theory of a Non-Exclusive Resource," Journal of Law and Economics, XIII (April, 1970), 49-70.

most local government research, it is necessary to evaluate the consequences of alternative patterns of institutional constraints and how they would affect the observed pattern of local government. Very little research into the nature of alternative institutional rules and the pattern of local government has been done.[1] If the observed pattern of government in a given metropolitan area is assumed to be optimal, for whatever reasons, what impact will a change in the number of residents have upon the local pattern of government? If we assume that the nature of the costs of public goods is such that they can be characterized by a U-shaped cost curve,[2] then the increase in the number of inhabitants in the area means that the pattern of local government is no longer optimal.

For example, let us assume that the pattern of cities observed at some point in time is optimal, both with respect to the size of the sharing groups and the spatial distribution. For simplicity, assume that a single congestable public good is provided by each governmental unit. Now suppose that individuals are tossed out of helicopters so that some come to reside in the existing cities and other land in the unincorporated areas surrounding the cities. As a result of this new

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[1]Richard E. Wagner, "Institutional Constraints and Local Community Formation," American Economic Review, LXVI (May, 1976), forthcoming; and Gregory C. Krohm, "An Economic Analysis of Municipal Annexation Policy: Approaches From the Theory of Fiscal Clubs" (Ph.D. dissertation, Virginia Polytechnic Institute and State University, 1973).

[2]For a summary of the empirical evidence concerning the shape of the cost curve for most public goods, see: Hirsch, "Supply of Urban Public Services," and "Local Versus Area-Wide Urban Government Services."

infusion of people, the existing pattern of cities can no longer be considered optimal. The sharing group in the cities is too large and the sharing group outside the city may or may not be too small, depending upon the increment added to the total population. Nonetheless, the existence of an optimal pattern of cities in the first instance would imply some readjustment of the existing boundaries.

The exact nature of the boundary adjustment depends upon the institutional framework, as well as the relationship between cost considerations and spillover considerations. It would be expected that the pattern of governments that emerged after the infusion of population would be altered in a predictable way: existing cities are reduced in size, due to the nature of the public good; and new cities are formed to take advantage of the most efficient production unit. The outcome that emerges at the end of the adjustment process would certainly contain more governmental units than the original equilibrium. An institutional structure that facilitates the formation of the most efficient governmental unit would, of necessity, contain provision for the expansion and contraction of existing units, as well as procedures for the formation of new cities from unincorporated territory, and the detachment of areas from incorporated units. The body of legal institutions must provide a mechanism for these types of adjustments, if individuals are going to be able to reside in their most preferred sharing group.

The existence of an institutional framework within which the size and/or number of municipalities in a metropolitan area can vary in response to changing conditions is a necessary adjunct to any

discussion of the achievement of allocative efficiency in the local government market. Very little is known about exactly how the myriad of legal provisions governing boundary adjustments affect the structure of the local government industry. The various properties of the legal-institutional structure in the United States as they relate to the pattern of community formation will be the major scope of this research. The next two chapters will be devoted to a discussion of the more important characteristics of the legal and institutional framework governing community formation and boundary adjustments in the United States, in general, and in California, in particular, to establish the framework for exploring the consequences of alternative institutional constraints on the local government industry.

CHAPTER III

SURVEY OF INSTITUTIONAL FRAMEWORK

This chapter contains a survey of the municipal incorporation and disincorporation practices in use in the United States. This review of statutory controls over the rights of individuals to form new communities is undertaken to give an indication of the degree of freedom to enter and exit the local government industry, and to provide insight into the assignment of rights to the formation of new communities. The approach of this chapter will be, first, to review the conditions required for incorporation, and then to look at the procedures to be followed once the conditions are met. Throughout this chapter, the assignment of rights to individuals concerned with the process will be the focal point of analysis.

Conditions of Incorporation

The statutes of each state prescribe the requisite conditions for incorporation of a city, town, or village. Although there is a large degree of variation among the states as to the exact criteria, the prerequisites for creation of a municipal corporation substantially conform to the following features.

Suitable territory

All states confine the formation of new communities to portions of the state that are not currently incorporated. The general rule of

law is that there may not be two distinct municipal corporations in the same territory, exercising the same powers.[1] Thus, the municipality is always given a monopoly franchise in a spatial context, and to prevent competition within its spatial sphere, the municipality must provide a full range of services, regardless of residents' preferences.[2]

Generally the land proposed for incorporation is required to be urban in nature. This requirement varies from a general statement such as contained in Florida's Revised Statutes that the "area must be compact, contiguous and urban in nature,"[3] to Georgia's specific provisions that ". . . 60 percent of total lots and tracts are in use for residential, commercial and industrial purposes . . . ."[4] Other statutes fix a minimum or maximum area that can be contained within the proposed new municipality.

The statutory provisions delineating the urban nature of incorporated areas, and the ban on new city creation and annexation in

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[1] West Chicago Park Commissioners v. Chicago, 152 Ill. 392, 38 NE 697 (1894).

[2] If a municipal incorporation chooses not to perform a given function, for example, fire protection, then an additional municipal corporation can be formed to provide this service within the same geographical boundary. The important point to note is that the existing municipality is given the monopoly franchise and then if it chooses not to exercise its right to provide a given service, only then can an additional unit of government be formed. Mesa v. Salt River Project Agricultural Improvement and Power District, 92 Ariz 91, 373 P2de 722, Anel (1962); and State ex rel. Northern Pump Co. v. So-Called Village of Fridley, 233 Minn 442, 47 SW2d 204 (1951).

[3] §165.001.

[4] Georgia Code §69-1401.

incorporated areas, have indirectly led to a number of states denying the right to incorporate to individuals who reside within specified distances of an existing city. Twenty-one states currently prohibit the creation of new cities in unincorporated areas from one to six miles from the boundary of an existing city. In 10 states, the statutory ban is outright and in the remainder, the formation of new cities can occur in these unincorporated areas only after (1) the existing city has granted written approval, or (2) the existing city has refused to annex the area. See Table 3.1 for the exact conditions in each state. To understand the pressures for the statutory changes, one need only look at the rules that were in force when the existing clubs came into being; they were required to be compact, thus they were unable to lay claim to large sections of undeveloped land. Further, once the boundaries of the city were established, legislative or judicial action was normally necessary to have them altered. If the unincorporated territory is allowed to form new communities as the urbanization process develops, then the expansion path of the existing city is closed off, and it is forced to compete with the satellite communities for population.

The interest of the existing cities is served by restricting entry into the local government industry. A review of the rationalization given for excluding new community formation in metropolitan areas is the fragmentation of control and overlapping of services caused by the existence of competing fiscal clubs.[1] An alternative explanation

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[1]For the standard philosophical exposition of the position, see, Commission Report on Governmental Structure: Organization and Planning

TABLE 3.1

UNINCORPORATED TERRITORY EXCLUDED BY STATUTE
FROM THE INCORPORATION PROCESS

State	Statute
Alabama	All territory within three miles of an existing city
Arizona[a]	Any territory within six miles of incorporated city with population of 5,000 or more and territory within three miles of incorporated city or town with population of 5,000 or less
Colorado	Any parcel less than 320 acres if within one mile of an existing city boundary
Florida	Any territory within two miles of an existing municipality within the same county unless there exists an extraordinary natural boundary such as a river or lake
Georgia[b]	Any territory within three miles of an existing municipality
Idaho[a]	Any territory within one mile of the boundary of an existing city of 5,000 population; territory within two miles of existing city of population greater than 5,000 but less than 10,000; territory within three miles of an existing city of population greater than 10,000 but less than 20,000; and territory within four miles of an existing city of 20,000 or more population
Illinois[c]	Any territory within one and one-half miles from an existing municipality
Indiana[d]	Any territory within four miles of an existing city with population of 250,000 or more; territory within three miles of an existing city of population greater than 35,000 but less than 250,000
Iowa	All territory within three miles of an existing municipality having population of 15,000 or more

TABLE 3.1--Continued

State	Statute
Missouri[b]	All territory within two miles of an existing city of 500 or more in the same county
Montana[b]	All territory within three miles of the boundary of an existing city
Nebraska	All territory within five miles of an existing village or city of any class
New Mexico[e]	All territory within three miles of an existing city of 5,000 or less population; territory within five miles of an existing city having population of 5,000 or more
North Carolina	All territory within one mile of the corporate limits of a city with population of 5,000 or more; territory within three miles of corporate limits of city with population of 10,000; territory within five miles of city with 50,000 or more population
Ohio[b,c]	Any territory within three miles of an existing city
Oklahoma	All territory in the same county within five miles of the corporate limits of city having population of 200,000 or more; or within three miles of the corporate limits of any city having less than 200,000
Oregon[a]	All territory within three miles of a city
South Carolina	All territory within two miles of an existing city with population of 15,000; territory within three miles of an existing city with 50,000 population; territory within five miles of an existing city of 90,000 or more population
South Dakota[b]	All territory which lies within three miles of any incorporated city or town
Tennessee	All territory within two miles of existing city that has population less than 500; or if territory is within five miles of city with 100,000

TABLE 3.1--Continued

State	Statute
Tennessee (cont.)	population or within two miles of city of more than 5,000 but less than 100,000, any notice of intent to incorporate must be followed by a 15-month waiting period to allow existing cities to exercise an option to annex part or all of the land area or population
Washington	Any territory within five miles (by air) of the boundary of any city having population of 15,000 or more

SOURCE: See Appendix to Chapter III for source material.

[a]Exceptions granted if (1) proposed area has biled a proper and legal petition requesting annexation to existing city or town and petition was not opposed within 120 days; or (2) the existing city council adopts an ordinance allowing proposed incorporation.

[b]Exception: residents in proposed municipality have been denied annexation by the existing city within the previous twelve months.

[c]Exception: the existing city consents to proposed incorporation.

[d]Exceptions: (1) when county already has three or more cities of population greater than 35,000 but less than 250,000, or (2) when all existing cities consent to the proposed incorporation by passage of an ordinance.

[e]Exceptions: Footnotes (b) and (c) above, as well as when the proposed municipality can show conclusively that the existing city is unable to provide it with municipal services.

might be a joint desire on the part of cities and the state legislators to make the local government market more monopolistic. The state legislatures, in adopting the prohibitions against new incorporations adjacent to existing cities, have extended the spatial monopoly that was already granted the existing city to territory that was outside their legal control. The ability of the individuals living in the fringe area to create their own fiscal club has been significantly diminished. Prior to this legislation, the criteria for incorporation did not require the consent of the other clubs within the area; now individuals may form clubs only if the existing clubs do not want to absorb the residents and territory themselves.

It is insightful to note that the monopoly franchise varies directly with the population size of the existing city, not with the population density or acreage of the existing city. The argument for preventing new clubs from forming clearly is not based on the crowded conditions within the existing cities. This type of requirement should reduce the number of new municipalities that are generated over time, and also increase the size of existing cities, both in area and in population.

Population eligibility requirements

Although the right of the state to create, change, divide, and even abolish municipal corporations is complete, legal theory distinguishes municipal corporations from quasi-public corporations on

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in Metropolitan Areas (Washington: Advisory Commission on Intergovernment Relations, July, 1961).

the grounds that municipalities are established only at the request or with the consent of the inhabitants.[1] Thus, all states specify the class of inhabitants that can begin the incorporation process. The right to initiate the incorporation proceedings rests with one or more of these four classes of individuals: (1) a resident of the area, (2) an elector (a resident who is registered to vote), (3) an owner of real property, and (4) an elector/real property owner. In only one state, Texas, and then only for towns of less than 10,000, does the fact of residence within the area confer upon the individual the right to participate in the initiation of the incorporation procedure. In all other states, the individual must meet voter registration requirements to be a party to the initiation process. This is true even in those states which do not use the electoral process in the incorporation of municipalities. Several states use the ownership of real property as the criterion to judge whether the individual should be allowed to participate in the initial stages of the incorporation process. The ownership of property has been used on the basis that those individuals who own the property have a greater interest in the operation of the local government.[2] And a few states require that the registered property owner begin the formation process.

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[1] Dillon, Municipal Corporations, §35-39.

[2] For an historical background on the use of property ownership as a criterion for voting, see: Donald G. Hagman and Sally Grant Disco, "One-Man One-Vote as a Constitutional Imperative for Needed Reform of Incorporation and Boundary Change Laws," Urban Lawyer, II (Fall, 1970), 459-79. For a comment with specific reference to remonstrance statutes, see: John G. Vogel, Jr., "Incorporation, Property Ownership, and Equal Protection," Urban Law Annual, 1974, 274-84.

The access of an individual to the initiation process is limited by the nature of the eligibility requirements. For example, to begin the incorporation process in Maryland, it is necessary to obtain the signatures of 20 percent of the residents who are owners of 25 percent of the property value in the proposed municipal corporation. The area residents who are nonproperty owners are excluded from participation in the initiation process. While it is not possible to define or measure the "degree of restrictiveness" of eligibility requirements based on a single percentage, they can still be considered an important factor in the incorporation process.

In addition to establishing criteria delineating the individuals who can begin the incorporation procedure, it is common for the states to prescribe a minimum number of inhabitants required for incorporation. Two states, Oklahoma and Idaho, have no minimum number of inhabitants for consideration of the petition; however, in most cases the minimum number of inhabitants is between 50 and 5,000, with the upper limit being more common in the recently revised statutes. A minimum number of inhabitants in relation to the area proposed for incorporation is a less common feature of legislative criteria. The density provisions are generally in terms of inhabitants per square mile; however, Colorado's statute is phrased in terms of registered voters per square mile (100).[1]

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[1] Colorado Rev. St., §31-1-108.

Miscellaneous requirements

In a number of states, the individuals seeking incorporation must be able to demonstrate that the proposed area is able to bear the financial burden of self-government. This requirement is met by providing an enumeration of the assessed value of all the real property within the proposed municipality. The practical impact of this requirement has been to discriminate against those areas with a lower property base, without taking into consideration that they might wish to supply themselves with a smaller and, hence, less costly bundle of public goods.[1]

The posting of bonds in an amount sufficient to cover the cost of handling the incorporation procedure is becoming a much more common procedure as barriers to incorporation have become more restrictive. The general procedure is for the individuals involved in the procedure to bear the costs of all unsuccessful incorporation attempts, and, if successful, the new community absorbs all costs.

Incorporation Procedures

The power of the legislature to control the incorporation process is plenary, except as limited by the constitution of the state; however, a majority of legislatures have substituted general rules of incorporation for direct controls. A consideration of the legally assigned rights of various parties to the incorporation procedure will

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[1]This result has been observed as it is generally held necessary for the area proposing incorporation to demonstrate that they can provide themselves with a level of public goods equal to or in excess of the current levels provided by the county. See, for example, Nevada Revised Statutes, §266.020-080.

TABLE 3.2

MINIMUM SIGNATURE REQUIREMENTS AND CLASS OF INDIVIDUALS WITH RIGHTS TO INITIATE INCORPORATION PROCESS

State	Limitation
Alabama	25 qualified electors
Alaska	10 or more qualified voters[a]
Arizona	2/3 of qualified voters or 1/10 of qualified voters, depending on specific procedure
Arkansas	20 or more qualified voters
California	25 signatures on notification of intent to petition, then 25 percent of the landowners representing 25 percent of the total value of the land, or 25 percent of registered voters who are residents
Colorado	150 elector/real property owners
Florida	15 percent of the qualified voters
Georgia	
Idaho	125 qualified electors
Illinois	200 qualified electors
Indiana	50 owners of real property
Iowa	25 qualified electors
Kansas	50 electors of the territory
Kentucky	2/3 of resident voters
Louisiana	25 percent of electors owning 25 percent in value of property
Maryland	20 percent of the residents who are owners of 25 percent of the property value in area
Michigan	30 legal voters
Minnesota	100 real property owners or resolution of the town board having jurisdiction
Mississippi	2/3 of qualified electors
Missouri	2/3 of taxable inhabitants
Montana	2/3 of qualified electors but not more than 300
Nebraska	Majority of taxable inhabitants

TABLE 3.2--Continued

State	Limitation
Nevada	Simple majority of qualified electors who are real property owners
New Mexico	200 qualified electors who have resided in territory at least 6 months or owners of 60 percent of the real property who are not delinquent in their real property taxes
New York	20 percent of qualified voters or owners of 50 percent of assessed valuation of real property
North Carolina	25 qualified voters
North Dakota	1/3 of registered voters in territory
Ohio	Simple majority of resident voters
Oklahoma	1/3 of all qualified voters
Oregon	20 percent of qualified voters
Pennsylvania	Majority of qualified electors
South Carolina	Percentage of qualified voters varies with class of city
South Dakota	1/3 of qualified voters
Tennessee	100 legal voters residing in area
Texas	20 signatures for town or village, a percentage of qualified voters for city status depending on form of government
Utah	100 real property taxpayers who are qualified voters
Virginia	20 qualified voters
Washington	Majority of registered voters
West Virginia	30 percent of qualified voters
Wisconsin	50 elector residents for proposed city whose population is 300 or more; or 25 elector residents for smaller cities
Wyoming	Majority of qualified electors

SOURCE: See Appendix to Chapter III for source material.

[a]In all cases, the term "qualified voter" refers to an elector who resides within the proposed city's boundary.

provide some indication of the nature of the club membership contract. It is essential at the outset to identify the individuals and/or institutions that are generally held to have a legal right to a voice in the incorporation procedure. Although this designation varies among the states, the following list of alternatives appears to be an inclusive summary: (1) the individuals who reside within the territory to be incorporated; some states make important distinctions between the rights of resident nonproperty owners and resident property owners; (2) the individuals who own property in the proposed municipality but reside elsewhere; (3) the residents of existing municipalities within specified distances to the proposed city; (4) residents of the entire county within which the city is proposed; and, in a few cases, (5) the residents of the entire state.

The municipal incorporation statutes can be dichotomized on the basis of those states that employ direct or special legislative acts, and those states that operate under a system of general laws. Within each classification, we can further break down incorporation procedures on the basis of whether control is vested in the individual residents involved in the incorporation bid, or is delegated to an elected or appointed body. The review of incorporation statutes will be focusing on the different classifications of property rights to community formation among the states, and, as such, is not intended to be a rigorous legal treatise on comparative municipal incorporation statutes.

Special charter plan

From colonial times to the middle of the nineteenth century, the special charter plan adopted from England was the common method employed to regulate new community formation. When incorporation is accomplished by special act, the legislature determines the form and content of the charter, the corporate name, the boundaries, and the privileges and powers of the municipal corporation. The special charter plan of incorporation has a long history of abuse by the state legislators. During the early 1800s, it was common practice for the state legislature to assume control of profitable or politically important aspects of city government. The states would assume control of public utility franchises, they would establish special commissions to administer local functions, and they would even remove local powers completely from the city. A common argument in support of the special charter act is that it allows a system of local government to be tailored to the preferences of the specific group of individuals who create the community. In actual practice, the state legislatures more often than not substituted their own preferences for those of the framers of the fiscal club, with the result that the emergent form of government did not provide a very satisfactory means of responding to the desires of the members of the fiscal club.

