

REGIONALIZATION AND INTERLOCAL BARGAINS

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Numerous commentators on local government law have advocated some form of regionalization to address metropolitan problems. These recommendations emanate from a conception of local governments, particularly suburbs, as isolated, self-interested entities that ignore or exploit the plight of their neighbors, particularly central cities. In this Article, Professor Clayton Gillette puts forward a justification for decentralized entities and posits a more sanguine relationship among localities within a region. Analogizing from literature concerning firms that form long-term contractual relationships, he contends that neighboring localities may be sufficiently interdependent that they have significant incentives to cooperate through interlocal contracts that realize economies of scale or that share regional distributional burdens. He suggests that any underutilization of interlocal contract depends less on suburban disinterest or exploitation than on contracting costs and legal obstacles that do not affect interfirm relationships as readily. Thus, problems attributed by advocates of regionalization to excessive localism may be redressed best through institutional arrangements that reduce contracting costs. Nevertheless, Professor Gillette argues that some costs inherent in regional burden-sharing contracts, such as those involving observability and verifiability of contract breaches, may be irreducible. He concludes, therefore, that some contracting costs that are endemic in interlocal relations are best circumvented through informal cooperative bargains that avoid problems of monitoring and enforcement.

INTRODUCTION

The actions of local governments affect their neighbors. This truism is frequently employed in critiques of the relationships between central cities and their suburbs.¹ Relatively poor cities allegedly suffer at the indifference of or exploitation by wealthier neighbors when the latter offer potential employers and residents lower tax rates than the former.² Pollution does not respect the boundaries of the jurisdiction from which it is generated. Strict zoning regulations in one jurisdic-

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¹ The relationship between cities and their suburbs has generated significant recent literature. See, e.g., Anthony Downs, *New Visions for Metropolitan America* (1994); Gerald E. Frug, *City Making* (1999); Myron Orfield, *Metropolitics* (1997); Neal R. Peirce, *Citistates* (1993); David Rusk, *Cities Without Suburbs* (2d ed. 1995). For commentaries in law reviews, see, for example, Symposium, *Regionalism*, 48 *Buff. L. Rev.* 1 (2000).

² See Joseph Persky & Wim Wiewel, *The Distribution of Costs and Benefits Due to Employment Deconcentration*, in *Urban-Suburban Interdependencies* 49, 67-68 (Rosalind

tion force prohibited uses into neighboring jurisdictions with more lenient regulations. Incorporation of rural communities may preclude their annexation by urban areas in need of an expanded tax base.³ And, of course, suburban amenities that induce individuals who work or shop in central cities to retreat nightly to distant residential areas with lower service costs and fewer redistributive needs impose the costs of sprawl on both urban and suburban neighbors.⁴ These and similar phenomena feed the common perception that, at best, local officials ignore extraterritorial costs when selecting a course of action. At worst, those officials strategically choose actions that are beneficial to their own constituents, but that impose costs on neighbors.⁵ Thus, many commentators have argued that fragmented and parochial local jurisdictions reduce regional wealth, intensify intraregional distributive inequities, create uncoordinated and inefficient service provision, and increase the costs of creating an informed citizenry.⁶ For some commentators, the culprit is local government law, which grants significant autonomy to decentralized units.⁷ These scholars believe that the solution lies in greater solicitude for intervention in local decisions by more centralized levels of government.⁸ Their underlying

Greenstein & Wim Wiewel eds., 2000) (describing how movement of manufacturing jobs from urban centers to suburbs confers benefits on suburbs at expense of central cities).

³ For a case in which incorporation appears to have been motivated by fear of annexation, see *Citizens of Rising Sun v. Rising Sun City Dev. Comm.*, 528 N.W.2d 597 (Iowa 1995).

⁴ See William W. Buzbee, *Urban Sprawl, Federalism, and the Problem of Institutional Complexity*, 68 *Fordham L. Rev.* 57, 69-75 (1999) (describing harmful effects of sprawl, including traffic congestion, air pollution, and deteriorating housing).

⁵ See, e.g., Frug, *supra* note 1, at 9 (“[I]t can be—and has been—to the advantage of some cities to gain power from the state at the expense of their neighbors.”).

⁶ See Mark Baldassare, *When Government Fails* 17-20 (1998) (surveying critical perspectives on political fragmentation in suburbs and arguing that fragmentation “poses serious constraints on local governance”); Kathryn A. Foster, *The Political Economy of Special-Purpose Government* 29 (1997) (describing tenets of institutional reform, including tenet that “metropolitan political fragmentation results in chaotic and inefficient service provision”). See generally Richard Briffault, *Our Localism* (pts. 1-2), 90 *Colum. L. Rev.* 1, 346 (1990).

