



Montreal Economic Institute

THE ECONOMIC ARGUMENTS AGAINST MUNICIPAL MERGERS

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Despite strong local opposition, the government of Quebec has forged ahead with its ambitious project of municipal reorganization. This means that beginning January 1st, 2002, the 28 municipalities on the island of Montreal will be amalgamated into a single city divided into 27 boroughs; elsewhere in the province, dozens of other municipalities have also been forced to merge.

However, the debate over the merits of this reorganization is set to continue. First because, in the political field, the main provincial opposition party has taken a stand in favour of a process that would allow a "demerger" in cities where a majority of residents wish to do so. But also because in spite of ideological fashions which vary from one country or one period to another, economic theory and data lead to a very precise conclusion: that citizens are better served in urban regions which have numerous small municipalities than in those dominated by only one or by a few.

The current mergers are thus likely to arouse dissatisfaction and disappointment when the anticipated benefits do not materialize. This can already be seen happening in Toronto and in Halifax, and it still can be seen in New York City more than a century after the amalgamation there – the last one in the United States similar to those now being implemented in Canada – formed the largest city in North America.

This *Note* will thus review the main economic arguments that should inform the debate on the principle of mergers, regardless of whether this debate continues after the next provincial election or resumes in the decades to come.

The theoretical basis

In 1956, Charles Tiebout published the first explanation of the link between high citizen satisfaction levels and a large number of local jurisdictions in a now celebrated article.⁽¹⁾ According to Tiebout's Model, a resident has little influence on the range and quality of local services (roads, police, fire brigades, parks, libraries, etc.) offered in his municipality, or on the price that he pays to obtain them. As public goods, these services are not sold in the same way that consumer goods are on the market. A citizen can of course try to influence his councillor into implementing his desires, or he can vote for someone else in the next election that will, but he will only be satisfied if a majority in his community agrees with him.

Tiebout however showed that if there existed, in a given urban region, a large number of small municipalities, people could then "vote with their feet" by settling in or moving to cities which offer what they would consider the optimal level of public services. Some people would be prepared to pay higher taxes to obtain better quality services; others would prefer fewer services at lower cost. Some cities would emphasize industrial development and job creation for their citizens; others would provide more greenery and leisure activities; and still others would specialize in family services.

In this context, every citizen would be able to find the community which is most suitable to him – just as he can have better choice in a competitive private market, where different products are on offer, than in a market dominated by a single provider. Therefore, every municipal entity will be under pressure to satisfy the needs and desires of its citizens, because it will be subject to the competition of nearby cities. In order to remain prosperous and to keep or attract residents, it will have to be more efficient in the provision of services and less greedy when setting taxation levels.

Costs and Economies of Scale

Tiebout's Model offers a good explanation of why large administrations that face little competition will tend, over time, to become bureaucratic, as well as why they will show themselves to be more responsive to the demands of pressure groups and municipal employees' unions than to their citizen-electors. Reducing costs nevertheless remains a major argument for those who support mergers.

In her *White Paper* on municipal reorganization made public in April 2000, the minister for Municipal Affairs and the Metropolis declared: *The merger of municipalities makes it possible to offer better services to the population, and this, at lower cost. By eliminating duplication and by making possible economies of scale, they allow municipalities to reduce costs and to reach a level of efficiency so that they can more easily provide services of better quality. The amalgamation of municipalities can also provide an opportunity to downsize and rationalize their organization.*

One of the most tenacious myths that surround this issue of cost is that reducing the number of mayors and councillors from small suburban municipalities can mean important savings. These expenses are not only marginal, they do not necessarily decrease in merged cities. Robert L. Bish compared the costs of 88 elected representatives and their staffs in 13 administrations, with those of 23 representatives elected within a merged administration serving the same population. He concludes that the per capita costs, in both cases, counted for less than 1% of total spending. Not only that, because of the higher salaries and the more numerous staff in the merged city, the per capita costs in both systems were practically identical.⁽²⁾

Furthermore, empirical research shows that economies of scale are negligible when it comes to municipal services. They can be achieved only for very specialized services, such as murder investigations, or for those that require important capital investments, such as water treatment plants. However, agreements between municipalities, which are already very numerous in Quebec, make it possible to realize these potential savings without compromising the autonomy of the participating municipalities. In the case of Montreal, the Montreal Urban Community (MUC) already administered these services, so the merger will make no difference.