The dissatisfaction with special acts led to outright constitutional bans on such procedures in many states, Ohio being the first in 1851. Additionally, a series of attempts were made to eliminate or modify their use in other cases. After a century of movement away from special charter acts, relatively few states continue

to use this incorporation procedure. It is found in several of the New England states. It is also found in Florida, Georgia, and Virginia.[1] This procedure was practiced in North Carolina until 1973.

In states that rely on special acts to provide the means of new club formation, the legislatures have usually established a set of minimum criteria as to the characteristics necessary to qualify for consideration for incorporation. The success of these modifications of absolute authority has varied from state to state, depending on the willingness of the legislators to relinquish this important power. The cases of North Carolina and Florida provide interesting examples of the methods states have used to overcome the difficulties of special charter acts.

Until 1973, North Carolina had two processes to grant charters to new municipalities: special acts of the legislature, or approval by the Municipal Control Board, a state body composed of the Secretary of State, the Attorney General, and the Public Utilities Commissioner. This board was created in 1917 to overcome the abuses of direct legislative control, and to apply uniform criteria to the incorporation of new municipalities.[2] In 1973, the municipal incorporation procedure was amended to grant the Municipal Board of Control exclusive control over the incorporation process. The Board was expanded from three to five members, and the composition was altered to include the Secretary

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[1] Although towns can be incorporated by special legislative acts, this practice is rarely employed.

[2] R. Rankin, The Government and Administration of North Carolina (New York: Thomas Y. Crowell, 1955).

of Local Government Commission, the chairmen of the House and Senate Committees on Local Government, and a city and a county elected official appointed by the Governor.[1]

The past record of the two procedures in granting charters may give some indication of the impact that the new law will have on the creation of new communities. Between 1917 and 1947, the legislature of North Carolina passed 567 "local, private or special acts" granting and amending municipal charters, while during a longer period from 1917 to 1953, the Municipal Board of Control issued only 108 such orders.[2] As initially conceived, the Board of Control was to ease the procedure for incorporation; however, the records indicate that it was easier to get the entire legislature to act than the three-man panel. The guidelines established by use by the Board give it a broad grant of discretionary power over incorporation petitions.

Florida and Georgia differ somewhat in their approaches in exerting more control over the right of the legislature to act independently. In Georgia, this has taken the form of specific prohibitions against incorporation acts. In Florida, a combination of the North Carolina and the Georgia procedures have been utilized. In 1971, Georgia altered the existing incorporation guidelines to apportion a veto right in new incorporations to existing cities within the state. Under new statute, no special charter act can be passed by the

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[1] General Statutes of North Carolina, §160-A-6 through 160-A-10 (1971; amended 1973).

[2] Rankin, Government and Administration of North Carolina.

legislature for territories within three miles of an existing city, unless the proposed municipal corporation can show proof that a petition for annexation to the existing city was denied within the previous 12 months. Further, the act provided that the population of the proposed city must exceed the population of the existing municipality. In adopting this restriction, the state legislature has taken the view that the existing cities have a preeminent right to control the use of territory within three miles of their boundaries, and have the first right of rejection to the individuals residing on the fringe of the community. This provision exerts a significant barrier to entry into the local government industry, so the expected outcome would be a reduction in the rate of new community formation. Further, the provision that a new municipality must have a greater population than the existing city will have the effect of halting all new community formations in the major metropolitan areas of the state.[1]

The Florida case is unique in that it creates new cities by special act of the legislature, but this procedure is expressly prohibited by the Florida constitution.[2] The Florida constitution commands the legislature to provide for cities' incorporation and alternative types of governmental structure by general law. The legislature has ignored the mandate, and this refusal has been upheld by the Florida Supreme Court.[3] Under the Formation of Local Government

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[1] Georgia Government Code, §69-1401-1405 (1963; revised 1971).

[2] Florida Constitution, Article VII, sec. 2.

[3] Wilder v. City of Jacksonville, 157 Fla. 276,25 So. 2d 569 (1946).

Act of 1974,[1] the legislature moved to establish standards that special laws must consider. The State Department of Community Affairs must give its statement of approval before any special law of incorporation can be enacted. The stated purpose of the legislative change is to assure "orderly patterns of growth and land use and to . . . eliminate and reduce avoidable differentials in fiscal capacity among neighboring local governments."[2] Thus, for a new city to come into existence, it must receive the stamp of approval from the appointed state agency and then receive its charter by special legislative act.

Those states that continue to rely on special legislative acts for new community formation have moved in the direction of more control over the procedure by administrative agencies and by outright prohibition of acts in certain cases. In the formation of new units of government, the state is still the most important party to the contract.

Characteristics of general law statutes

The legislative willingness to release control over cities has been slow in coming and the battle has been hard-fought. A standard treatment for all like-situated individual cities has been a criterion that has long been sought by participants in the governing of localities. However, legislatures, even when prohibited by outright bans on special legislative acts, have found ways to treat like-situated municipalities unequally. These have been accomplished by classification schemes in which a single city ends up in each classification, and by assigning controlling roles in the incorporation process to administrative agencies

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[1] Florida Rev. Stat., §165.011-165.093. [2] §165.011.

of the state whose procedures are controlled by the legislature. In short, even those states that have required that general legislation be established for the equal treatment of parties to the incorporation process, criteria exist that allow selective treatment. The general law statute can be characterized on several bases; the first feature we will discuss is the degree of discretionary control that designated agencies to the incorporation process exercise.

Degree of discretionary power. Generally the first step to initiate the incorporation process is to file a petition with the designated local or state agency, requesting that a charter be granted, and affirming that all conditions set down in the general legislative act have been completed. The task of the agency receiving the petition is to ascertain that the criteria enumerated by the legislature have been met, and that the statutory action (in some states, chartering the proposed city; in others, calling elections, etc.) required of their agency should be performed. The power to interpret legislative criteria by the designate agency varies vastly from state to state.

The measure of discretionary control for purposes of this study will be based on whether the designated agency has any grounds to reject a petition for incorporation that meets the criteria established by the state legislature. For example, after notice of filing of a petition for incorporation in the state of Kentucky, individuals have 20 days to file objections based on improprieties relating to area, signatures on petition, and the number of inhabitants. Then the court will hold a hearing on the basis of the objection; however, ". . . if

court shall be satisfied that the population within the prescribed boundary is sufficient, and proper notice or publication has been made or given, it shall have no discretion as to the establishment of the town."[1] On the other extreme, which has been labeled "complete discretionary power" in Table 3.3, is the state of Maryland, where ". . . no municipal corporation will be created without the specific approval of the County Board of Supervisors."[2] The grounds for this approval are completely unspecified by the statute; therefore, the petition for incorporation can meet the legislative criterion as to population, area, assessed valuation of property, etc., and be halted at the county level, if the commissioners chose not to approve it and call the required referendum.

Due to the wide range of variation from state to state, it is difficult to generalize about the range of discretionary powers contained under the "some" classification in Table 3.3. Most of the 12 states that do permit the use of some discretionary power by the designated agencies, however, contain phrases such as ". . . Board shall determine that incorporation will serve the best interests of the territory involved . . ."[3] or that the request for incorporation is ". . . reasonable."[4]

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[1] Kentucky Revised Statutes, §81.040-81.070 (1971).

[2] Annotated Code of Maryland, Article 23A, §21.-20. (1973).

[3] Indiana Statutes Annotated, §18-3-1-3 through 18-3-1-28 (1973).

[4] Mississippi Code Annotated, §21-1-13 through 21-1-23 (1972).

TABLE 3.3

INCORPORATION PROCEDURAL FORMS USED BY GENERAL LAW STATES

State	Agency Petitioned	Scope of Action	Degree of Discretionary Power
Alabama	County probate judge	Calls election	None
Alaska	State dept. of community & regional affairs/ local boundary comm.	Petition review	None/complete
Arizona	County board of supervisors	Grant charter by ordinance or call election	None
Arkansas	County court	Hearing & grant charter	None
California	County board of commissioners/ Local agency formation comm.	Hearing & calls election	None/complete
Colorado	County court	Calls election	None
Idaho	County board of commissioners	Hearing & grant charter by ordinance	Some
Illinois	County circuit court	Hearing & calls election	None
Indiana	County board of commissioners	Hearing & grant charter by ordinance	Some
Iowa	County circuit court	Hearing & calls election	Some
Kansas	County board of commissioners	Hearing & grant charter by ordinance	Complete
Kentucky	County circuit court	Hearing & grant charter	None
Louisiana	Governor of state	Calls election	None

TABLE 3.3--Continued

State	Agency Petitioned	Scope of Action	Degree of Discretionary Power
Maryland	County board of commissioners	Hearing & calls election	Complete
Michigan	County board of supervisors	Hearing & issue order declaring incorporation	None
Minnesota	State municipal commission	Hearing & grant charter	Complete
Mississippi	County chancery court	Hearing & grant charter	Some
Missouri	County court	Hearing & grant charter	Some
Montana	County board of commissioners	Calls election	Some
Nebraska	County board of commissioners	Hearing & grant charter	None
Nevada	County board of commissioners	Hearing & grant charter	Some
New Mexico	County board of commissioners	Take census and call election	None
New York	Supervisor of town	Hearing & call election	None
North Carolina	State municipal board of control	Grant charter	Some
North Dakota	County board of commissioners	Call election	None
Ohio	County board of commissioners	Hearing & grant charter	None
Oklahoma	County board of commissioners	Hearing & call election	None
Oregon	County court	Hearing & call election	Some
Pennsylvania	County court	Hearing & grant charter	Some
South Carolina	Secretary of state	Call election	None

TABLE 3.3--Continued

State	Agency Petitioned	Scope of Action	Degree of Discretionary Power
South Dakota	County board of commissioners	Call election	None
Tennessee	County clerk or justice of peace	Hearing & call election	Complete
Texas	County judge	Call election	None
Utah	County board of commissioners	Call election	Some
Virginia	County circuit court	Hearing & grant charter	Complete
Washington	County board of commissioners	Hearing & grant charter	Some
West Virginia	County court	Take census & call election	None
Wisconsin	Court/Head of planning	Hearing/Hearing & calls election	None/complete
Wyoming	County board of commissioners	Hearing & call election	None

SOURCE: See Appendix to Chapter III for source material.

Although it is not possible to attribute a philosophy of government to such a diverse body as a state legislature, it would appear that there exist two extreme notions of the role of the state in the incorporation process, as interpreted from the willingness to grant discretionary powers and the extent of the powers granted. The responsibilities imposed on the court or agency to whom the petition is presented vary from a mere ministerial ascertainment that statutory requirements have been met to an exercise of judicial discretion as to the granting of incorporation, the reasonableness of the boundaries, and similar factors.

As indicated in Table 3.3, 19 of the general law states in the survey give no discretionary powers to the agency petitioned. Under this same classification, it appears that 12 states permitted some degree of discretionary power, and 5 states granted complete control to the agencies that were the recipients of the incorporation petition. Only three states used two or more agencies in the petition review process. In the general law states that allow no discretionary control to the designated agency, the following philosophy of government may be said to prevail. The state role can be interpreted as assuring that the new community will be of a reasonable size and land area to avail itself of the public goods provided by the local governments; beyond these minimum requirements, it is the "right" of individuals to express their preferences for local government by forming new communities.

At the other extreme are the five states who delegate a large freedom of action to the designated agencies. In these states the

legislative criteria enumerated in the petitioning process can be viewed as a necessary first step to reach consideration by the agency. In Virginia and Maryland, the criteria for deciding upon incorporation is not enumerated, but is left up to the delegated agency to determine reasonable standards. In the other states, a general list of the important points for the agency to consider is provided, although these should not be interpreted as ". . . exclusive or binding . . ." on the agency.[1] For example, when considering an incorporation petition in Kansas, the commissioners shall take into account ". . . the general effect upon the entire community, should there be additional cities in the area; all of these and other considerations having to do with the orderly and economic development of the area and to prevent an unreasonable multiplicity of independent governments."[2] The petition for incorporation can be denied if the commission ". . . determines that present or future annexation to an adjacent city or creation of a special district would better serve the interest of the area."[3] It is apparent that the preferences for new communities by individuals are subservient to the will of the state for orderly, monopolized local government.

Three states--Alaska, California, and Wisconsin--employ a procedure whereby the agency receiving the incorporation petition has no discretionary powers, but cannot act until a second body with complete discretionary powers has received the petition and granted its approval.

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[1] See, for example, Wisconsin Statutes Annotated, §66.013-66.018 (1965).

[2] Kansas Statutes Annotated, §15-121 (1974). [3] Ibid.

For example, the county court in Wisconsin which receives the initiating petition can determine only if the legislative signature requirements are met; then the petition is forwarded to the local planning head who has broad powers. If he approves, then the court will call for a referendum on the question.[1] The California procedure will be discussed in detail in Chapter IV. As would be expected this procedure would lead to a smaller number of municipalities being formed and the transactions costs of such procedures being significantly higher.

Degree of local determination. It is not required under the due-process clause of the Fourteenth Amendment that municipal incorporation laws allow every individual a right to be included or excluded, according to his choice.[2] In fact, except where prohibited by a constitutional requirement of consent of the inhabitants,[3] legislatures need not inquire into the preference of the inhabitants for a new form of government. In the 41 states surveyed, all provided some mechanism for determining the wishes of the inhabitants. In the 23 states that allowed referendums on incorporation, they all allowed the decision to be finalized on the majority vote of those casting ballots on the issue. In all cases, eligibility to vote was dependent upon being a full-time resident within the area to be incorporated, as well as meeting the other general voting requirements.

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[1] Wisconsin Statutes Annotated, §66-013 through 66-018 (1965).

[2] People v. Cain, 410 Ill. 39, 101 NE 2d 74, 79 (1951).

[3] See, Wyoming Constitution, Article 13, section 2, which states: "No municipal corporation shall be organized without the consent of the majority of the electors residing within the district proposed to be so incorporated . . . ." Wyoming Revised Statutes.

In the 15 states that issue the incorporation charter by ordinance or decree, all hold hearings where the local population is provided a forum to comment on the proposed governmental structure. The legal grounds on which objections to the new community can be heard vary widely from state to state. As noted earlier, in Kentucky the hearing is held to hear objections as to failure to comply with the legislative criteria; it is not relevant to file an objection based on preferences to county rather than town structure. In North Carolina, the Municipal Board of Control is to consider whether the incorporation will serve the ". . . public interest and is necessary and expedient . . .";[1] thus, objections of all types can be filed with the board. The impact of the issuance of incorporation charters by ordinance on the rights of individuals to form such government varies significantly due to the discretionary powers of the designated agency. Even in those states which have election provisions, the existence of discretionary powers by the agency who receives the petition allows for the halting of the incorporation process by decree, thus removing any aspect of local determination. The case of Wisconsin as noted earlier is characterized by this feature.

The remaining state, Arizona, has provisions for both procedures: holding of elections, and granting the charter by ordinance. If two-thirds of the qualified voters in the proposed city petition the county board of supervisors seeking incorporation, the board can grant a charter by ordinance. The other procedure is used when 10 percent of the qualified electors petition the county board of supervisors asking

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[1] General Statute of North Carolina, §160 A-6 to 160 A-10 (1971).

for an election to decide the question of incorporation. The county board is required to call an election within 90 days.

One further measure of the degree of local determination in the formation of communities is the ability of the individuals residing within the area of the proposed community to halt the incorporation process at any point short of a determination on the petition. Two features are worth noting: in the majority of states that allow some discretion in the incorporation process, it is not possible to withdraw the petition once it is filed; and in all these states there exists a prohibition against refiling petitions for the same area within one to two years. One additional point is that all states except Indiana have now removed the remonstrance clauses that were a common feature of state legislation in earlier periods.

Disincorporation and Dissolution

The power to disincorporate or dissolve a municipal government is, like the incorporation power, vested in the state government. As a general proposition, the legislature may accomplish dissolution by direct action through special or general acts, as permitted by the state constitution; by indirect action through the vote of the inhabitants of a municipality; or by action of the court under terms and conditions prescribed by the legislature.[1]

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[1]By special act, Hatfield v. Prince, 156 Fla. 411, 23 So2d 481 (1945); by special law, Shosone Highway District v. Anderson, 22 Idaho 109, 125 P 219 (1912); by vote of the inhabitants, Green v. Davis, 253 Ky. 105, 68SW2d 759 (1934); and by court action, Boone County v. Verona, 190 Ky. 430, 227 SW 804 (1921).

The procedure for accomplishing dissolution or disincorporation of municipalities are usually statutory and, while they vary from state to state (see Table 3.4 for a brief description of procedures used in several states), they contain a similar process. The disincorporation procedure generally provides for the filing of a petition signed by a specified percentage of the voters, or property taxpayers, or both, to initiate the action. In some cases, the petition is filed with the district court which enjoys discretion with respect to dissolution.[1] However, a more common practice is the filing with the government body in question, and then the issue is decided by an election of the inhabitants or voters who reside permanently within the municipality.

Texas is the only state which treats entry and exit in a uniform manner; the procedure for both is the same. Several states which decide the issue of incorporation by the use of hearings and decree use the electoral process to settle the question of disincorporation. The process in general is much more responsive to local determination, as the use of discretionary power is much less common. Further, states which decide the question of incorporation by simple majority vote require either that the vote in favor of disincorporation be more than a simple majority,[2] or that the vote represent a certain percentage of the total number of voters within the municipality.[3]

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[1] Code of Alabama, 37 §17-25 (1973).

[2] See, Revised Statutes of Montana, §11-203 through 11-210 (1947).

[3] See, Revised Code of Washington Annotated, §35.02.010 through 35.02.150 (1965).

TABLE 3.4

PROCEDURAL FORM FOR DISINCORPORATION:
SELECTED STATES

State	Procedural Form
Alabama	No provision if municipal corporation's population is greater than 1,100. Otherwise, 3/4 of qualified voters petition probate judge to hold hearing. Dissolves if it appears that 3/4 are in favor. Also dissolved by forfeiture.[a]
Alaska	Majority petition to Department of Community Affairs or by majority election.
Arizona	Petition of 2/3 of qualified voters to Board of Supervisors. Hearings held.
California	20 percent of qualified electors, as shown by the last general state election, petition city's legislative body, election held, majority of votes cast rules. If vote is for disincorporation, city ceases 30 days after date of election.
Florida	Special act of legislature or passage of a municipal ordinance of disincorporation which is approved by majority vote of qualified electors.
Georgia	Special act of legislature.
Idaho	Petition signed by 1/2 of qualified voters to city council, special election called, passed if gets 2/3 of votes cast.
Iowa	Petition of 25 percent of number voting in preceding municipal election filed with district court, special election, passed if gets majority of votes cast. Also dissolved for forfeiture.
Maryland	By a majority vote to cease functioning or forfeiture.
Missouri	Petition signed by 3/4 of legal voters to county court. Court decides after circulation of a notice of intent to disincorporate.
Montana	Petition signed by 20 percent of voters to county board of commissioners; election must be held within 30 days, if 60 percent of those voting favor disincorporation, then city government ceases. Also by forfeiture.