⁷ See Richard Briffault, *The Local Government Boundary Problem in Metropolitan Areas*, 48 *Stan. L. Rev.* 1115, 1143 (1996) (describing local boundaries as basis of interlocal conflicts); Sheryll D. Cashin, *Localism, Self-Interest, and the Tyranny of the Favored Quarter: Addressing the Barriers to New Regionalism*, 88 *Geo. L.J.* 1985, 2015-27 (2000) (contending that commitment to localism permits favored minority to exploit metropolitan fragmentation for personal benefit); Audrey G. McFarlane, *Race, Space, and Place: The Geography of Economic Development*, 36 *San Diego L. Rev.* 295, 335-36 (1999) (linking local government law’s impact on racial and class demographics within given metropolitan region to “facially neutral” policies that nevertheless have “racially segregative effect[s]”).

⁸ See, e.g., Briffault, *supra* note 6, at 447-54 (advocating more significant role for states in arranging local affairs); Cashin, *supra* note 7, at 2033 (contending that advocates of metropolitan cooperation “will necessarily have to engage state or federal institutions” to accomplish their purposes). Not all critics of local autonomy look to centralization as a

theory is that a centralized decisionmaker would consider the interests of all subordinate subdivisions and reach an accommodation that served the net interests of all polities within the region.

In this Article, I examine the assumptions that self-interested local activity is the cause of intraregional conflict and that centralized decisionmaking is the cure. I claim that significant local autonomy is both desirable and consistent with regional prosperity. I argue that, at least in theory, there are conditions under which autonomous localities have incentives to be attentive to the interests of neighbors, including intraregional inequities. Where those conditions exist, therefore, it is plausible that regional interests are best addressed through cooperation among distinct localities, rather than through centralization.

I focus on interlocal bargains. The literature on interlocal relations tends to ignore interlocal bargains, perhaps because commentators assume that localities will not voluntarily assist their neighbors.⁹ The premise of interlocal bargains is that gains are available from trade between the parties. But, as the examples I cite above indicate,¹⁰ mutual gains are not necessarily forthcoming when one locality seizes the benefits of an action and imposes the costs on neighbors.

I posit a more sanguine relationship among localities within a region. In a wide category of cases (including some that others have seen as indicative of suburban exploitation of cities), neighboring localities are sufficiently interdependent that they have significant incentives for cooperation. If bargains are underutilized, I contend, the cause is not exploitation, but the presence of contracting costs that make otherwise efficient bargains too costly to negotiate and implement. I claim that a combination of legal doctrines, organizational structures, and related difficulties of monitoring and verifying contract compliance best explain the paucity of interlocal bargains. To demonstrate the effects of contracting costs and their reduction, I compare the legal and organizational arrangements of local governments to

solution. See, e.g., Frug, *supra* note 1, at 115-42 (favoring "community building" over centralization); Gerald E. Frug, *Against Centralization*, 48 *Buff. L. Rev.* 31, 34-35 (2000) (alleging that conversation among decentralized parties is superior to centralization).

⁹ See Briffault, *supra* note 6, at 433. For exceptions, see, for example, Janice C. Griffith, *Local Government Contracts: Escaping from the Governmental/Proprietary Maze*, 75 *Iowa L. Rev.* 277, 348-63 (1990) (proposing standards to determine whether local government contracts impair use of essential public functions); Shelley Ross Saxer, *Local Autonomy or Regionalism?: Sharing the Benefits and Burdens of Suburban Commercial Development*, 30 *Ind. L. Rev.* 659, 672-76 (1997) (noting that constraints on enforcing interlocal contracts limit range of options for communities otherwise willing to engage in interlocal contracting).

¹⁰ See *supra* notes 5-7 and accompanying text.

those of private firms. My objective is to demonstrate that firms possess legal and organizational flexibility in interfirm relations that allows them to overcome the contracting costs that frustrate local efforts to address regional issues. This comparison of localities and firms suggests that many problems attributed to excessive localism or interlocal exploitation best may be redressed through institutional arrangements that reduce contracting costs. Moreover, it suggests that regional problems are frequently not the consequence of invidious discrimination, but of more prosaic, if not more remediable, institutional failures.

This is not to say that local governments ignore regional welfare in reaction to contracting costs. To the contrary, localities have incentives to resort to informal bargains that do not entail the monitoring and verification costs inherent in explicit contracts. Implicit in my argument is a claim that we are too attentive to the absence of explicit contracts and insufficiently attentive to tacit interlocal bargains that permit localities to realize the benefits of cooperative conduct and regional welfare while avoiding contracting difficulties. These bargains eschew highly stylized contracts and enumeration of the obligations of each party. Instead, they rely on recognition of the interdependence of localities to stimulate conduct that optimizes regional welfare while attaining the benefits of decentralization.