Professor David Sjoquist of Georgia State University has looked at operating costs in 48 metropolitan regions of the Southern United States and observed that the costs of services are smaller in regions that contain numerous small municipal administrations.⁽³⁾ Furthermore, Professor Jacques Desbiens of the Université du Québec à Chicoutimi has argued that for the majority of municipal services, economies of scale are already in place even in cities of very small size, and, in fact, that it is diseconomies of scale that one sees when municipalities of more than 2000 inhabitants are amalgamated.⁽⁴⁾

Having reviewed numerous studies on this subject, Robert L. Bish concludes that *there is overwhelming evidence that the least expensive local governments are found in polycentric systems of small and medium-sized municipalities that also cooperate in providing those services that offer true economies of scale. Large municipalities do not seem to be as capable of cooperating in this way, of decentralizing their services, or of using alternative delivery mechanisms for services that lack economies of scale.*⁽⁵⁾

Even a report commissioned by the City of Montreal from the consulting firm Secor arrives at similar conclusions.⁽⁶⁾ According to the authors, *municipal mergers do not necessarily, and especially not automatically, result in savings. There are few economies of scale to be realized in municipal functions and these savings are*

reached when populations are relatively small. About half of the potential savings identified in the report originate in the elimination of duplication (multiple city halls, mayors and support staff, etc.), an area where hopes are bound to be disappointed, as shown above. The other half comes from the reorganization of services that the merger would allow. But the report notes that *some of these savings could in theory take place in each of the cities separately, even if the probability of seeing them realized would increase appreciably because of the opportunity created by the dynamics of the merger.*

So in the end, mergers offer a probability that relies on short-term dynamics of a bureaucratic nature instead of permanent incentives stemming from a competitive environment

Regional Equity

Another important reason used to justify the mergers is that of the fiscal disparities between municipalities of the same urban area and the need to establish equity between rich and poor districts. This argument does not hold water for several reasons.

First, on the issue of financing regional equipment, the MUC already acted as a mechanism for sharing costs for the entire island of Montreal. If the goal were to simplify the structures and to include off-island suburbs in this cost sharing, expanding the territory covered by creating the Metropolitan Community of Montreal would have been enough; there was no need to amalgamate the municipalities of the island.

Also, besides having a system of "progressive" taxation, the federal and provincial governments already devote billions of dollars to various social programs. It is absurd to upset municipal administration in order to add an additional mechanism to transfer wealth. In any case, if the mergers were really a solution to regional inequities, all the municipalities of the region would then have to be included in the new city, including Laval and the prosperous suburbs of the north and south shores, and not those of the island only.

Finally, as is the case for federal equalization payments and other regionally based wealth transfer programs, redistributionism often creates a vicious cycle whereby underdevelopment is being fostered instead of being eradicated. Wrong incentives lead local decision makers to try to obtain a larger slice of the redistributed funds instead of improving the competitiveness of their region. Small municipalities, which have to count on their own means to prosper, do not have this option and thus tend to make better decisions.

International Competitiveness

Helping urban centres to face international competition is also a major argument used by those who favour mergers. The *White Paper* explains that *the absence of a coherent development strategy makes it difficult for our urban centres to take up the challenge of competing with the rest of the world. Indeed, there is a connection between the creation of strong socio-economic poles, able to effectively sustain competition in the context of the market globalization, and the existence of a clear development strategy emanating from a decision-taking role at the level of city regions.*

However, this belief does not correspond to the facts either. Dynamic urban regions as different as Silicon Valley, Boston, Houston and Dallas were able to prosper with very fragmented municipal administrations (see **Table 1**). No empirical link between the centralization of decision-making authority and international competitiveness has ever been established by researchers.

Table 1
Municipal fragmentation in Montreal (before the merger)
and in American urban areas of comparable size

Urban area	Population (000)	Number of municipalities*
Boston	5,828	282
Detroit	5,439	151
Dallas	4,683	207
Houston	4,320	115
Atlanta	3,627	102
Miami	3,515	55
Seattle	3,368	88
Montreal	3,327	111
Cleveland	2,908	146
Phoenix	2,840	32
Minneapolis	2,792	192
San Diego	2,723	18
St-Louis	2,558	228
Pittsburgh	2,361	238
Denver	2,318	67

*Excludes counties, except in Boston where they have the same functions as multi-level municipal administrations, including cities.
Source: Andrew Sancton, *Merger Mania: The Assault on Local Government*, 2000.