TABLE 3.4--Continued

State	Procedural Form
Nebraska	Petition signed by 1/3 of voters who are taxpayers filed with county clerk, election held, if majority of voters in said village vote on disincorporation, government ceases. Provided all liabilities are liquidated.
North Dakota	Repealed statute covering dissolution 1967.
Oklahoma	Petition of 1/3 of legal voters to board of trustees, election called, if majority of votes cast favor disincorporation and this number is 2/3 of number of all the legal voters in town, then disincorporation 6 months hence.
Oregon	Petition of 5 percent of registered voters, election held and if majority of the number of voters, not just those voting, favor disincorporation, then it takes place 6 months hence. Only petition if city is not liable for any debt or obligation.
South Dakota	If city has 250 inhabitants or less, the majority of owners of real property or the majority owners of assessed property value petition county circuit court, court issues "show cause" order to city, then court decides on disincorporation issue. If less than 1,000 inhabitants but more than 250, petition of 1/2 legal voters to city board, hold election, if majority of votes case are for disincorporation and this number is 2/5 of number of total legal voters, then city ceases 6 months hence.
Texas	For towns less than 10,000 population procedure is the same as for incorporation; if over 10,000, then 100 property taxpayers who are qualified voters petition judge, election held, majority of votes cast decides, or if total number of property taxpayer/electors is equal to 100, then only need simple majority.
Utah	1/4 of legal voters petition district court, election held, majority of those voting decides.
Virginia	1/4 of voters who were qualified to vote in the preceding November election petition circuit court, election held, majority of those voting decides.

TABLE 3.4--Continued

State	Procedural Form
Washington	No provision for city of population over 4,000. Petition of majority of registered voters to city council, election held, if majority of those voting favor disincorporation and this number is a majority of the registered voters in city, corporation is dissolved. Also disincorporation for forfeiture.
West Virginia	No provision for city over 10,000. 25 percent of legal voters petition government body, election held, majority of votes cast decides; if for disincorporation, municipality ceases upon termination of the term of the governing body in office, provided that all debts will be settled in full. All disincorporated for forfeiture.
Wyoming	No provision for city over 35 people. 3/4 of governing body or if no governing body, a majority living in county may resolve to dissolve government by transferring corporate assets to the closest city or town within the same county.

SOURCE: See Appendix to Chapter III for source material.

[a]The forfeiture clauses vary from state to state, but they are all intended to be initiated by prolonged failure of the municipality to exercise its corporate powers.

CHAPTER III

APPENDIX

Listed below are the sources used to formulate the tables in this chapter.

1. Code of Alabama, 37 §10-16 (1958).
2. Alaska Statutes, §§29.18.010-29.18.460 (1972).
3. Arizona Revised Statutes, Annotated, §9-101 to 9-281 (1974).
4. Arkansas Statutes, 1947 Annotated, §19-101-111.
5. Annotated California Codes, §34080 et. seq. (1966).
6. Colorado Revised Statutes, §21-1-101 to 31-1-530 (1973).
7. Florida Statutes Annotated, §165.011-165.093 (1974).
8. Georgia Code Annotated, §69-1401 to 1405 (1973).
9. Idaho Code, §50-101 to 104 (1967).
10. Illinois Annotated Statutes, §2-2-1 to 2-2-13 (1973).
11. Indiana Statutes Annotated, §18-3-1-3 to 18-3-1-28 (1973).
12. Iowa Code Annotated, §362.1-362.10 (1974).
13. Kansas Statutes Annotated, §15-115 to 15-125 (1974).
14. Kentucky Revised Statutes, §81.040-81.070 (1971).
15. Louisiana Revised Statutes, §33.51-33.55 (1967).
16. Annotated Code of Maryland, Art. 23A §21.-30. (1973).
17. Michigan Statutes Annotated, §5.1201-5.1214 (1969).
18. Minnesota Statutes Annotated, §414.01-414.09 (1962).

19. Mississippi Code, 1972, Annotated, §21-1-13 to 21-1-23.

20. Annotated Missouri Statutes, §80.020-80.030 (1953).

21. Revised Code of Montana, §11-203 to 11-210 (1947).

22. Revised Statutes of Nebraska, §17-201 to 17-201.01 (1972).

23. Nevada Revised Statutes, §266.020-266.080 (1973).

24. New Mexico Statutes, §14-2-1 to 14-2-8 (1965).

25. New York Village Law, §2 (1964).

26. General Statutes of North Carolina, §160-A-6 to 160-A-10 (1971).

27. North Dakota Century Code, §40-02-01 to 40-02-16 (1967).

28. Ohio Revised Code Annotated, §707.01-707.30 (1971).

29. Oklahoma Statutes Annotated, §971-984 (1972).

30. Oregon Revised Statutes, Title 21 §221.010-221.106 (1974).

31. Pennsylvania Statutes Annotated, §53-45201-452119 (1971).

32. Code of Laws of South Carolina, §47-101 to 47-351 (1962).

33. South Dakota Compiled Laws, §9-3-1 to 9-3-21 (1967).

34. Tennessee Code Annotated, §6-101 to 6-134 (1971).

35. Texas Civil Statutes, §1133-1139a (1972).

36. Utah Code Annotated, §10-3-1 to 10-2-6 (1953).

37. Virginia Code, §51.1-967 (1964).

38. Revised Code of Washington Annotated, §35.02.010 to 35.02.150 (1965).

39. West Virginia Code, §8-2-1 to 8-2-8 (1969).

40. Wisconsin Statutes Annotated, §66.013-66.018 (1965).

41. Wyoming Statutes, §15.1-21 to 15.1-34 (1965).

CHAPTER IV

MUNICIPAL INCORPORATION IN CALIFORNIA: A CASE STUDY

In 1963, the California legislature acting for ". . . the discouragement of urban sprawl and the encouragement of the orderly formation and development of local government agencies . . ."[1] radically altered the process by which new communities are formed. The California action is significant, as it marks the beginning of a trend toward more restrictive incorporation policies in a number of states. Once the results of the California experiment become known, the development can be expected to affect policies in other states. It is necessary to look at the historical climate of California city formation to get some understanding of the impact of this legislative change on the local government industry. Attention will be paid to the roles assigned to the various members of the local government structure. The general incorporation procedure will be discussed. Then the chapter will examine in detail the changes that were mandated by the Knox-Nisbet Act and the creation of Local Agency Formation Committees.

Historical Background

During the period of California's first state constitution, 1849 to 1879, the legislature could pass special acts. They were empowered

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[1] Annotated California Codes, §54774 (1967).

to grant charters controlling the structure, financing, and functioning of cities, and to dictate changes at will. As in other states, the opposition to special legislation grew in California cities. When a new constitution passed in 1879, it contained legislation prohibiting the granting of special charters, or laws regarding cities.[1] Article XI, section VI of the 1879 constitution read:

> Corporations for municipal purposes shall not be created by special laws; but the Legislature, by general laws, shall provide for the incorporation, organization, and classification, in proportion to population, of cities and towns, which laws may be altered, amended, or repealed. Cities and towns heretofore organized or incorporated may become organized under such general laws whenever the majority of the electors voting at a general election shall so determine, and shall organize in conformity therewith; and cities or towns heretofore or hereafter organized, and all charters thereof framed or adopted by authority of this Constitution, shall be subject to and controlled by general laws.[2]

In addition to requiring the establishment of a system of general laws for municipal incorporation, the constitution provided for home rule charters. These charters could be granted to any city of over 100,000. At the time the legislation was passed, only San Francisco qualified. Thus, California followed the lead of Missouri and became the second state in the Union to make provision for local government control of local government affairs through home rule.

This began for California a long period of asserting the freedom of the cities from the control of the legislature. California's

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[1] For an interesting and detailed account of the California Constitutional Convention of 1879, see: H. L. McBain, The Law and the Practice of Municipal Home Rule (New York: Columbia University Press, 1916). Chapters VIII through XI treat the interface between the cities and the judiciary in California.

[2] Ibid., p. 202.

constitution was altered several times between 1879 and 1930, always with the aim of assuring greater local autonomy for the cities.[1] For example, when in the 1890s the courts were disposed to interpret the last line of Article XI, section VI,[2] to mean subject to any and all legislative controls, the people of the state responded by amending that section to read ". . . except in municipal affairs."[3] Therefore, in a period when many states were enacting more rigid controls over city affairs, California was assuring a greater measure of freedom of action. Further, informed observers note that the courts in California have ruled in favor of the municipalities, especially in the case of home rule or charter cities, much more frequently than the national norm.[4] Even before the enactment of the 1879 constitution, the California Supreme Court had abandoned the doctrine of absolute legislative supremacy over the cities.[5] In the four years immediately preceding the 1879 convention, the court had announced three implied limitations on legislative control over cities: (1) no interference with city affairs by mandatory state legislation, as such action violated the inherent right of local self-government; (2) no legislatively authorized claims against cities for municipal purposes without the consent of those to be taxed; (3) no creation by the legislature of claims which are not for

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[1] Joseph D. McGoldrick, Law and Practice of Municipal Home Rule, 1916-1930 (New York: AMS Press, Inc., reprinted in 1967), pp. 49-69.

[2] See previous page. [3] McGoldrick, Municipal Home Rule, p. 49.

[4] John C. Bollens and Stanley Scott, Local Government in California (Berkeley: University of California Press, 1951), pp. 12-15.

[5] People v. Hoge, 52 Cal. 612 (1878).

municipal purposes against the funds or property of cities.[1] The municipal corporation fared well under both the legislature and the courts. As might be expected in this atmosphere, new cities were continually being formed.

Traditional political theory suggests that cities come into being for a variety of reasons, such as a break in the transportation network or the proximity of natural resources or an advantageous location with respect to natural energy sources.[2] Such cities are more or less self-contained settlements that control their own destinies. In this view, cities are agencies that render services that neither private, state, nor county agencies are capable of, or willing to, provide. Other common reasons that areas may seek city status are to prvent annexation by an existing city, and to maintain an advantageous tax structure. When cities are created for these latter reasons, they are often termed "special interest" cities and are condemned as disruptive to the ". . . orderly pattern of local government."[3] As a result of California's liberal attitude toward community formation, many such cities were formed in the late 1950s and early 1960s. When the boundaries of an existing city extended close to an industrial, commercial, or agricultural enclave, these areas incorporated. For example, Vernon has a daytime population of over 70,000 people, but only 236 residents.[4] Industry is

[1]Bollens and Scott, Local Government in California, pp. 12-28.

[2]Anwar Syed, The Political Theory of American Local Government (New York: Random House, 1966).

[3]For a commonly cited statement of this point of view, see: Samuel E. Wood and Alfred E. Heller, "The Phantom Cities of California," California Tomorrow (1963), pp. 43-60.

[4]Ibid.

18 miles long, and from 200 feet to 2 miles wide. The city supports itself entirely from the proceeds of a sales tax, and has 16 books in its public library.[1] Then there are the cities of Dairyland and Dairy Valley, which contain many cows and few people.

California general law cities enjoy more local autonomy than do the home rule cities of many other states. These general law cities possess 32 enumerated powers, in addition to an inclusive grant of authority ". . . to pass ordinances not in conflict with the constitution and laws of this state or of the United States . . . . "[2] The city can choose from alternative forms of city government, and has broad powers regarding taxes, franchises, and licenses as long as the amount does not exceed $1 per $100 of property value. In contrast, in most home rule states, the legislature enjoys concurrent or superior power, even in matters of local concern. In these states, general acts of the legislature take precedence over ordinances or home rule charter provisions.[3]

This generosity of state laws has led to another California phenomenon: the contract city. The idea was introduced into California in 1954, when the residents of the newly incorporated city of Lakewood decided to purchase services from Los Angeles County, rather than

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[1] Bernard L. Hyink, Seymor Brown, and Ernest W. Thacker, Politics and Government in California (7th ed.; New York: Thomas Y. Crowell Co., 1971).

[2] Ann. Calif. Code, §40506.

[3] For a more detailed discussion of the powers of home rule cities in various states, see: Charles R. Adrian and Charles Press, Governing Urban America (4th ed.; New York: McGraw-Hill Book Co., 1972), pp. 174-98.

provide their own. Between 1954 and 1963, 27 of the 28 new incorporations in Los Angeles County were contract cities. Eight other counties have at least one contract city which they provide with municipal services.[1] The contract city plan eases entry into the local government market, as new city residents can avoid the large capital outlays usually necessary to provide municipal services. As the number of special interest and contract cities increased, the rhetoric used to change the municipal incorporation procedure mounted. The current law was accused of abetting the ". . . hopeless scatteration of governmental responsibilities for the land and the landscape of the region."[2] Existing cities were quick to point to the erosion of "their" tax base caused by "defensive" incorporation.[3] Local governments increased their demands that the legislature and the governor take action. The result was the appointment of the Governor's Commission on Metropolitan Area Problems.

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[1]Leroy C. Hardy, California Government (7th ed.; New York: Harper and Row, Inc., 1970), pp. 95-113.

[2]Samuel E. Wood and Alfred E. Heller, "The Phantom Cities of California," California Tomorrow (1963).

[3]If a municipal incorporation chooses not to perform a given function, for example, fire protection, then an additional municipal corporation can be formed to provide this service within the same geographical boundary. The important point to note is that the existing municipality is given the monopoly franchise and then if it chooses not to exercise its right to provide a given service, only then can an additional unit of government be formed. For a detailed discussion of this point of view with respect to new municipal incorporations in metropolitan areas, see: Amos Hawley, "The Incorporation Trend in Metropolitan Areas, 1900-1950," in Collected Research of the Department of Sociology and Institute of Public Administration (Ann Arbor: University of Michigan, 1959); and Roscoe C. Martin, "Government Adaptation to Metropolitan Growth," in Metropolis in Transition (Washington: Housing and Home Finance Agency, 1963), pp. 1-11.

In the summary Commission Report issued in December, 1960, certain "critical metropolitan problems" were defined that required solutions on an area-wide basis. Number one on the list was:

> The complexity in local government structure. The tremendous migration of people into California's metropolitan areas has created (a) increased demand for more and broader governmental services, (b) excessive discrepancies in the level of urban services, (c) tax structures that have little or no relation to services received, (d) a greatly increased number of independent and overlapping local government units. California's nine metropolitan communities containing over 200 cities and all or part of 24 counties collectively contain over 2,000 separate governmental jurisdictions in all. These numerous governmental jurisdictions have divided responsibility and produce a segmentalized approach to problems of metropolitan areas.[1]

The Commission, whose recommendations on the municipal incorporation laws of California were to have substantial impact on subsequent legislation, recommended ". . . that the Governor take appropriate action to achieve the following:

> 1. Improve, simplify, and rationalize the structural relationships of existing and future local government units. (The Commission's recommendations do not include or relate to school districts.)
>
> (a) Discretionary criteria should be developed and enacted into statutes to serve as a guide in the establishment and alteration of local units of government.
>
> (b) Annexation laws should be amended to provide that California cities may initiate proceedings for the annexation of inhabited territory on their own motion.
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> (c) Annexation laws should be amended to provide for the submission of proposals for inhabited annexations to the electorate of both annexing city and the area to be annexed with adoption of the proposal to be decided by majority vote of those voting on the proposal.

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[1] "Report on Meeting Metropolitan Problems," Governor's Commission on Metropolitan Area Problems (December, 1960), pp. 1-5.

(d) Analysis, necessary revision and recodification should be undertaken for all present legal provisions affecting the creation and alteration of local units of government.[1]

Further, the Commission recommended that the state establish by statute a "State Metropolitan Area Commission" to be appointed by the governor. The Commission would exercise quasi-judicial powers in the review and approval of proposals for: "(1) the incorporation of, or annexation to, cities, and (2) for the creation of, or annexation to, special districts."[2]

In his 1963 inaugural address, Governor Brown urged the state legislature to provide laws ". . . to end the haphazard formation of new cities and service districts."[3] The result of the governor's directive was the passage of the Knox-Nisbet Act of 1963. The act altered Chapter 34303.5 of the government code dealing with the creation of new cities. The legislature responded by creating Local Agency Formation Committees in each county of the state. These agencies differ from the single state-wide body recommended by the Governor's Commission. The goals of the Local Agency Formation Committees (also referred to as LAFCOs) are the discouragement of urban sprawl and the encouragement of the logical and orderly development of local government agencies. The introduction of the LAFCOs simply replaced the existing Local Boundary Commissions. On the surface, it appears that the procedure to create a new city remains substantially unchanged, when, in fact, California moved from a legislative structure which permitted existing cities and

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[1] Ibid., p. 5. [2] Ibid.

[3] Samuel Gorlick, "Control of Urban Sprawl," The Urban Lawyer, II (Winter, 1970), 96.

counties no control over entry into the local government industry to a legal structure that grants these entities virtually complete control.

Incorporation: Conditions and Procedure

The first step in the incorporation process under the 1974 statutory provisions is to obtain the approval of the LAFCO of the county. The purposes of the LAFCOs are extremely general and loosely defined, giving these agencies a large degree of discretionary power. By statute, the LAFCOs are charged with: discouraging urban sprawl, contributing to the logical and reasonable development of local governments, shaping the development of local agencies so as to provide for the future need of the county and the communities, and determining the maximum service area and service capacities of existing governmental agencies, to name but a few of their functions.[1] An additional function was added in 1967, when the Knox-Nisbet Act was amended to add the so-called "sphere of influence" clause. The amendment requires that the LAFCOs ". . . develop and determine the sphere of influence of each governmental agency within the county. As used in this section 'sphere of influence' means a plan for the probable ultimate physical boundaries and service area of a local governmental agency."[2]

Powers of the LAFCOs

The commission is empowered

> . . . to (a) review and approve, or disapprove with or without amendment, wholly, partially, or conditionally, proposals for:

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[1] Ann. Calif. Code, §54774.

[2] Ann. Calif. Code, §54774, amended by Stats. 1967, c. 920, p. 2374, §14.

1. The incorporation of cities;
2. The formation of special districts;
3. The annexation of territory to local agencies (cities and special districts);
4. The exclusion of territory from a city;
5. The disincorporation of a city;[1]
6. The consolidation of two or more cities.

and (b) to adopt standards and procedures for the evaluation of [the above] proposals . . . .[2]

The LAFCOs possess several additional powers as well. A LAFCO is able to incur the usual and necessary expenses required for the accomplishment of their functions. It can appoint and assign staff personnel, as well as employing or contracting for professional or consulting services to carry out and effect its functions. It has the function of reviewing boundaries of the territory involved in any proposal, so as to ensure that the boundaries are definite and certain. It can waive restrictions on the shape of a new city or an annexation, if it finds both that the application of the restrictions would be detrimental to the orderly development of the community, and that the area to be enclosed by the annexation or incorporation is so located that it cannot reasonably be annexed to another city or incorporated as a new city.[3] The above powers of the LAFCOs are, of course, in addition to the powers enumerated by the 1967 amendment directing the establishment of spheres of influence.

In order to plan and shape the ". . . logical and orderly development and coordination of local governmental agencies . . . ,"[4] the commissions are to determine the sphere of influence of each

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[1]This power was added in 1967. [2]Ann. Calif. Code, §54790.

[3]Ibid. [4]Ann. Calif. Code, §54774.

governmental unit, considering the following factors:

1. The maximum possible service area of the city or special district;
2. The range of services that are or could be provided;
3. The projected future population growth;
4. The type of development occurring or planned;
5. The present and future service needs of the area;
6. The local governmental agencies currently serving each area and the present level, range and adequacy of these services;
7. The existence and degree of social and economic interdependence and interaction between the existing governmental unit and the area that surrounds it.[1]

The commissions adopt the spheres of influence that are developed under the above guidelines, after a public hearing has been held for that purpose. Once adopted, the spheres of influence represent the official position of the LAFCO on the governmental units in the given county. The commissions are supposed to review and update the adopted spheres of influence periodically. Should any local agency (city or special district) or county wish to amend or revise an adopted sphere of influence, a written petition is filed with the commission. Upon receipt, the commission schedules a hearing on the request and may deny or approve, in whole or in part, the request.[2] Further, the city, special district, or county that requests the hearing must reimburse the commission for ". . . the reasonable and necessary costs, not to exceed

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[1]Ibid. [2]Ann. Calif. Code, §54774.2.

five hundred dollars . . . ."[1] There are no provisions of the statute that allow interested parties to request a hearing on the spheres of influence once they are adopted.

The commissions are expressly enjoined from imposing conditions that would ". . . directly regulate land use or subdivision requirements."[2] The commission's jurisdiction over special districts is limited to those that are independent and excludes school districts.[3] In over 10 years of operation, there are at present only three reported decisions concerning the power of the commission. In City of Ceres v. City of Modesto,[4] the concept of spheres of influence was tested. The court held that the action of the Local Agency Formation Commission in establishing tentative future boundaries for the two adjoining cities did not, of itself, deprive one of these cities of the power to extend sewage disposal services into contiguous unincorporated territory. In San Mateo County Harbor District v. Board of Supervisors of San Mateo County,[5] the commission had been asked to approve the dissolution of a county harbor district. In the letter granting approval of the dissolution, the commission stated it had reservations about the dissolution. The court held that the commission is required to evaluate evidence for and against a particular proposal and to make its own independent decision. In other words, the commissions must issue clear

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[1] Ibid. [2] Ann. Calif. Code, §54790.

[3] Ann. Calif. Code, §54775.

[4] 79 Cal. Reptr. 168,274 C.A.2d 545 (1969).

[5] 77 Cal. Reptr. 871,273 C.A.2d 165 (1969).

yes or no decisions. In Meyers v. Local Agency Formation Commission of Tulare County,[1] the membership of the commission was contested on grounds of conflict of interest. The court held that the residents of the areas annexed to the city were not deprived of a fair hearing on the matter. This was in spite of the fact that county property was involved in the annexation, and that two of the five members of the LAFCO were also members of the county board of supervisors.

Commission membership

Each commission is composed of five members--two representing the county, two representing the cities within the county, and one from the general public.[2] The commission of any county may be enlarged to seven members to allow representation of the independent special districts within the county.[3] Each member serves a four-year term, and the terms of service are staggered. Members receive no salary, but are reimbursed for the actual amounts of their reasonable and necessary expenses in attending meetings; however, the board of supervisors may authorize payment of per diem to commission members.

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[1] 110 Cal. Reptr. 422,34 C.A.3rd 955 (1973).

[2] Ann. Calif. Code, §54780. In cases where the county has only one city, the commission composition is as follows: two elected members of the board of supervisors, one city officer, and two members representing the general public who are appointed by the other three; §54782. When the county does not have any cities, the commission composition is three members representing the county who are also members of the board of supervisors, and two members representing the general public appointed by the other three; §54781.

[3] Ann. Calif. Code, §54782.6.

The county members are appointed by the board of supervisors from their own membership. The board also appoints an alternate, who represents the county when the regular member is absent or when he disqualifies himself from participation. The city members must be city officers and are appointed by the City Selection Committee; an alternate is also appointed.[1] The member representing the general public is appointed by the other four members of the committee. In cases where the membership of the commission includes special district representation, the members, and two alternates, must be elected or appointed officials of special districts. The law expressly provides that when the LAFCO is considering a proposal for the annexation of territory to a city, of which one of the members of the commission is an officer, the member is disqualified from participating in the proceedings.

Commission operation

When an application is filed, and accepted by the executive officer of the commission, proceedings are initiated. Any proponent, any legislative body, or any member of the legislative bodies may initiate the proceedings by submitting an application.[2] The executive officer of the commission sets the matter for a hearing, and notifies each affected county, city, or special district. He also notifies any

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[1]The California legislature in 1974 enacted new controls over the City Selection Committees. The mayor of each city is the representative on the committee. In order for appointments to be enacted, the majority of members must be present. The law does not specify the decision rule for the committee's appointment of LAFCO members. Ann. Calif. Code, §50270-§50281.

[2]Ann. Calif. Code, §54791.

interested party who has filed a written request for such notice, and any officers designated in the application for the purpose of receiving a mailed notice. If the proposal is for annexation of a territory to a city, the incorporation of a new city, or the formation of a special district, the notice of hearing must be published at least 15 days prior to the hearing.[1]

Hearings in which the commission hears any interested person, and considers the findings of the executive officer, must be open to the public.[2] Within 15 days after the conclusion of the hearing, the commission must adopt a resolution making its determination upon the proposal. If the commission approves a proposal, proceedings may be initiated, and completed pursuant to the applicable provisions of the law. If the proposal is disapproved, the proceedings are terminated, and no application for the same proposal can be filed for one year without commission consent.[3] The commission can also approve proposals with modifications or conditions, and can offer short-term designations for the affected territory.

When considering any proposals enumerated above, the law directs the commission to consider the following factors in the review:

1. Population, population density; land area and land use; per capita assessed valuation; topography, natural boundaries and drainage basins; proximity to other populated areas; the likelihood of significant growth in the area, and in the

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[1] Ann. Calif. Code, §54793. [2] Ann. Calif. Code, §54793.

[3] Ann. Calif. Code, §54797.

adjacent incorporated and unincorporated areas during the next 10 years.

2. The need for community services, and their present and projected costs both in terms of the methods of providing them, and the probable effect of the proposed incorporation, formation, annexation, or exclusion.
3. The effect of the proposed action and of alternative actions on adjacent areas, on mutual social and economic interests; and on the structure of local government in the county.
4. The conformity of the proposal and its anticipated effects with both adopted commission policies on providing planned, orderly, efficient patterns of urban development; and the policies for the preservation of open space.[1]

The LAFCO is not bound by the above list, and can consider any factors it considers relevant to the proposal. Even a cursory review of the powers given to the LAFCOs indicates that these agencies have complete control over every phase of the municipal incorporation process in California. It seems clear that LAFCOs are not going to ". . . provide the mechanism for a disinterested review, at a level above the disputing parties, of the factual basis and competing policy consideration which enter into the creation or modification of local boundaries . . . ."[2] Rather these agencies can be viewed as a market-sharing cartel. The

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[1] Ann. Calif. Code, §54796.

[2] Robert G. Dixon, Jr., "New Constitutional Forms for Metropolis: Reapportioned County Boards; Local Council of Governments," Law and Contemporary Problems, XXX (Winter, 1965).

legal mechanism has been provided, whereby existing governmental units can control the shares of the local government industry.

Pre-1963 conditions

Prior to 1963, a notice of intent to circulate a petition for incorporation had to be submitted to the Local Boundary Commission (LBC). The LBC, in turn, reported to the proponents of incorporation, with respect to the definiteness and certainty of the proposed boundaries. If the Local Boundary Commission failed to report on the notice within 20 days, it was assumed correct. The incorporation procedure could then continue. As initially conceived, the only function of the boundary commissions was to assure that the boundaries specified did not contain any incorporated areas. In 1955, this section was amended to cause the boundary commissions to check for ". . . the non-conformance of proposed boundaries with lines of assessment or ownership, the creation of islands or corridors of unincorporated territory or other similar matters affecting the proposed boundaries."[1] Even with this expansion of function, the LBC had little, if any, discretionary powers to halt the incorporation process. The background of the LBCs has been presented, in order to provide a base to compare the changes initiated by the Knox-Nisbet Act.

Incorporation process

Once approval of the LAFCO is obtained, the procedure is much the same as it was before the 1963 change. The creation of a city

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[1] Ann. Calif. Code, §34303.5.

requires at least 500 individuals living within an unincorporated area. In counties with more than 2 million inhabitants, the requirement is modified to 500 registered voters. In California, it is necessary to notify the county board of supervisors of the intent of residents or property owners to circulate a petition asking for incorporation. The notice of intention filed by the proponents must contain: (1) names and addresses and be signed by 25 to 50 registered voters who reside in the proposed city or 25 to 50 qualified owners of property (they need not be residents);[1] (2) the specific boundaries of the proposed city; (3) the name of a person designated to act as Chairman of the proponents. A notice of receipt of the notice of intention must be circulated to the legislative bodies of all cities whose territorial limits lie within three miles of the proposed city.[2]

Proceedings are initiated by filing with the board of supervisors--at a regular meeting--a petition seeking incorporation. The petition must contain:

(1) the signatures of 25 percent of the registered voters who are residents of the proposed city or the signatures of 25 percent of the property owners (they need not be residents), representing at least 25 percent of the assessed value of the land included in the proposed city limits;

(2) the address of each registered voter or the identity of the property owned by each signer;

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[1]The 1974 legislature amended this section, §34302.1, to allow for initiation of the incorporation process by nonproperty owners and nonresidents. Prior to this change, only property owners who resided in the area were allowed to begin the procedure. The 1974 legislature also changed §34303, so that nonproperty-owning residents and property-owning nonresidents could sign petitions.

[2]Ann. Calif. Code, §34302.5.

(3) an accurate description of the proposed boundaries;

(4) the number of inhabitants contained in the proposed city (or in a county of 2 million or more, the number of registered voters);

(5) an affadavit attesting to the authenticity of the signatures and the fact that they were obtained within 120 days of filing the notice of intent.[1]

From this point on, the procedure is very simple. The county clerk checks to make certain that the signatures are correct, and, if so, collects a sum of money from the proponents sufficient to defray the cost of publication of notices for hearings and the election. At the next regularly scheduled meeting, the board of supervisors sets a hearing date and causes notice of publication to be printed. The board must hold the hearing at the time and date specified in the notice. It may adjourn the hearing from time to time, as long as the total adjournments do not exceed two months.

At any time before the final hearing on the petition, any owner of real property within the area proposed for the city can make a written request for exclusion of his property from the incorporation. The request must contain sufficient information to allow the board to identify the property. At the final hearing, the board may "make such changes in the proposed boundaries as it finds proper."[2] The board can change the boundaries in such a way that the proposed city does not meet the population requirements. Then the board can refuse to take any further action. The courts have held that ". . . whether it is good or bad policy to leave supervisors a discretion with respect to

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[1] Ann. Calif. Code, §34303. [2] Ann. Calif. Code, §34315.

incorporation of new cities so unguided that it may be exercised in an arbitrary manner where no vested right is involved is a question for the legislature and not the courts."[1]

After the boundaries are established, the board of supervisors calls an election on the question of incorporation. The notice of election must be published for two weeks prior to the vote. To vote in an incorporation election, the individual must be qualified to vote in the state of California, and have resided within the limits of the proposed city for at least 54 days prior to the election. If the majority voting are opposed to incorporation, no incorporation proceeding may be initiated containing any of the same area for a period of at least two years. If the majority favors incorporation, the county clerk files an order so stating with the secretary of state.

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[1]See, Peart v. Board of Supervisors of Santa Clara County, 301 P.2nd 874,145 C.A. 2d (1956).

CHAPTER V

A CONCEPTUAL EXAMINATION OF THE KNOX-NISBET ACT

When Local Agency Formation Committees (LAFCOs) were mandated by the passage of the Knox-Nisbet Act of 1963, all subsequent boundary changes initiated by the various units of local government were subject to the direct regulation of the Commission. The broad discretionary powers granted to the LAFCOs gave these agencies control over entry and exit of municipal corporations, annexations, and dissolutions. Between 1957 and 1972, the structure of the local government industry in California underwent significant changes; the main features are summarized in Table 5.1. Only three of California's 58 counties had new communities formed in each of the five year periods, and in all cases the average city size increased markedly in the period after the institutional change.

This alteration in the average city population size corresponds with the introduction of the LAFCOs into the California government scene; however, it does not necessarily follow that the LAFCOs had any measurable impact on the rate of new community formation. The observed changes in the rate of new entrants could have been a response to independent political and economic factors, rather than a result of the legal change. Even if we assume that the reduction occurred as a

TABLE 5.1

NEW MUNICIPAL INCORPORATIONS AND AVERAGE CITY SIZE: CALIFORNIA, 1957-1972

Category	1957-1962	1962-1967	1967-1972
No. of new communities formed	42	28	9
No. of consolidations	0	1	2
Change in population in counties creating new cities	1,170,371	1,625,502	758,900
Avg. new city size of selected counties:			
Los Angeles	25,278	193,933	157,700
Orange	29,262	467,476	358,300
San Mateo	20,873	37,366	40,900

SOURCE: Data extracted from Census of Governments, 1957-1972, U. S. Bureau of Census.

consequence of the institutional change,[1] there is still the important problem of ascertaining the consequences of the reduced entry, in addition to an assessment of the impact. In other words, what will be the likely result of a reduction in new municipal incorporations, and how will this reduction alter the public goods bundle that is provided? This chapter will present two alternative perspectives concerning the probable effects of restricting entry into the local government market,[2] and then will look at the empirical consequences suggested by the alternative perspectives. The thrust of the chapter will be to present a conceptual framework that will assist in evaluating the effects of the institutional shift.

Entry Restrictions: Alternative Perspectives

The central issue addressed by the legislative change of the institutional structure governing new community formation and boundary adjustments is what is the best pattern of local government in the metropolitan areas of California. One body of literature suggests that

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[1]The practical effect of casting the conceptual argument in this manner is to assume that the LAFCOs have been effective in closing the market to new entrants. Of course, this is an empirical question and will be dealt with, in detail, in the following chapter.

[2]In light of the importance entry plays in private sector analysis of the allocation of resources, it is surprising that there is very little empirical attention devoted to an examination of public sector outcomes under alternative institutional contraints. Two research efforts are important exceptions: Sam Peltzman, "Entry in Commercial Banking," Journal of Law and Economics, VIII (October, 1965), 11-50; and Regulation of Pharmaceutical Innovation: The 1962 Amendment (Washington: American Enterprise Institute for Public Policy Research, 1974).

entry restrictions will be efficiency-inducing, based on the assumption that fragmented and overlapping layers of government prevent solutions, in addition to causing problems.[1] An alternative perspective suggests that managers of municipalities, bureaucrats and politicians, can be treated as behaving analogously to the entrepreneur of the private sector. Within this framework, restrictions on entry are viewed as a method by which managers of existing governmental units increase their monopoly power, and provide a means to stabilize the formation of a market-sharing cartel.[2] The following section will explore the arguments presented by each perspective.

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[1]For a general survey of the "traditionalist's" propositions as relating to metropolitan reform, see: Elinor Ostrom, "Metropolitan Reform: Propositions Derived From Two Traditions," Social Science Quarterly, LIII (December, 1972), 474-93. For a concise presentation of the "traditional reform" approach to local government, see the statements of the Committee for Economic Development, Modernizing Local Government and Reshaping Government in Metropolitan Areas (1970). For a brief history of the reform movement, see: John C. Bollens and Henry J. Schmandt, The Metropolis: Its People, Politics, and Economic Life (New York: Harper and Row, 1965), Ch. XIV, pp. 400-39; and Syed, Political Theory of American Local Government. There is an extensive body of literature in legal journals which supports reform tradition; for a representative sample, see: "Symposium: State and Local Government," Hastings Law Journal, XXIII (March, 1972), which contains reference to California, D. Wayne Jeffries, "LAFCO: Is It In Control of Special Districts?", 913-30; or "A Symposium on Restructuring Metropolitan Government," Georgetown Law Journal, LVIII (March and May, 1970). With particular reference to California, see: Stanley Scott, Lewis Keller, and John C. Bollens, Local Government Boundaries and Areas (Berkeley: University of California Press, 1961). This is the work that is credited with generating the legislation creating LAFCOs.

[2]For recent empirical evidence that the theory of monopoly provides a superior explanation of local government behavior, see: Richard E. Wagner and Warren E. Weber, "Competition, Monopoly, and the Organization of Government in Metropolitan Areas," Journal of Law and Economics, forthcoming; Albert Breton, The Economic Theory of Representative Government (Chicago: Aldine-Atherton, 1974); Robert L. Bish and Robert Warren, "Scale and Monopoly Problems in Urban Government

Entry restrictions as efficiency-enhancing

The organization of local government in metropolitan areas has two primary characteristics: the fragmentation of governments in which many independent entities each provide services to their residents; and the overlapping of governments in which alternative services are supplied by different units of government. This fragmented and overlapping structure of local government is said to lead to a misallocation of resources in the public sector for such reasons as interjurisdictional spillovers, the existence of multiple production functions for many publicly provided goods, high information costs for residents when making decisions dealing with many governmental units, and the nonaccommodation of demands for public services because of insufficient population size within a given governmental unit.

The provision of public goods, by their very nature, makes it difficult, if not impossible, to assure that interjurisdictional spillovers will not occur. It is argued that the rate of output produced by a single governmental unit will not correspond to the "real" desired rate, as the preferences of nonresidents will not be taken into account. This is said to lead to either an under- or overproduction of the public good, depending on the nature of the spillover.[1] The

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Services," Urban Affairs Quarterly, VIII (September, 1972), 97-120; Gordon Tullock, The Politics of Bureaucracy (Washington: Public Affairs Press, 1965); William A. Niskanen, "Bureaucracy and the Interests of Bureaucrats," Journal of Law and Economics, forthcoming.