The *White Paper* repeatedly mentions the danger of "sterile competition" that would be damaging to economic development. This stems from the discredited notion that development results from a consensus among local actors and from centralized economic planning. On the contrary, a multiplicity of municipal administrations can stimulate healthy competition between several development strategies, a situation that favours experimentation and specialization while minimizing the consequences of failure for the whole region.

The ideal of having a region "speak with one voice" is doubtless relevant when it comes to lobbying higher levels of government or international organisations with the aim of obtaining subsidies, projects or prestigious events, but it has no effect on what matters above all for the prosperity of a city, namely the dynamism of its private sector economy. For this, the quality of basic services and competitive taxation levels are the major factors. As for the promotion of the city abroad, this can be taken up by bodies such as Montréal International or by the Metropolitan Community of Montreal and in no way requires the amalgamation of the municipalities of the island.

Conclusion

The forced mergers, in Montreal as in the other urban areas of Quebec, are the wrong remedy for a badly diagnosed problem. In the case of Montreal, the suburban municipalities were generally prosperous and well managed, and if one takes as representative the crushing majorities which voted against the merger plan when local referenda were held, one has to conclude that their citizens were satisfied with the services that they received. These politico-economic successes were nonetheless jeopardized in order to solve the problems of the central city, an administration notoriously indebted, badly managed and with deficient services.

In the new City of Montreal, 18 boroughs correspond to the territory of the former 27 suburban municipalities, while the ancient City of Montreal by itself gets 9 boroughs. This geographic apportionment points to an alternative solution to solve the problems of the central city: its division into several smaller municipal entities.

Increasingly, this is indeed what city dwellers fighting for urban renewal in the United States have been doing. In New York, Los Angeles, Miami, Houston, Atlanta and in other American cities, citizens' movements resist the expansion of central cities, advocate the incorporation of new municipalities in the surrounding districts and even try to detach districts belonging to big cities. The case of the New York borough of Staten Island, where two thirds of the residents voted in favour of secession during a consultative referendum in 1993, is doubtless the best-known example.

Professor Howard Husock of the Kennedy School of Government of University Harvard explains how this solution would help restore life to old and decrepit central city neighbourhoods:

Rather than expanding cities, we should break them up into an array of independent, neighbourhood-based governments that would set their own property-tax rates, elect their own officials, and give city residents the same control and sense of community that their suburban counterparts take for granted. City dwellers could direct public spending to the things they consider most important. They could ask the local public works director why their street went unplowed or unpaved, or push the local chief of police to deal with the rowdy playground gang before things get out of hand. Inevitably, such a system would favour economic growth over redistribution. Freed from centralized bureaucracies, these neighbourhoods, including many of the older, poorer ones, would prosper. As for paying to maintain, or build, expensive regional infrastructure systems: for that purpose, these independent local governments could cooperate in a loose confederation, or "special purpose district".(7)

Here we have, summarized in a few sentences, the real debate on municipal reorganization that should have taken place, and will one day or another have to be held.

1. Charles Tiebout, "A Pure Theory of Local Expenditures", *Journal of Political Economy*, n° 64, October 1956, p. 416-424. >>
2. Robert L. Bish, *Local Government Amalgamations: Discredited Nineteenth-Century Ideals Alive in the Twenty-First*, C.D. Howe Institute Commentary 150, March 200, p. 10. >>
3. David L. Sjoquist, "The Effect of the Number of Local Governments on Central City Expenditures", *National Tax Journal*, no 35, p. 79-88. >>
4. Jacques Desbiens, *Fusions municipales et économies d'échelle: mythes et réalités*, 1999. >>
5. Robert L. Bish, op.cit., p. 24. >>
6. Secor, *Économies potentielles liées à une fusion des municipalités de l'île de Montréal en une seule ville*, rapport présenté à la Ville de Montréal, 14 septembre 1999. >>
7. Howard Husock, "Let's break up the big cities", *City Journal*, Winter 1998, Vol. 8, No. 1. >>

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