[1]Weisbrod has argued that public goods will be undersupplied even in the case where "equally valued spillins" from other communities are taken into consideration. See, Burton Weisbrod, External Benefits of Public Education: An Economic Analysis (Princeton, NJ: Princeton University Industrial Relations Center, 1964), pp. 6-7.

argument is framed in the following way: it is seldom, if ever, possible for the residents of a locality to confine the benefits and/or the costs from their expenditures on public goods to the residents whose taxes finance the expenditures. If residents of city A choose to provide a haven for bank robbers and drug pushers by providing themselves with a low level of police protection, negative spillovers may be generated for the surrounding communities. The recommended solution to the problem of interjurisdictional externalities is the internalization of the externalities by bringing the affected communities under the same political jurisdiction. The alteration of the political boundaries could be efficiency-enhancing, for a mechanism could be provided whereby those individuals who had benefited in the past, but who bore no portion of the cost, could be made to contribute their fair share; or, in the case of negative externalities, those individuals would be made to bear the full costs of their actions. The existence of boundary problems related to spillovers has led some to the conclusion that political boundaries should be extended until all externalities are internalized.[1]

The existence of many single-function governmental units at the local level is said to prevent significant cost savings by failing to

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[1]For a discussion, see, Gordon Tullock, "Federalism: Problems of Scale," Public Choice, VI (Spring, 1969), 19-30; Mancur Olson, "Changing Roles of Different Levels of Government: A Comment," in The Analysis of Public Output, ed. by Julius Margolis (New York: Columbia University Press, 1970), pp. 210-18. It should be noted that critics of the expansion of political boundaries on externality grounds point to many alternative methods to internalize the spillovers, such as intergovernmental grants, contracts, and minimum standards imposed by legislation at a higher level of government. See, Wagner, Fiscal Organization of American Federalism, esp. Ch. III, pp. 34-57; and Bish, Public Economy of Metropolitan Areas, pp. 35-61.

take advantage of the economies of joint production. For example, there may exist considerable savings to the taxpayer/resident if the producer and distributor of water is also the collector and processor of sanitary sewage. The introduction of entry restrictions will allow existing governmental units to take full advantage of these cost reductions and pass that savings on to the residents in the form of lower public goods prices. In addition, the purported high administrative costs of this type of governmental unit will be reduced by the more efficient multifunctional administrative structure.[1]

A further argument in favor of restricting entry into the local government market focuses attention on the decisionmaking costs involved when there are many layers of government, each providing varied public goods bundles. It is argued that the most conscientious of voters have difficulty remaining knowledgeable about which public officials are accountable for which decisions. By simplifying and streamlining the government organization, especially in metropolitan areas, it will be easier for citizens to hold public officials accountable and responsible for decisions. Public officials in areas that have these "streamlined governments" will be aware that the voters hold them personally responsible and, therefore, greater care will be taken to see

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[1]There does not appear to be any empirical evidence to support the claim that single-function governments have higher per unit administrative costs than multifunctional governments. In fact, quite the opposite conclusion is suggested by recent research; see, Vincent Ostrom, The Intellectual Crisis in American Public Administration (University: University of Alabama Press, 1973), and "Operational Federalism: Organization for the Provision of Public Services in the American Federal System," Public Choice, VI (Spring, 1969), 1-18.

that public goods are provided more efficiently, with the net result being lower prices for the taxpayer/consumer.[1]

It is also argued that one of the consequences of fragmented government is the scattering of public authority, and the division of political power into many small units. As a result, it is alleged that decisions on such matters of general concern as mass transit and air pollution will not be forthcoming. Further, certain classes of services are not provided.[2] For example, comprehensive area-wide sewer or water plans are often cited as activities that only a single area-wide governmental unit can adequately provide. Metropolitan reformers have contended that the absence of metropolitan government has contributed to the inability to solve problems because these area-wide plans were unavailable.[3] The proponents of restrictions on entry argue that the

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[1]For a further elaboration of this theme, see: Robert C. Wood, 1400 Governments (Cambridge, MA: Harvard University Press, 1961). For an alternative view of the ability of the decisionmaker to make informed decisions as the size of the organization increases, see: Oliver E. Williamson, "Hierarchical Control and Optimum Firm Size," Journal of Political Economy, LXXV (April, 1967), 123-38. For recent empirical evidence on the voter's view of governments' responsiveness and performance in nine metropolitan areas, see: Floyd J. Fowler, Jr., Citizen Attitudes Toward Local Government, Services, and Taxes (Cambridge, MA: Ballinger Press, 1974), esp. Ch. X, pp. 199-217.

[2]For a legalistic argument based on this approach, see: Norman Beckman and Page L. Ingraham, "The States and Urban Areas," Law and Contemporary Problems, XXX (Winter, 1965), 76-101; and Dixon, "New Constitutional Forms for Metropolis." For a discussion of the view that entry restrictions are desirable as they prevent a ". . . stable solution 'high up' on each individual producer's average-cost curve whereas a lack of price competition among adjacent groups, when combined with ease of entry, may result in overdiversification and overproliferation of small, high-cost jurisdictions," see McQuire, "Group Segregation and Optimal Jurisdictions," 130.

[3]For a discussion of this point of view, see: Robert C. Wood, "A Division of Powers in Metropolitan Areas," in Area and Power, ed. by Arthur Maass (Glencoe, IL: The Free Press, 1959), p. 59.

condition of undersupply of these types of services would be alleviated by the introduction of this institutional change. The budgetary consequences would be a rise in expenditures for these particular types of services.[1]

Finally, many advocates of tighter restrictions on the boundary adjustment process in the local government market claim that reorganization and consolidation of governments can be expected to achieve many economies of large-scale operation. For example, specialized police services that could be provided for a large city such as police crime laboratories, central records and communications systems, are provided at a higher per-unit cost by small local police forces.[2] However, under conditions of service contracting, the economies of large-scale production are not relevant to a consideration of the optimum pattern or size of the local governmental unit. There is no necessity that public financing of goods be equated with public production.[3] The benefits of a publicly financed good or service can be available to all members of the jurisdiction, but the collective-consumption good may be produced by a private sector firm, another municipality, or the county government. Contracting for the production of public goods is a widely used technique in California, where the municipalities' managers act as

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[1]For an early empirical test of this type of fragmentation hypothesis, see: Brett W. Hawkins and Thomas R. Dye, "Metropolitan 'Fragmentation': A Research Note," American Behavioral Scientist, V (May, 1962), 11-18.

[2]See, Luther Gulick, The Metropolitan Problem and American Ideas (New York: Alfred A. Knopf, Inc., 1962).

[3]For an example of this point, see, Roger Ahlbrandt, "Efficiency in the Provision of Fire Services," Public Choice, XVI (Fall, 1973), 1-16.

buyers for a consumer cooperative in negotiating purchases of traditional municipal goods and services from other governmental units and the private sector.[1] If there are areas within the California local government market where contracting has not provided the means to exploit all the advantages of large-scale production, then the entry restrictions would be efficiency-enhancing in that lower per-unit costs could be achieved.[2]

Entry restrictions as monopoly-enhancing

An alternative perspective for viewing the intertwining, overlapping, fragmented character of metropolitan area government is that this structure evolved in response to a need for an organizational form to represent the diversity and complexity of individual preferences for public goods and services. The complex nature of the governmental structure is a response to the complexity of the urban society. Urbanologist William Alonso has noted, "The chaos of which critics complain, then, refers not to the lack of structure but to the

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[1]For a discussion of the Lakewood Plan phenomenon, see, Robert O. Warren, "A Municipal Services Market Model of Metropolitan Organization," Journal of the American Institute of Planners, XXX (August, 1964), 193-204. An estimate of the extent of service contracting is provided by a 1973 survey by the Task Force on Local Government Reform. It found extensive use of contracting among California cities and counties. One hundred forty-eight cities reported 2,081 contracts, and 26 counties reported 388 contracts. For more detailed information on the nature of the contractual agreements, see: Public Benefits from Public Choice (Sacramento, CA: Task Force on Local Government Reform, 1974), pp. 14-17.

[2]For a development of the notion that, given little or no costs to contracting, there can never be unexploited economies of scale, see: Tullock, "Federalism: Problems of Scale," and J. Roland Pennock, "Federal and Unitary Government: Disharmony and Frustration," Behavioral Science, IV (April, 1959), 147-57.

difficulty of perceiving it . . . ."[1] The theoretical framework that treats public sector managers as behaving analogously to private sector entrepreneurs has developed as a means of examining the existing governmental structure and predicting outcomes as a result of institutional changes.[2]

If private sector firms are going to be able to achieve excess profits in the long run, it is a necessity that they have some effective mechanism to control entry into their industry. Without such control, any larger than normal profits will attract new suppliers to the industry, thereby reducing the benefits available to the existing producers. Thus, in the private sector it has been stated as a general hypothesis of behavior that ". . . every industry or occupation that has enough political power to utilize the state will seek to control entry. In addition, the regulatory policy will often be so fashioned as to retard the rate of growth of new firms."[3] Does this behavioral hypothesis apply equally well to the "local government industry"? Do the managers of existing governmental units have any incentive to form a

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[1]William Alonso, "Cities, Planners, and Urban Renewal," in Urban Renewal, ed. by James Q. Wilson (Cambridge, MA: M.I.T. Press, 1966), p. 44.

[2]For a discussion of the development of the approach of applying economic methodology to the problems of political institutions and urban governments, see: Vincent Ostrom and Elinor Ostrom, "Public Choice: A Different Approach to the Study of Public Administration," Public Administration Review, XXXI (March-April, 1971), 203-16. For an application of public choice theory to governmental organizations, see: Breton, Economic Theory of Representative Government; Vincent Ostrom, Charles Tiebout, and Robert Warren, "The Organization of Government in Metropolitan Areas," American Political Science Review, LV (December, 1961), 831-42.

[3]George J. Stigler, "The Theory of Economic Regulation," Bell Journal of Economics and Management Science, II (Spring, 1971), 3-21.

market-sharing cartel? Managers of firms in the private sector have residual rights to the monopoly profits generated by the operation of the cartel. However, public managers do not have residual claimant status; therefore, they cannot directly take home any monetary rewards from restrictions on entry into the local government market. Why, then, should existing cities pursue policies to retard growth?[1]

It has been argued that because bureaucrats are not permitted to pursue profits, they will seek instead to increase the power, prestige, and salary levels of their office.[2] It has been asserted that the ability of the public sector manager to obtain these financial advancements and perquisites of office depends upon the size of the budget he controls. If the financial rewards of public managers are tied to the size of the budgets they manage, and this relationship is positive, then it is clearly in their best interest to expand the size of the budget.[3] Niskanen has argued quite persuasively that this is

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[1]When speaking of policy of existing cities, it is important to remember that cities do not make policy, individuals do. The reference is simply used as a shorthand way of referring to the public manager's policy decisions.

[2]For a detailed discussion of the behavior of bureaucratic managers, see, Tullock, Politics of Bureaucracy; and William A. Niskanen, Bureaucracy and Representative Government (Chicago: Aldine-Atherton, 1971).

[3]For evidence of the existence of such a positive relationship, see: S. R. Klatzky, "Relationship of Organization Size to Complexity and Coordination," Administrative Science Quarterly, XV (December, 1970), 428-38; and, Public Benefits from Public Choice, sec. II. See, also, Robert J. Staaf, "The Public School System in Transition: Consolidation and Parental Choice," in Budgets and Bureaucrats: Organization of Government Growth, ed. by Thomas E. Borcherding (Durham, NC: Duke University Press, forthcoming 1976).

a very common behavioral pattern for government bureau managers at the federal government level.[1]

If local government managers are analogous in their behavior, and attempt to maximize the budgets under their control due to the positive relationship between pecuniary rewards and city budget size, then one way to accomplish this would be to reduce the number of cities in existence. This line of behavioral logic leads to the prediction that city managers will attempt to use the state to restrict entry in exactly the same manner as their private sector counterpart. The LAFCOs, which are controlled by existing governmental officials, could be predicted to vote to keep new competition out of the local government market.

If restrictions on entry enhance the monopoly power of existing governments in local government industry, the level of public expenditures would be expected to rise. This outcome is predicted to occur because of output restrictions and price discrimination practices common to monopolistic suppliers.[2] Further, the public goods bundle is likely to be altered in composition as the preferences of the public sector managers are substituted for those of the residents. For example, if local governmental units are sufficiently fragmented in a metropolitan

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[1] W. A. Niskanen, Bureaucracy: Servant or Master (London: Institute of Economic Affairs, 1973), and "Bureaucracy and the Interests of Bureaucrats."

[2] For recent research that supports the perspective that behavioral conclusions generated from a theory of monopoly are most useful in explaining local governments, see: Wagner and Weber, "Competition, Monopoly, and Organization of Government"; E. S. Savas, "Municipal Monopolies Versus Competition in Delivering Urban Services," in Improving the Quality of Urban Management, ed. by W. D. Hawley and D. Rogers (Beverly Hills, CA: Sage Publishing Co., 1974), pp. 473-500.

area so that individual taxpayer/consumers can choose among residence in several jurisdictions without great effect on community costs; local government managers will have only limited ability to redistribute incomes through tax-expenditure policies. Competitive pressures will tend to force government managers to combine inputs in a least-cost manner, and to provide services that the majority of residents desire. As the cost to residents of locating in another community or forming a new public goods sharing group falls, residents will increasingly pay only for the public services they want.[1] It seems clear, then, that the ability of the majority to extract any fiscal surplus from the minority is dependent upon the costs of alternative community formation and the availability of large numbers of communities providing a wide variety of public goods bundles. Restrictions on entry can be predicted to alter the public goods bundle in that the power of the existing governments to pursue policies that the consumer was previously unwilling to support has increased.[2]

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[1]The notion that individuals will alter their residential location in response to the public goods mix provided by the local government was first popularized by Charles M. Tiebout, "A Pure Theory of Local Expenditures," Journal of Political Economy, LXIV (October, 1966), 416-24. For an empirical test of the "voting with your feet" model, see: Wallace Oates, "The Effects of Property Taxes and Local Public Spending in Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis," Journal of Political Economy, LXXVII (December, 1969), 957-71. For a discussion of how competition among governmental units is the analogue to competition among firms in the private sector, see: George J. Stigler, "The Tenable Range of Functions of Local Government," in Federal Expenditure Policy for Economic Growth and Stability (papers submitted to 85th Congress, 1st Session, 1957), pp. 213-19.

[2]There are a number of studies on this problem as it relates to racial minorities and "Big City" governments; see: A. Rendon, "Metropolitanism: A Minority Report," Civil Rights Digest, II (Winter,

To understand exactly how the entry restrictions will assist in the formation of a market-sharing cartel, it is necessary to examine closely the local government market in California. Prior to the passage of the Knox-Nisbet Act, county officials were compelled to use contract arrangements with local city officers, if they wished to maintain their base of power, and their budget, at a maximum rate. For example, when a new city is formed from unincorporated county territory, the new city has the right to take over production of the majority of local government services. Before the imposition of entry restrictions, county officials were powerless to stop the incorporation of new cities; therefore, the only way these bureaucrats could retain their budget positions was to convince the new city to contract with it for services. The county would argue that they could provide the services at a lower cost as they had previously served the unincorporated area, and they should continue to do so by contracting for the provision of the public services. This system was characterized by inherent tendencies toward the production of the public goods bundle with a minimal degree of inefficiency, as the city could always withdraw from the contractual arrangement.[1] The ability of a municipality to find another source of supply allows it to strike better bargains.

1969), 5-13; G. M. Ratner, "Inter-neighborhood Denials of Equal Protection in the Provision of Municipal Services," Harvard Civil Rights-Civil Liberties Law Review, IV (Fall, 1968), 1-63; and M. Parenti, "Power and Pluralism," Journal of Politics, XXXII (August, 1970), 501-30. For a view of the problem as it relates to the suburban communities, see: Oliver P. Williams, Harold Herman, Charles S. Liebman, and Thomas R. Dye, Suburban Differences and Metropolitan Policies (Philadelphia: University of Pennsylvania Press, 1965), Ch. VIII.

[1]The contracting system helps to offset the forces toward inefficient production that result when governmental functions are

Under the contract plan, each individual unit of local government retains its "production option"--that is, the right to produce the good itself, or seek an alternative source of supply. This option generates a pressure for efficiency in the same way as decentralization of governmental functions. With the introduction of entry restrictions, the county and city officials are given a large degree of control over the formation of new communities, as well as all other boundary changes proposed for the county. As it is now more difficult for new cities to be formed, it is predicted that the pressure for efficient provision of services to residents living in unincorporated areas will have been reduced.

City and county managers should be in agreement as to the desirability of a reduction in the number of new entrants into the local government industry. If all new incorporations were halted, any growth in the population would be forced to occur in existing cities and unincorporated county areas. The potential competition established entities face would be reduced, the base for salary and fringe benefits would be increased, and the pressure toward efficiency reduced, as a result of closing the market to new entrants. The monopolistic reductions in the level of output would increase the size of the public budgets. The monopoly profits generated by the market-sharing cartel are not accrueable to the members of existing governments as monetary returns, but rather are "vested," which results in the observed costs

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centralized. For a discussion of the effects of centralization on the efficient operation of government, see: James M. Buchanan, "Who Should Distribute What in a Federal System?" in Redistribution Through Public Choice, pp. 22-42.

of services supplied publicly exceeding the minimum possible cost of that service.[1]

The impact of entry restrictions on other types of boundary adjustments is not as clear cut. The annexation policy that emerges as a result of the change in the relative price ratio between incorporation of unincorporated territory, and absorption by annexation to existing cities, will depend on the magnitude of the reaction of existing governments. The introduction of LAFCOs into the market leads to ambiguity as it creates both demand and supply shifts. This can be seen with the aid of Figure 5.1, where the pre- and post-LAFCO positions are depicted. The demand curves represent the willingness of municipalities to acquire unincorporated territory at various prices, and the supply curves refer to the availability of unincorporated territory. The S and D curves represent the pre-LAFCO situation, and the S' and D' curves depict the situation after the introduction of LAFCOs into the market. The impact of LAFCOs is two-fold. One, it increases the supply of annexable territory because of the reduction in municipal incorporations. This effect is depicted by the outward shift in the supply curve from S to S'. Secondly, it decreases the demand for unincorporated territory since the probability of the potential annexed area incorporating is decreased. The threat of defensive incorporation should be significantly reduced following LAFCO's introduction into the local government market. This is depicted by the demand curve shift from D to D'. The net effect

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[1] See, Wagner and Weber, "Competition, Monopoly, and Organization of Government"; and Robert M. Spann, "Public vs. Private Provision of Governmental Services," in Budgets and Bureaucrats.

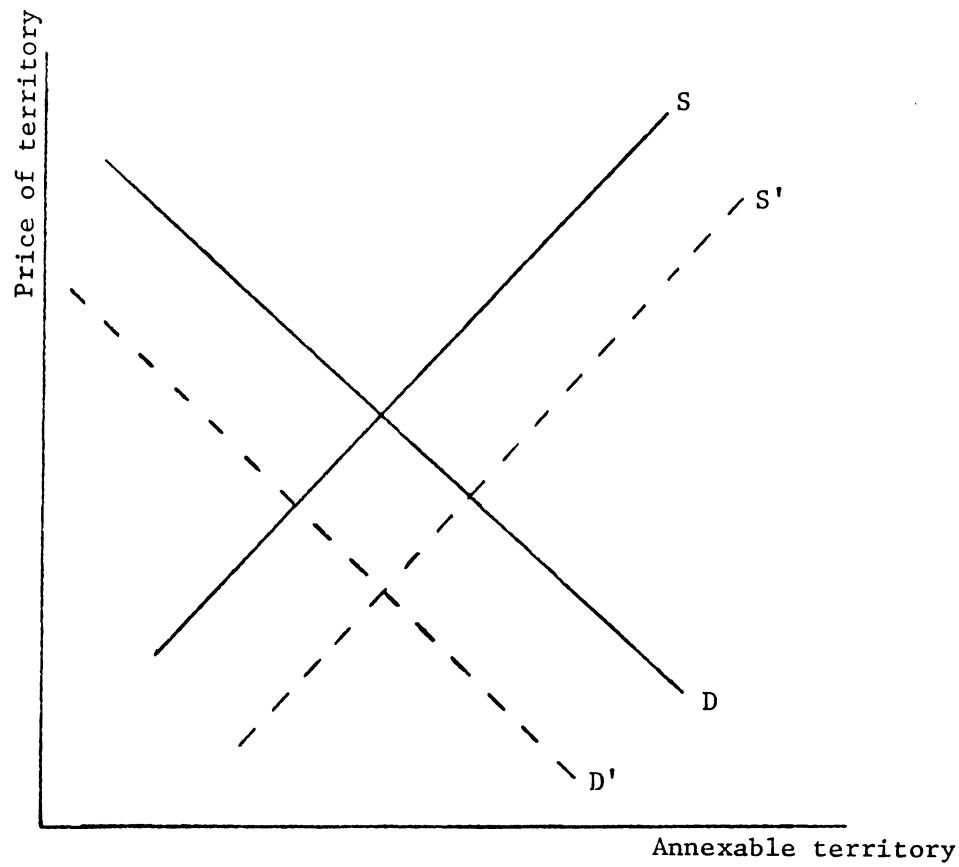

Fig. 5.1. A graphic representation of the impact of LAFCO's introduction into the market for annexable territory

on the annexation policy of existing cities cannot be unambiguously predicted, and would seem to be an empirical matter.

A related issue raised by entry restrictions into the local government market deals with the distortion in the value of ownership shares due to the increase in information and transactions costs. This perspective asserts that the optimal number or pattern of governments in the metropolitan area should be determined by equating the marginal cost of discoordination with the marginal gains from the fuller accommodation of personal preferences. Even if efficiency considerations are set aside, the value of the ownership share can vary as the pattern of cities changes within the geographic region. For example, consider the case of two governments within a metropolitan area, A and B. A resident can own either a share of city A or a share of city B, but not both. Should A and B merge into city C, the value of the ownership share should change. Before merger, the residents had the right to refuse to be an owner of one of the governments. When the cities are merged, the right of refusability is lost, which decreases the value of the ownership share. This is analogous to convertible assets of corporations; for example, convertible bonds have a slightly higher market value than nonconvertible bonds, as the owner has a greater range of flexibility. In governments, the mere fact that the resident/taxpayer has a wide range of options should make the managers more sensitive to the preferences of the residents.

Entry Restrictions: Alternative Predictions

The foregoing discussion of the impact of restricting the entry of new "firms" into the local government industry suggests that the

alternative perspectives generate behavioral predictions that are subject to empirical examination. The two quite contradictory perspectives yield generally different predictions as to changes in the public expenditure levels as a result of the institutional change.

The perspective that views the increased barriers to entry as efficiency-promoting predicts that the institutional change will facilitate greater productive efficiency, which will be reflected in lower per-unit costs for governmental services. The impact on the total governmental budget of this cost reduction depends upon the nature of the demand for public goods provided at the local level. If taxpayer/consumers are very responsive to price changes, so that the demand for these goods is elastic, then the reduced costs should generate increased total budgets.[1] The nature of the demand for local public goods and

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[1]An alternative possibility exists, irrespective of the nature of the demand elasticity, that expenditures will increase as a result of new demands for public goods finally being taken into account. It is argued that many small fragmented units of government serving the needs of taxpayer/residents will be unable to provide certain types of goods and services. The consolidation of governmental units into larger demand blocs should result in an increased ability of government to accommodate the demands of its residents. This argument would predict increased public expenditures as a result of entry restrictions. While the possibility exists that consolidation can be an efficiency-enhancing device, as described above, the probability of this result occurring in California appears to be low. California's local government market is characterized by a highly developed system of service contracting which can be taken as reflective of minimal transactions costs to accommodate intercommunity demands for public goods. In states where service contracting is not possible, political institutions are often barriers to accommodation of demands, and the consolidation of government would not remove or soften these barriers. Further, if the consolidation of governments is generally beneficial, then the rates of approval by residents would be uniform over geographic areas. The empirical evidence suggests that rates vary substantially among cities. There is also a growing body of literature that suggests that the ability of governments to respond to the demands of the residents is inversely related to the size of the governmental unit. For empirical

services is an empirical question, and recent research efforts concerning the elasticity of demand suggest that the demand for local public goods is less than unity in absolute value.[1] Under these conditions, any cost reduction would be expected to lead to a reduction in total expenditures. The test of the veracity of this perspective will be provided by an examination of the level of public expenditures pre- and post-LAFCO. If this perspective correctly explains why entry into the local government market was restricted, the evidence will be reflected in lower expenditure levels after the institutional change.

The perspective that views restrictions on entry as monopoly-enhancing sees the institutional change as providing an enforcement mechanism for the establishment of a market-sharing cartel by the existing units in the local government industry. If managers of local governmental units behave in such a way as to maximize the total budget under their control, then the predicted result of the change in the institutional structure will be an increased level of total expenditures. The accuracy of the perspective in explaining the forces behind the movement toward higher entry costs will be tested by an examination of

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verification of this latter point, see: Elinor Ostrom, Roger Parks, and Gordon Whitaker, "Do We Really Want to Consolidate Urban Police Forces? A Reappraisal of Some Old Assertions," Public Administration Review (September/October, 1973), 423-32; and D. P. Bradford, R. A. Malt, and W. E. Oates, "The Rising Cost of Local Public Services: Some Evidence and Reflections," National Tax Journal, XXII (June, 1969).

[1]See, for example, T. E. Bergstrom and R. P. Goodman, "Private Demands for Public Goods," American Economic Review, LXIII (June, 1973), 280-96; and T. E. Borcherding and R. T. Deacon, "The Demand for the Services of Non-Federal Governments," American Economic Review, LXII (December, 1972), 891-901.

budgetary level prior to the legal change and then after it became effective.[1]

The following chapter will examine the expenditure patterns in the local government market prior to the institutional change and after the entry restrictions became effective. An analysis of the budgetary data for the pre- and post-LAFCO periods will allow testing of the two conflicting budgetary predictions, to see which perspective more nearly explains the observed phenomenon.

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[1]For completeness of analysis, an additional perspective will be considered. This view is that restrictions on entry have no significant effect on the local government market. This perspective implies that the institutional structure within which local governments operate has no impact on their performance. If changes in the institutional structure have no effect on the performance of the industry, then the explanatory value of the variables which were used to test the level of current expenditures should remain unchanged in the pre- and post-LAFCO period. For a similar analysis of the no-effect hypothesis as applied to regulatory agencies, see: G. J. Stigler and C. Friedland, "What Can Regulators Regulate? The Case of Electricity," Journal of Law and Economics, V (October, 1962), 4-11.

CHAPTER VI

AN EMPIRICAL EXAMINATION OF INSTITUTIONAL CONSTRAINTS ON COMMUNITY FORMATION: CALIFORNIA'S KNOX-NISBET ACT

The Knox-Nisbet Act gives existing cities and counties in California a veto power over the chartering of new municipalities. With the passage of this act, the legal arrangements permitting virtually free entry into the local government industry ended. There remains the empirical question of whether the act has in fact altered the rate of municipal incorporations. How much or how little the actual level of new community formation has been affected by the statutory change is the empirical question that this chapter will address. A second area of investigation will be what effect, if any, the change in institutional arrangements has had on the budgetary operations of existing cities and counties.

There are two areas of investigation suggested by the California experience. First, to investigate if the introduction of Local Agency Formation Committees into the local government market has a perceptible effect on the number of new communities formed. This will involve a determination of the relationships that cause new cities to be created, and an investigation of these relationships after the passage of the Knox-Nisbet Act. Has the change in the institutional constraints led to a change in the rate of entry? Second, we will look

at the public expenditure patterns of the existing cities and counties before and after the passage of the act. The analysis of the current expenditure levels in the local government market will provide a framework with which to test which of the conceptual hypotheses discussed in the previous chapter best fit the observed spending patterns in the pre- and post-LAFCO periods. In order to determine the impact, if any, of the statutory change, it is necessary to construct a model of community formation and a model of budgetary operations. In this way, the relationships that are significant in explaining the number of cities can be used to predict the rate of new community formation in the absence of any statutory change. The procedure for the development of a model to examine the variables that are significant in explaining local expenditure levels will have a similar purpose.

The empirical analysis of the impact of the LAFCO legislation upon the incorporation of new cities must conform to the availability of the data. The data base for the analysis is the information contained in the Census of Governments for 1957, 1962, and 1967, with metropolitan county data now available for 1972. The demographic data are taken from the 1960 and 1970 Census of Population. Unfortunately, the data base does not correspond exactly to the change in the constraints governing community creation. The five year period, 1962-1967, contains two years prior to the formation of the LAFCOs and three years after they were operative. Given the data limits, the idea behind constructing a model of community formation and budgetary operations will be to see if there are statistically significant differences in the determinants for the pre-LAFCO and post-LAFCO periods.

LAFCOs and Municipal Incorporation

To arrive at some notion of the important variables that are determinants of the stock of cities, it is necessary to consider the factors that cause municipalities to be formed. The analysis has two aspects: (1) the factors that affect the stock of cities at any point in time; and (2) the factors that affect the flow of immigrants into an area, which affects the rate of change in the stock of cities. Individuals create new municipalities for a variety of reasons, one of which is to provide themselves with certain collective-consumption goods and services. Given that the cost structure of most public goods seems to be U-shaped,[1] the total number of people in an area at any time would certainly be an important variable to be considered in determining the stock of cities. A greater population should be associated with a greater stock of municipalities.

Population density can also affect the cost of providing services, as there are two dimensions to the output of public services: the geographic area served by the city, and the number of people served. For example, the cost per gallon of treating municipal sewage decreases, up to a point, with the number of gallons treated; however, collection costs increase rapidly with the area over which wastes are collected.[2] If two cities have the same population but differing population dispersion over their respective geographic areas, the community with the lower population density is likely to have higher municipal sewage

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[1] W. Z. Hirsch, The Economics of State and Local Government (New York: McGraw-Hill Book Company, 1970), pp. 167-84.

[2] Ibid., Ch. 7.

costs. Given this relationship between density and cost of provision, it is hypothesized that, other things being equal and within limits, the greater the population density of an area, the fewer the stock of cities.

The amount of income that is received from outside sources to defray the cost of providing residents with governmental services could be expected to increase the stock of cities formed, as these transfers can be treated as reductions in the cost of creating cities. The amount of state aid received is hypothesized to be positively related to the number of cities that are formed. The ability of individuals to finance governmental services, and the desirability of alternative choices of such bundles could be expected to affect the number of incorporations that occur. Therefore, the level of wealth as measured by the assessed value of taxable property is included as a determinant, as is the percentage of the total population which have incomes in excess of $15,000.

Given the legal constraints prohibiting the creation of new cities in existing incorporated territory, the availability of unincorporated land would be expected to affect the rate of new community formation. For example, San Francisco city and county are consolidated, so that there is no available territory from which new communities could be formed. As a result of the present unavailability of data on unincorporated territory for each of the five year periods, this variable could not be used. As a substitute, the percent of the population living in nonurban areas was used as a proxy for the percent of territory available for incorporation.

The relationship between the dependent variable, number of municipalities, and the independent variables are analyzed with the aid of a multiple correlation program. This program fits the data to linear regression equations in the form $Y = a_o + a_1X_1 + a_2X_2 + \ldots n$. The empirical investigation is carried out by contrasting the results of the model of the stock of cities in 1962 with a model of the stock of cities for 1967. Regression equations in the form

$$MUN_{62} = a_0 + a_1POP_{60} + a_2DEN_{60} + a_3RURPOP_{60} + a_4RPOP_{60} + a_5SAID_{62} + a_6ASV_{61} + e \,, \tag{6.1}$$

and

$$MUN_{67} = b_0 + b_1POP_{66} + b_2DEN_{66} + b_3RURPOP_{70} + b_4RPOP_{70} + b_5SAID_{67} + b_6ASV_{66} + e \tag{6.2}$$

are estimated for the stock of cities in the two periods.[1]

Table 6.1 shows the results of these regressions. These results are presented in a standard form which is followed throughout this chapter. The heading provides the information about the dependent

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[1]The variables listed above are subscripted to indicate the year to which the data refer. The abbreviations are defined as follows: POP = total population of the county; DEN = population density of the county; RURPOP = percent of the population not living in areas classified by the Census as urban; RPOP = percent of the population with incomes over $15,000; SAID = dollar amount of financial aid from the state government; ASV - assessed value of taxable property.

The state aid and the taxable assessed value variables were adjusted to account for changes in the price level and, therefore, are in terms of real 1958 dollars. This procedure was necessary so that the coefficients could later be tested for comparability. The variable, e, is an independently and identically distributed error term with mean of zero and finite variance σ^2.

TABLE 6.1

EMPIRICAL RESULTS OF ESTIMATED STOCK OF CITIES, 1962 AND 1967

Independent Variables	1962	1967
Constant	-0.051268 (-0.047726)	-0.525025 (-0.392213)
Population	-0.198400×10^{-4} (-1.27548)	0.238299×10^{-4} (1.94846)[a]
Density	-0.456224×10^{-3} (-1.96966)[a]	-0.869327×10^{-3} (-4.09927)[b]
Rural Population	-0.0624587 (-2.84205)[b]	-0.0444687 (-2.41871)[b]
Rich Population	0.179557 (2.33627)[b]	0.187036 (2.60150)[b]
State Aid	0.375159×10^{-3} (3.64586)[b]	-0.189217×10^{-5} (-0.0240111)
Assessed Value of Taxable Property	-0.168855×10^{-6} (-0.0527880)	-0.480460×10^{-5} (-1.92349)[a]
	$R^2 = 0.9343$ F-Stat(5,52)=148.002[b] SEE = 2.69730	$R^2 = 0.9321$ F-Stat(5,52)=142.821[b] SEE = 2.90594
	Test for Identical Coefficients	
	Calculated F = 3.4096 Critical Value F(6,46) = 3.239 (0.01)	

[a]Coefficient statistically significant at 0.05 level.

[b]Coefficient statistically significant at 0.01 level.

variables and indicates which group of counties is involved. The t-statistics are presented in parentheses below the coefficient estimates, and those t-statistics which are statistically significant are noted. As the results indicate, the variables selected appear to be good estimators of the determinants of the stock of cities for the two time periods. It was hypothesized that the number of people would be positively related to the stock of cities, and while the population was not significantly different from zero with respect to the 1962 data, it was as predicted with respect to the 1967 data. The density variable and the rural population variable entered the regressions as predicted. While state aid was statistically significant and positively signed, as predicted, in 1962, this variable changed sign and was not significantly different from zero in the 1967 regression. The only variable that was not related to the stock of cities as predicted was the wealth variable, assessed value of taxable property. It was hypothesized that a desire for diversity is a normal good, and that the higher the level of income and wealth, the greater the stock of cities, reflecting the willingness to pay for differentiation. While the percentage of the population with income of $15,000 or more was positively related to the stock of cities, the wealth variable, while not different from zero in 1962, was negative and significant at the 0.05 level in the 1967 regression.

Since the central idea behind the empirical analysis is to test whether the formation of LAFCOs in California has had any effect on the rate of entry into the local government industry, it is necessary to test whether there is any statistically significant difference with respect to the determinants of the number of municipalities in the two

periods. The null hypothesis to be tested is that the LAFCOs had no effect upon the rate of entry into the local government. Therefore, the introduction of LAFCOs did not affect the determinants of the stock of cities as between the two periods. The confirmation of this hypothesis will be if all coefficients are identical for the two time periods. The vector, $\bar{c}$, is defined to be the difference in the estimated coefficients for 1967 - 1962. The appropriate test is that the null hypothesis is equal to zero, $\bar{c} = 0$, against the alternative hypothesis that $\bar{c} \neq 0$.[1] The F-statistic presented at the bottom of Table 6.1 shows the result of test of the null hypothesis. The value of the test statistic, 3.4096, indicates that the null hypothesis can be rejected at better than the 0.01 level of significance. The results indicate that the determinants of the stock of cities differ significantly for the pre- and post-LAFCO periods.

In addition to investigating the impact of LAFCOs on the stock of cities, a model of the flow of municipalities between the two five year periods was constructued. The regression equations in the form

$$MUN_{62} - MUN_{57} = \alpha_0 + \alpha_1(POP_{60}-POP_{57}) + \alpha_2(DEN_{60}-DEN_{57}) + \alpha_3(ASV_{61}-ASV_{56}) + e \,, \tag{6.3}$$

and

$$MUN_{67} - MUN_{62} = \beta_0 + \beta_1(POP_{66}-POP_{60}) + \beta_2(DEN_{66}-DEN_{57}) + \beta_3(ASV_{66}-ASV_{61}) + e \tag{6.4}$$

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[1] For a detailed explanation of the testing procedure utilized, see: J. Johnston, Econometric Methods (2nd ed.; New York: McGraw-Hill Book Company, 1972), esp. Ch. VI, pp. 290-207.

were used to estimate the flow of cities over the 10 year period. A smaller set of variables was used in the testing of the model as the previous data set did not correspond to the years under consideration in the case of the aid variable and the other demographic variables. The regression results are reported in Table 6.2. As with the stock of cities, the statistic of interest is the test of identical coefficients for the two periods. The statistical procedure discussed above was again used to test if the null hypothesis could be rejected. As the F-statistic at the bottom of Table 6.2 indicates, the null hypothesis that the coefficients are identical can be rejected at better than the 0.001 level of significance.

Community formation and LAFCOs:
the evidence

The empirical results indicate that the determinants of community formation are significantly affected by the institutional structure. To provide an indication of the degree to which the Knox-Nisbet Act retarded the growth of new municipalities in California, the estimated coefficients for 1962 were run with the independent variables for 1967. This procedure gives a prediction of the number of municipalities that would have been created if the estimators had remained the same over time. The result of this operation is a predicted increase in the number of cities in 46 of the 58 counties. If the relationship between the variables had held for the 1962-1967 period, 63 new cities would have been created. However, the actual number of new cities was 28, with one reduction due to consolidation. The creation of the LAFCO can be credited with a 56 percent reduction in

TABLE 6.2

EMPIRICAL RESULTS OF THE ESTIMATION IN CHANGE OF NUMBER OF MUNICIPALITIES, 1957-1967

Independent Variable	1957-62	1962-67
Constant	0.0406226 (0.330409)	0.189819 (2.01960)
Change in Population	0.717850×10^{-5} (1.11812)	0.146244×10^{-4} (5.38998)[a]
Change in Density	0.358990×10^{-2} (1.33409)	-0.117137×10^{-2} (-1.32027)
Change in Assessed Value	0.226902×10^{-5} (4.73832)[a]	-0.374634×10^{-5} (-3.75345)[a]
	$R^2 = 0.9317$ F-Stat(3,54)=245.65[a] SEE = 0.796339	$R^2 = 0.5048$ F-Stat(3,54)=18.3455[a] SEE = 0.652557
	Test for Identical Coefficients Calculated F = 17.34218 Critical Value F(4,50) = 5.74 (0.001)	

[a]Coefficient statistically significant at 0.05 level.

the rate of new community formation. The most notable impact appears to be in the rapidly growing metropolitan counties. For example, Los Angeles County actually accounted for four incorporations between 1962 and 1967, whereas the predicted number of new cities was 21. Similarly, Orange County added one new community, where the data predicted a growth of 10 new cities. Santa Clara County data predicted five new incorporations, but no new cities were added. Of the 63 new cities that were predicted, 57 percent of the increase would have been in these three counties; whereas, in actuality, these three counties accounted for only 18 percent of the new cities incorporated. This result would indicate that not only has the creation of the LAFCOs led to a total reduction in the number of cities created, but it has also caused a change in the rate of city formation between metropolitan and nonmetropolitan counties. It is important to note that the composition of the LAFCO membership differs between counties which have more than two cities (most of which are metropolitan) and those counties with one or no cities, with cities more heavily represented in the former. This may be indicative of a tendency for metropolitan county LAFCOs to follow more restrictive policies toward new incorporations.[1]

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[1]The empirical evidence that the rate of new incorporations is rapid in the metropolitan counties with several cities appears at first glance to be contradictory to what theory would suggest. Since the nonmetropolitan counties have a greater proportion of county representatives on LAFCO boards, it would appear that these LAFCOs could be expected to follow the most restrictive policies of the two groups. A possible explanation of this counter-intuitive result has been suggested by Jordan in his analysis of the impact of regulation on competitive and noncompetitive markets. Briefly, the impact of a change in the market structure that is monopoly-enhancing is predicted to be much larger, if the market, prior to regulation, was highly competitive. If the monopoly gains have already been exploited prior to the alteration in

LAFCOs and Public Budgets

The level and pattern of expenditures which are observed to take place in California municipalities and counties are a result of a complicated series of interrelated decisions, which have extended over a long period of time. Therefore, the change in the institutional structure of community formation may not have its full force felt until some years after the passage of the legislation. Nonetheless, a model of public expenditure is posited to investigate whether the Knox-Nisbet Act has resulted in changes in the expenditure pattern of California counties.

The conceptual framework developed in the previous chapter suggests that the comparative veracity of treating restrictions on entry into the local government market as efficiency-inducing and treating entry restrictions as monopoly-enhancing is capable of empirical examination. An empirical test is possible, as these two hypotheses concerning changing the institutional structure of the local government industry yield different predictions as to the level of public expenditures. Proponents of the introduction of LAFCOs have argued that restricting the entry of new governments into the local government industry will lead to increased efficiency in the provision of public goods, and per-unit cost reductions. The budgetary consequences of such cost reductions depend upon the price elasticity

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the legal structure, then the change is predicted to have little or no impact. For a more detailed exposition of this line of analysis, see: William A. Jordon, "Producer Protection, Prior Market Structure, and the Effects of Government Regulation," Journal of Law and Economics, XV (April, 1972), 151-76.

of demand for local government output, assuming government is on the median voter's demand curve. As noted previously, recent empirical studies suggest that the absolute value of the elasticity of demand for public output is less than unity.[1] Given the demand structure, any cost reductions could be predicted to lead to lower levels of public expenditures. The view that market restrictions are a tool to confer, or increase, the monopoly power of existing cities and counties would generate the prediction that public budgets would increase.[2] An empirical analysis of the public expenditure pattern pre- and post-LAFCO will allow the testing of the efficiency hypothesis against alternative hypotheses to see which more nearly explains the observed phenomenon.

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[1] See, Bergstrom and Goodman, "Private Demands for Public Goods," and Borcherding and Deacon, "Demand for Services of Non-Federal Governments."

[2] Two related points should be noted with respect to the empirical testing of the conflicting hypotheses. First, the budgetary consequences of entry restrictions, as seen from the efficiency-enhancing perspective, predict a fall in the expenditure level based on the findings of recent research efforts into the nature of the price elasticity of demand for nonfederal public goods. The present level of such research is clearly nonexhaustive, and the results must be classified as tentative, pending confirmation from further research. While recognizing the tentative nature of the present empirical evidence, it still seems sound to treat the price elasticity of demand for local government goods as less than unity in absolute value. Secondly, the perspective that views entry restrictions as monopoly-enhancing is faced with an apparent contradiction between the empirical evidence of an inelastic demand for local public goods and the pricing policies of a monopolist. While it is true that a private sector monopolist will never operate in the inelastic portion of his demand curve, the behavior of a public sector manager may be optimal when he pursues just such a policy. The governmental manager does not have residual claimant status to the "profits" of his enterprise, so an increase in output may increase his rewards as his remuneration is tied to the size of his budget and his level of output. This point is developed fully by Niskanen, "Bureaucracy and the Interests of Bureaucrats."

During the last 40 years, a substantial number of studies have been undertaken that were designed to determine factors affecting expenditures of state and local governments.[1] A review of these research efforts shows that the most important determinants can be categorized under three major headings: (1) demographic variables such as population density, urbanization, foreign-born population; (2) socio-political variables such as percent of population in various age categories, racial composition of the population; (3) economic variables such as percent of families with income above or below the poverty level, financial aid from other governmental sources, and the assessed value of

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[1]One of the earliest studies of the impact of state and local spending was done by Gerhard Colm et al., "Public Expenditures and Economic Structure," Social Research, III (February, 1936), 129-66. For more recent examples of public expenditure research, see: Glenn W. Fisher, "Determinants of State and Local Government Expenditures: A Preliminary Analysis," National Tax Journal, XIV (December, 1961), 349-55; Seymour Sacks and Robert Harris, "Determinants of State-Local Government Expenditures and Intergovernmental Flows of Funds," National Tax Journal, XVII (March, 1964), 75-85; Alan Campbell and Seymour Sacks, Metropolitan America: Fiscal Patterns and Governmental Systems (London: The Free Press, 1967); R. S. Adams, "Determinants of Local Government Expenditures," Review of Economics and Statistics, XLVII (November, 1965), 308-13; R. Barlow, "Comment on Alternative Federal Policies for Stimulating State and Local Expenditures," National Tax Journal, XXII (June, 1969), 282-85; J. E. Fredland, S. Ymans, and E. L. Morss, "Fluctuations in State Expenditures: An Econometric Analysis," Southern Economic Journal, XXXIII (April, 1967), 496-517; J. Miner, Social and Economic Factors in Spending for Public Education (Syracuse, NY: Syracuse University Press, 1963); Gail Wilensky, "Determinants of Local Government Expenditures," in Financing the Metropolis: Public Policy in Urban Economics, ed. by John P. Crecine (Beverly Hills, CA: Sage Publications, 1970), pp. 197-217; Glenn W. Fisher and Robert P. Fairbanks, Illinois Municipal Finance: A Political and Economic Analysis (Urbana: University of Illinois Press, 1968), esp. Appendix A; and Hirsch, "Supply of Urban Services," in Issues in Urban Economics, "Cost Functions of an Urban Government Service: Refuse Collection," and "Local versus Area-Wide Urban Government Services."

taxable property.[1] The empirical investigation of the public expenditure levels was carried out using the 58 California counties. Two separate estimations of the budgetary relations were examined using, first, the level of total current expenditures by all governments in the county, and, then, the per capita level of current expenditures by the same unit was the dependent variable.[2] The independent variables were selected to reflect the economic, sociopolitical, and demographic factors that previous research had singled out as significant.

The statistical technique employed is summarized in a regression equation of the following form:

$$EXPT_j = a_0 + \sum_{i=1}^{n} a_i X_{ij} + e_j \; ; \quad j = 1,\ldots,58 \; , \tag{6.5}$$

where

$EXPT_j$ = total current expenditures on public goods and services for all governmental units in county j,

a_0 = constant term,

X_{ij} = value of the ith determinant of expenditures for the jth county,

a_i = regression coefficient for the ith variable,

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[1] This delineation of determinants of public spending into categories was first presented by Glenn W. Fisher, "Interstate Variation in State and Local Government Expenditure," National Tax Journal, XVII (March, 1964), 55-74.

[2] Capital expenditures were omitted from the analysis, as they are apt to be more irregular, occurring during some period when a new facility was constructed and then not until an additional new building is desired. Thus, capital expenditures tend to be a function of past capital expenditures and other variables. One would expect that higher coefficients of correlation would be obtained from the use of current expenditures only.

n = number of determinants,

e_j = an independently and identically distributed error term with mean zero and finite variance σ^2.

Nine independent variables were used in the total expenditure analysis. Four variables, NWPOP, UPOP, YPOP, and FBPOP, are included to reflect the social and demographic characteristics of the population, such as race, age, geographic distribution of the population in the county, and ethnic background.[1] They may be associated with the demand for governmental services, or with the ability to finance governmental services, or they may be related to the political process in some way. Variables 5 through 7, RPOP, SAID, and ASV, are tax capacity variables, but they differ considerably in character. The assessed value of taxable property in the municipality should be one of the most important determinants of the ability to finance a given level of governmental services. Variable 8, ASL, is included to account for differences in the cost of providing services. Variable 9, SMSA, is a dummy variable and is included to ascertain if metropolitan counties vary significantly from nonmetropolitan counties in their expenditure pattern. Median family income and total income are so highly correlated with assessed value that they are not utilized in the analysis. The expenditures data,

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[1]The abbreviations for the nine independent variables used in the total current expenditures analysis are defined as follows: NWPOP = percent of population nonwhite, UPOP = percent of population classified by the Census as urban, YPOP = percent of population under 18 years old, FBPOP = percent of population foreign born, RPOP = percent of population with incomes over $15,000, SAID = dollar amount of financial aid from the state government, ASV = assessed value of taxable property, ASL = average salary of governmental employees, SMSA = a dummy variable which takes on the value of 0 if the county is not included in a Standard Metropolitan Statistical Area, and 1 if the county is included.

the assessed value data, as well as the average salary data, have been adjusted to take into account price level changes, so that all monetary variables are in terms of constant 1958 dollars.[1]

Total current expenditures

The empirical investigation is carried out by contrasting the results of the model examining the level of total current expenditures in 1962 with the level of current expenditures in 1967. The results of the regressions for 1962 and 1967 are presented in Table 6.3. The specified variables appear to have good explanatory power; however, as was the case with the municipality data, interest is in testing for statistically significant differences in relationships before and after the creation of the LAFCOs. The null hypothesis to be tested is that the number of cities in any given county has no effect on the budgetary behavior of the city and county managers; therefore, an institutional change that has been shown to reduce the number of cities created will not affect the level of current expenditures. A confirmation of the null hypothesis will be an identity of all coefficients in the two time periods. As discussed in relation to the municipality data, a vector, $\bar{c}$, is defined to be the difference in the estimated coefficients for the two periods, and the null hypothesis is that $\bar{c} = 0$. This is tested against the alternative hypothesis, $\bar{c} \neq 0$. The F-statistic of 2.2639,

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[1] For a discussion of the rationale for adjusting municipal expenditures, see, Norman Walzer, "A Price Index for Municipal Purchases," National Tax Journal, XXIII (December, 1970), 441-48. The public expenditure data were adjusted using the Implicit Price Deflators for Governmental Goods and Services, published annually by the U. S. Department of Commerce.

TABLE 6.3

EMPIRICAL RESULTS OF ESTIMATION OF TOTAL CURRENT EXPENDITURES, 1962 AND 1967

Independent Variable	1962	1967
Constant	-10,651.3 (-0.842807)	-17,516.4 (-1.18142)
Assessed Value	0.0499195 (11.6042)[a]	0.0410736 (8.77724)[a]
Non-White Population	280.834 (2.08406)[b]	481.450 (2.23685)[a]
Urban Population	-8.19761 (-0.136196)	38.5762 (0.743455)
Average Salary	3,853.47 (1.87878)[b]	1,402.74 (0.496834)
State Aid	1.11795 (7.82557)[a]	1.46028 (11.2302)[a]
Young Population	-237.563 (-0.918097)	-25.3391 (-0.0918432)
Foreign Population	826.089 (2.68399)[a]	36,573.2 (1.08455)
Rich Population	-40.4724 (-0.196918)	493.782 (2.61399)[a]
SMSA	9,095.12 (2.60327)[a]	2,730.44 (1.08438)
	R^2 = 0.8992 F-Stat(9,48)=6,803.43[a] SEE = 5,734.58	R^2 = 0.8994 F-Stat(9,48)=8,247.65[a] SEE = 6,624.00
	Test for Identical Coefficients Calculated F = 2.2639 Critical Value F(10,38)=2.096 (0.05)	

[a]Coefficient statistically significant at 0.01 level.

[b]Coefficient statistically significant at 0.05 level.

reported at the bottom of Table 6.3, indicates that the null hypothesis can be rejected at better than the 0.05 level of significance. The results indicate that the two time periods differ significantly with respect to the determinants of total current expenditures.

The empirical evidence indicates that the determinants of total current expenditures are statistically different for the two time periods under consideration. To ascertain if the changes in the determinants of expenditures led to any systematic increase or decrease in public budgets, it is necessary to employ an additional statistical technique. The estimated coefficients generated by the 1962 regression are fitted to the 1967 data, and the level of expenditures in 1967 is predicted. Then, the predicted expenditure levels are compared to the actual expenditure levels for 1967, and the over- and underpredictions noted. The null hypothesis is that the residuals are randomly distributed and unbiased. If the null hypothesis is rejected, then the direction of the bias will indicate whether the coefficients of the 1962 variables, when fitted to the 1967 data, systematically over- or underestimated budgetary outlays.[1]

When the procedure is employed, a Z-value of -1.8756 allows us to reject the null hypothesis that the residuals are randomly distributed. A comparison of the predicted expenditures with the actual current expenditures for 1967 shows that the 1962 relationships underpredict in 47 of the 58 counties. A Wald-Wolfowitz test was

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[1]For a discussion of this statistical procedure, see: Hubert M. Blalock, Jr., Social Statistics (New York: McGraw-Hill Book Company, 1972), Ch. XIV, pp. 243-69.

employed to determine if this distribution could have been randomly generated, and the test was rejected at the 0.05 level of significance. Although considerable variation in current expenditure levels is encountered among the counties, the empirical evidence clearly allows us to reject the notion that the change in the institutional structure had no impact on expenditure levels. Had the determinants of current public expenditures remained unchanged between 1962 and 1967, the level of public budgets in 1967 would have been approximately 17 percent lower than actually observed.

Per capita current expenditures

An alternative formulation of the data is to utilize current expenditures per capita, rather than total expenditures, as the dependent variable. The adjustment of the relevant variables to a per capita basis will reduce any bias in the sample due to the inclusion of both rural and urban counties. The demographic variables that were used in the total current expenditure analysis were unchanged, with the economic variables entering the regression on a per capita basis.[1] The statistical technique employed is similar to that outlined for the analysis of the total budgetary data. Regressions were run on the 1962-1967 data using per capita measures as noted. The results of this alternative formulation are reported in Table 6.4. When adjusted to a per capita basis, the specified variables have slightly less explanatory power as indicated by the fall in the R^2 value. However, as in the

[1]The altered independent variables are defined as follows: SAIDPC = dollar amount of financial aid from the state government per capita; ASVPC = assessed value of taxable property per capita.

TABLE 6.4

EMPIRICAL RESULTS OF ESTIMATION OF PER CAPITA CURRENT EXPENDITURES, 1962 AND 1967

Independent Variables	1962	1967
Constant	0.171113 (2.82018)[a]	-0.0267026 (-0.382968)
Assessed Value Per Capita	0.0220386 (6.21690)[a]	0.0389114 (7.75057)[a]
Average Salary	-0.0206728 (-2.19573)[b]	-0.0126685 (-1.01180)
State Aid Per Capita	0.659503 (5.46422)[a]	0.907010 (8.31408)[a]
SMSA	0.0186119 (1.26800)	-0.023700 (-2.02828)[b]
Non-White Population	0.863351×10^{-4} (0.100034)	0.324449×10^{-2} (2.74278)[a]
Urban Population	-0.889434×10^{-4} (-0.290793)	-0.956863×10^{-4} (-0.303697)
Young Population	0.148848×10^{-2} (1.23298)	0.414277×10^{-2} (2.99949)[a]
Foreign-Born Population	0.285743×10^{-2} (1.91178)[b]	0.828231×10^{-3} (0.489769)
Rich Population	-0.824630×10^{-3} (-0.827720)	0.160531×10^{-2} (1.76059)[b]
	$R^2 = 0.7794$ F-Stat(9,48)=38.9[a] SEE = 27.01	$R^2 = 0.7994$ F-Stat(9,48)=47.66[a] SEE = 32.43
	Test for Identical Coefficients	
	Calculated F = 8.66 Critical Value F(10,38)=2.836 (0.001)	

[a]Coefficient statistically significant at 0.01 level.

[b]Coefficient statistically significant at 0.05 level.

previous cases, the main interest of this analysis lies in testing for statistically significant differences in the relationships as a result of the change in the institutional structure. The test of the null hypothesis that the number of cities in any given county will have no effect on the budgetary behavior of county and city managers is again posited. A vector, $\bar{c}$, is defined to be the difference in the estimated coefficients for the 1962 and 1967 periods. The null hypothesis is that the value of $\bar{c}$ is equal to zero. The alternative hypothesis that $\bar{c}$ is not equal to zero is also tested. As indicated by the results reported in Table 6.4, an F-statistic of 8.66, the null hypothesis can be rejected at better than the 0.001 level of significance. As noted in the discussion of the total expenditure analysis, this result indicates that the determinants of per capita expenditures differ significantly between the two time periods.

Employing the statistical procedure previously discussed, the data were then tested to determine if the differences in the variables over the time span were a result of a shift in the expenditure pattern. A Z-value of -2.02 allows the rejection of the null hypothesis that the residuals are randomly distributed. In addition, a test to see if the observed distribution was randomly generated is rejected at the 0.01 significance level. In 49 of the 58 counties, a comparison of the predicted expenditures per capita with the actual per capita levels shows that 1962 coefficients underestimate the 1967 levels of budgetary outlays. The observed budgetary outlays for 1967 would have been 13 percent lower had the determinants of per capita expenditures remained unchanged from 1962.

Expenditure evidence and LAFCOs

The empirical examination of the budgetary pattern for the 58 California counties is undertaken to provide a method of verification of the two conflicting hypotheses dealing with local governmental market structure developed in the previous chapter. As noted, if the restrictions placed on entry into the local government market result in increased efficiency in the production of public goods and services, then the level of total expenditures after the introduction of the restrictions should decline. This result is due to the nature of the demand for local public goods. On the other hand, if the restrictions on entry provide the means by which existing governmental units can enforce a market-sharing cartel, then the result of the change in the institutional structure should be reflected by an increased level of public expenditures. The empirical evidence clearly allows us to reject the hypothesis that the introduction of the LAFCOs into the government market resulted in decreased budgetary levels. Had the change in the institutional structure not occurred, when measured in terms of constant dollars, the budgetary levels were estimated to have been 13 to 17 percent lower than observed levels of spending. The budgetary consequences of entry restrictions seem to be more fruitfully explained by the monopoly-enhancing perspective. The empirical results clearly indicate that the determinants to total, or per capita, expenditures are affected by the institutional structure of the local government industry.

LAFCOs and Annexation

The creation of LAFCOs in 1963 not only resulted in higher barriers to entry in the local government market, but changed the relative price structure as regards annexation and incorporation of unincorporated territory.[1] The demand of the existing cities for acquiring unincorporated territory through annexation should be substantially reduced, as the potential threat of defensive incorporation has been virtually removed. The predicted result of the decrease in demand for annexable territory would be reflected in a lower rate of new territorial acquisitions by existing cities. However, as the cost of incorporating increases, the rate of new community formation should fall, and the supply of annexable land would increase. The predicted result of the increase in supply should be an increased rate of annexations. As the impact of LAFCOs has opposing effects, the rate of annexation after their introduction into the local government market cannot be unambiguously predicted.

Further the composition of the LAFCO board may dampen the impact of the relative price changes, as all annexations must be approved by the LAFCOs and county officials are represented on these boards. It can be expected that the county officials on the LAFCO boards would generally be opposed to annexations due to the loss of territory and control over

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[1] For a discussion of the trade-offs involved in alternative forms of boundary alterations, particularly annexation, see: Krohm, "Economic Analysis of Municipal Annexation Policy." For an alternative consideration of the factors that influence the rate of annexation in metropolitan areas, a good review is presented by: Thomas R. Dye, "Urban Political Integration: Conditions Associated with Annexation in American Cities," Midwest Journal of Political Science, VIII(November, 1964), 430-46.

budgetary outlays. One possible outcome might be an increase in the rate of annexations based on an implicit pre-LAFCO agreement between the existing cities and the county to carve up the unincorporated territory in order to make each existing governmental unit larger than it would have been had the rate of entry not been restricted.

A quick test of the impact of the institutional change would be to look at the amount of territory existing cities acquired pre- and post-LAFCO, and see if the rate increased significantly after 1963. Unfortunately, the lack of available data covering the amount of territory annexed by existing cities before and after 1963 makes it impossible to perform this simple test. Therefore, the next best alternative, given the limited nature of the available data on annexations, is to use as an indicator the number of cities that annexed territory from 1950 to 1960, and from 1960 to 1970. Of the 380 cities in California during the 1950s, 188 or 49 percent annexed some territory, as compared to 265 or 66 percent undertaking annexation during the 1960s.

Given the limited nature of the data, the empirical investigation was carried out by contrasting the results of a model of the number of cities undertaking annexation in 1960 with a similar model for 1970. It is hypothesized that the important factors that influence the decision of a city to undertake annexation of additional territory are similar to the factors that influence community formation in the first place. The greater the concentration of the population within the bounds of the existing city, the greater the pressure to acquire additional growing space; thus, the density of the existing area

is considered an important variable. The availability of unincorporated territory to annex is certainly a significant factor. As indicated in the community formation discussion, the percentage of the population classified by the Census as rural is used as a proxy for the extent of unincorporated territory. The level of income is used as an indicator of the ability of individuals to finance governmental services, and the desirability of additional territory could be expected to affect the rate of annexations. A dummy variable is used to test whether the rate of annexations varies with the urbanization of the county.[1]

The relationships between the dependent variable, number of cities annexing territory, and the four independent variables are analyzed utilizing a multiple correlation program. Regression equations in the form

$$ANN_{60} = a_0 + a_1TOTY_{60} + a_2DEN_{60} + a_3RURPOP_{60} + a_4SMSA_{60} + e \quad (6.6)$$

and

$$ANN_{70} = b_0 + b_1TOTY_{70} + b_2DEN_{70} + b_3RURPOP_{70} + b_4SMSA_{70} + e \quad (6.7)$$

are estimated for the number of cities undertaking annexation in the two periods. Table 6.5 presents the results of these regressions. As the empirical analysis is being conducted to test if the change in the institutional framework has had any effect on the rate of annexations by

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[1]The abbreviations for the independent variables are defined as follows: TOTY = total income of the county measured in constant 1958 dollars; DEN = population density of the county; RURPOP = percent of the population not living in areas classified by the Census as urban; SMSA = a dummy variable which takes on the value of 0 if the county is not included in a Standard Metropolitan Statistical Area, and 1 if the county is included.

TABLE 6.5

EMPIRICAL RESULTS OF ESTIMATED NUMBER OF CITIES UNDERTAKING ANNEXATION, 1960 AND 1970

Independent Variable	1960	1970
Constant	-0.0152103 (-0.251573)	-0.0164290 (-0.0234798)
Total Income	0.107206×10^{-8} (12.2243)[a]	0.388785×10^{-9} (11.4772)[a]
Density	-0.000784920 (-0.594550)	0.000201619 (0.117317)
Rural Population	-0.0401149 (-2.65864)[a]	-0.0410255 (-2.97791)[a]
SMSA	1.16613 (1.43875)	2.04130 (2.75016)[a]
	$R^2 = 0.9026$ F-Stat(4,48)=111.204[a] SEE = 1.65702	$R^2 = 0.8948$ F-Stat(4,48)=102.105[a] SEE = 2.18288
	Test for Identical Coefficients	
	Calculated F = 7.18243 Critical Value F(5,48)=5.442 (0.001)	

[a]Coefficient statistically significant at 0.01 level.

existing cities, it is necessary to test for statistically significant differences in the determinants for the two periods. The null hypothesis is that the introduction of the LAFCOs into the local government industry had no effect upon the rate of territorial acquisitions by existing municipal corporations. The confirmation of the null hypothesis will be if all coefficients are identical for the two time periods. The vector, $\bar{c}$, is defined to be the difference in the estimated coefficients, (1967 - 1962). The appropriate test is that $\bar{c} = 0$, against the alternative hypothesis that $\bar{c} \neq 0$.

As the results in Table 6.5 indicate, the F-statistic of 7.18243 reported at the bottom of the table allows us to reject the null hypothesis of identical coefficients at the 0.001 level of significance. Further, the SMSA dummy variable is highly significant in 1970, indicating that the cities within metropolitan counties have a high rate of annexation of unincorporated territory. This variable is not statistically significant for 1960. Although the data are not refined, in that no square mileage figures are available, the empirical investigation indicates that the determinants of the number of cities undertaking annexations are statistically different for the two periods.

CHAPTER VII

SUMMARY AND CONCLUSIONS: LAFCOS AND THE LOCAL GOVERNMENT INDUSTRY

The institutional focus of this research is based on the premise that it is impossible to impose optimal solutions; thus, the research agenda contains an analysis of the divergent outcomes that are likely to occur under differing institutional constraints. The legal structure governing the ability of individuals to form municipal corporations, or to alter the size and shape of existing entities, is the primary concern of this research endeavor. California's institutional framework is singled out for extensive investigation, as conditions in this state have been radically altered within the recent past, and as the past and present institutional arrangements represent the broad spectrum of rules and regulations concerning institutional arrangements. California has moved from institutional regulations that allow virtually no discretionary powers over new community formation to a system that vests complete discretionary power in the hands of the existing governments. The information gleaned from California's experience has implicational spillovers for many other states. While the legal structure varies from state to state, approximately one-half of the states have procedures that vest no discretionary powers in the administrative agency that handles new municipalities, and about one-fifth of the states grant the

administrative agency complete discretion over the process.[1] Since California has employed both institutional procedures, the examination of the municipal incorporation process provides valuable insights into the outcome of various institutional constraints on groups of individuals wishing to alter the pattern of local government.

The purpose of this chapter will be to summarize the findings of the research conducted into the pattern of local government under alternative institutional arrangements, and to present a brief review of the empirical evidence on the impact of institutional changes. The purpose of the Knox-Nisbet Act was to control entry into the local government market. This chapter will briefly summarize the empirical evidence as to the effectiveness of this institutional change in achieving its stated purpose. Next, a brief outline of the alternative perspectives regarding the probable outcome of entry restrictions will be presented, as well as the empirical support for each view. Finally, some assessment of the costs of the institutional change will be made, and the possible applicability of the California experience to other states.

Entry Restrictions: Effectiveness of the Knox-Nisbet Act

The legal structure of the municipal incorporation process was altered radically in 1963 by the passage of legislation establishing Local Agency Formation Commissions. The primary purpose stated in the legislation was the ". . . discouragement of urban sprawl and the

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[1] For a discussion of this matter and regulation mechanisms of the states, see Table 3.3.

encouragement of the orderly formation and development of local government . . . ."[1] Order was to be achieved by the regulation of entry into the local government industry. A model was developed to test whether the formation of the LAFCOs has had any discernable effect on the rate of entry into the local government market. The empirical evidence indicates that the institutional structure significantly affects the determinants of new community formation. An estimate of the extent to which the introduction of LAFCOs retarded the growth of new communities revealed that in the absence of an institutional change, California would have increased its cities by 17 percent rather than the 7 percent increase that did occur. Instead of the 28 new communities that were actually formed, 63 new cities would have been created. The rate of new community formation fell by 56 percent pre- and post-LAFCO. This figure, however, tends to underestimate the restrictive effect of the LAFCOs. The data used do not correspond to the periods pre- and post-LAFCO, due to unavailability of exact data. The periods examined were 1962 and 1967, and the act was passed in 1963. Therefore, the data contain two years without LAFCOs and three years with LAFCOs; the impact of the institutional change would be more pronounced if data were available to coincide with the institutional change.

The empirical evidence yields another important conclusion: the formation of LAFCOs altered the previous rate of new city formation more in the urban than in the rural counties of California. The distribution

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[1] Annotated California Codes, §54774 (1967).

of cities in California is concentrated in the urban areas of the state, and the formation rate of new cities with respect to population growth prior to the passage of the new institutional constraints was one new municipal incorporation for approximately 26,000 additional people. The formation rate in metropolitan areas changed to 200,000 people for one new city after the passage of the act. Approximately 57 percent of the increase in new cities was predicted to occur in the three most rapidly growing counties, when in fact this group accounted for less than 18 percent of the new city development. The data suggest that the greatest impact of the new entry restrictions was felt in the highly competitive metropolitan areas. This conclusion is consistent with similar empirical evidence dealing with the impact of regulation on industries that operate under differing market conditions. This related research suggests that the impact of a change in market structure that is monopoly-enhancing will be significantly greater if the industries, prior to the change, were highly competitive. The structure of the local government industry in California's metropolitan areas has been repeatedly referred to as being characterized by "ruinous competition." The introduction of the Local Agency Formation Commissions significantly retarded the expansion of new community formation, this effect being felt more severely in metropolitan areas of the state where the previous free-entry status was most conducive to an efficient government size and a public goods bundle.

Impact of Restrictions on Entry: Alternative Perspectives and Predictions

There exist many divergent views as to what is the "correct" structure of local governments, especially in metropolitan areas. One body of literature stresses order as the primary goal for which to strive, while another views the governmental structure that most closely equates the marginal gains from fuller accommodation of personal preferences with the marginal cost of discoordination to be the desired goal. These two divergent views of the local government industry lead to differing perspectives concerning the impact of entry restrictions into the market. The perspective that views the desired structure as an orderly pattern of well-coordinated units supports institutional changes that would decrease the number of existing governmental units through merger and consolidations, and suggests that entry restrictions will result in increased efficiency. The alternative view, that multilayered, nonhierarchical patterns of local government are merely reflections of the diversity of individual preferences for public goods sharing groups, suggests that entry restrictions will reduce the responsiveness of government to taxpayer-residents and provide a mechanism by which governmental managers can achieve monopoly returns from the operation of local governments.

An empirical examination of the public expenditure levels for the counties of California is posited as a method of testing the veracity of the two conflicting perspectives regarding the effect of increased entry restrictions in the local government industry. Should the new restrictions on entry result in increased efficiency in the

production and administration of the public goods package, then the level of current total expenditures should fall. This decrease in expenditures is predicted due to the nature of the demand for local government services. Alternatively, if the entry restrictions provide a means for existing governmental managers to enforce a market-sharing cartel, then the public expenditure level should increase as a result of the change in the legal structure.

Comparing the budgetary level for the counties within California from 1962 through 1967 shows that when measured in terms of constant dollars, the expenditures during this period were substantially higher after the institutional shift. The results of the California experience clearly indicate that the determinants of total, or per capita, current expenditures are significantly affected by the institutional rules and regulations under which local governments operate. Had the more restrictive policies not been introduced into the local government industry, the budgetary levels are estimated to have been significantly lower than the actual levels of spending. Reductions in the public budget are estimated to range from 13 to 17 percent had relative free-entry conditions remained in force during the entire period. These effects are consistent with the perspective that LAFCO regulation made it possible for the existing governmental managers to organize a mechanism to permit expansion of governmental budgets, and thus allow them to derive monopoly profits.

On the other hand, the findings of this research are quite inconsistent with the implications of the perspective that holds entry restrictions to be efficiency-inducing. This is not to say that no

taxpayer-resident has benefited from the introduction of LAFCOs into the local government structure, quite the contrary is true. The ability of those who hold the majority view with respect to the public goods bundle to extract a fiscal surplus from the minority has been strengthened. As the cost of forming new communities or altering the boundaries of existing ones has greatly increased, so has the power of existing governmental managers to pursue policies that the consumer previously would not have supported. However, the empirical investigation of the expenditure levels allows the rejection of entry restrictions as efficiency-enhancing as the observed levels of public expenditures were significantly higher after the alteration in the legal structure.[1]

Institutional Constraints and the Local Government Industry

The purpose of this research has been to provide the basis for evaluating changes in the structure of rules, regulations, and constraints on individual action that govern the creation, dissolution, and alteration of communities in the United States in general, and in California in particular. While the empirical investigation centered on California, pre- and post-LAFCO, the conclusions should have some general applicability to other states. The key factor that emerges as being of first-order importance appears to be entry control. Once new

[1]The view that the institutional structure under which local governments operate will have no effect upon the behavior of the governmental units can also be rejected. The empirical evidence shows the determinants of new community formation and public expenditure levels to be significantly different pre- and post-LAFCO.

community formation and boundary adjustments within the California local government market were effectively closed by LAFCO regulation, the determinants of community formation were significantly altered. A brief review of the legislative changes in the laws governing municipal incorporation and boundary adjustments reveals that throughout the United States, the existing trend is toward more restrictive controls over the boundary adjustment process. If the California experience has any general applicability, institutional alterations that make individual adjustment more costly should generally be opposed. The analysis of the California local government market suggests that much additional research is needed into the institutional framework for controlling government. The study of the LAFCOs implementation of the newly achieved "sphere of influence" power, as well as other states' agencies with similar broad discretionary powers, should provide additional evidence regarding the deleterious effects of granting monopoly franchises to existing units of government.

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THE INSTITUTIONAL FRAMEWORK OF COMMUNITY FORMATION: THE LAW AND ECONOMICS OF MUNICIPAL INCORPORATION IN CALIFORNIA

by

Dolores Tremewan Martin

(ABSTRACT)

This research explores the organizational and budgetary consequences of alternative institutional structures governing the creation, alteration, and dissolution of municipal corporations. The primary hypothesis is that the legal structure governing the formation of communities will significantly affect (1) the number of cities, and (2) the efficiency with which existing cities provide taxpayer/residents with public goods and services. A conceptual basis for such a presumption is presented. The local government literature suggests two alternative perspectives concerning the possible effects of institutional structures that restrict entry into the market for local public goods. One view suggests that entry restrictions will be efficiency-inducing, thus resulting in reduced public outlays after their institution. The alternative perspective suggests that entry restrictions are a method by which managers of existing governmental units increase their monopoly power, and provide themselves with the tool to stabilize the formation of a market-sharing cartel. These two

hypotheses are tested by using data from California, as this state provides a useful setting for a positive analysis of alternative institutional arrangements.

Prior to 1963, California could be classified as a free-entry state, as residents were easily able to form new communities. After 1963, California established Local Agency Formation Committees (LAFCOs), whose membership is from existing governmental units, which were given broad discretionary veto powers over the formation of new municipal corporations. A model of community formation was estimated and the empirical evidence suggests that the alteration in community formation regulations in California resulted in a reduced rate of new municipal incorporations by 56 percent, supporting the hypothesis that the institutional structure affects the number of cities created. Further, a model of public expenditures was developed and a comparison of the budgetary levels for California counties, pre- and post-LAFCO, suggests that the impact of the entry restrictions on the expenditure behavior of cities is substantial, with per capita expenditures 13 percent higher after the introduction of LAFCOs into the local government market.