Most of the literature that does address interlocal bargains is concerned solely with formal contracts for the joint provision of mutually desired services rather than with redress of interlocal inequalities.¹¹ The few legal commentators who discuss interlocal contract tend to view it with skepticism bordering on animosity.¹² They do so, in large

¹¹ See, e.g., Briffault, *supra* note 6, at 378-80; Cashin, *supra* note 7, at 2029-30 (discussing regional cooperation for delivery of services).

¹² See Briffault, *supra* note 7, at 1149 ("As long as cooperation is voluntary, no locality will cooperate with another unless it sees that it will benefit from such cooperation.").

Professor Gerald Frug recently has suggested that interlocal negotiations may reduce imbalances of wealth and services. It is not clear whether the negotiations he has in mind would occur among traditional localities. See Gerald E. Frug, *City Services*, 73 N.Y.U. L. Rev. 23, 43-44 (1998) [hereinafter Frug, *City Services*]; Jerry Frug, *Decentering Decentralization*, 60 U. Chi. L. Rev. 253, 294-303, 328-34 (1993). Frug contends that negotiation occurs among localities deciding how to allocate entitlements, rather than through the creation of a regional government. Frug, *City Services*, *supra*, at 43 n.60. Nevertheless, he also contends that the allocational objective of the negotiation process may be embodied in a regional legislature. *Id.* Frug, who recognizes and seeks to preserve the political and participatory benefits of decentralization, favors a reorientation of local concerns so that they include those of neighbors. See Frug, *supra* note 1, at 10 (defining benefits as "freedom gained from the ability to participate in the basic societal decisions that affect one's life, the creativity generated by the capacity to experiment in solving public problems, and the energy derived from democratic forms of organization"). Frug is less attentive to (and oddly hostile towards) the efficiency benefits of decentralization. See *id.* at 167-73. For

part, I suggest, by looking at interlocal relationships statically, as if the conduct of one locality could not generate responses by other localities. My analysis assumes a dynamic relationship among localities, so that both cooperative and noncooperative conduct by one locality produces strategic responses by neighbors.

I first examine interlocal arrangements in which multiple localities realize economies of scope or scale through provision of a single public good. These arrangements, such as metropolitan waste disposal agencies or regional ambulance services, constitute the bulk of interlocal contracts. My primary interest, however, concerns interlocal agreements to alleviate socio-economic disparities within a region. These agreements involve subsidies from some localities (typically suburbs) to others (typically central cities) that bear disproportionate redistributive burdens. I refer to these subsidies as "burden sharing." Such subsidies may entail accepting a fair share of undesirable land uses or a fair share of residents who need redistributive services (and hence more taxes based on ability to pay rather than benefits received), or the dedication of tax revenues generated in suburbs to the central city. Burden sharing includes situations in which interlocal bargains generate net gains for the region, but only as a result of (short-term) sacrifice by one or more localities within the region. Common examples include requirements to provide affordable housing in communities that otherwise would practice exclusionary zoning¹³ and to equalize per capita spending by school districts within states.¹⁴ These examples suggest that parochial localities resist burden

Frug, the objective of reorienting local concerns to include those of neighbors can be satisfied either by requiring explicit consideration of regional effects by cities or by deemphasizing boundary lines. *Id.* at 10. I admit to some uncertainty over the implementation of this vision, but read Frug's suggestion as consistent with the common assumption that, without some form of internalization, neither local constituents nor their officials would be willing to dedicate locally generated tax dollars to subsidize nonlocal activities. However, my argument is less dependent on Frug's assumption that inducing regional consideration requires significant alteration of the outlook of decentralized localities. Nothing in my exploration of bargains depends on processes of "decentering" local government perspectives or transforming local government perspectives into those of more altruistic or politically liberal communities. Instead, bargains presumably proceed, if at all, from the self-interest (albeit an informed self-interest) of the localities. In emphasizing local self-interest, I am attempting to avoid the difficulties inherent in mechanisms that transform self-interested localities into something else.

¹³ See, e.g., *S. Burlington County NAACP v. Township of Mt. Laurel*, 336 A.2d 713, 724 (N.J. 1975) (requiring that municipalities afford opportunities for low and moderate income housing).

¹⁴ See, e.g., *Edgewood Indep. Sch. Dist. v. Meno*, 917 S.W.2d 717, 726-29, 750 (Tex. 1995) (approving legislative plan that required school districts with taxable property valued in excess of specific cap to take action that would confer benefit of that property on other districts).

sharing, so that interlocal cooperation will occur only under the threat of legal sanction. If these examples are representative of the burden sharing that actually occurs, then reliance on bargains to constrain exploitation of neighbors seems inconsistent with experience.

I hope to demonstrate that a significant, if suboptimal, amount of burden sharing is plausible without threat of legal sanction, and that the primary obstacle to its achievement lies in a more mundane, if no less unrelenting, source. Lest my claims seem overly naive, let me introduce three caveats. First, the possibility of bargains, whether explicit or implicit, does not always mean that those bargains that are achieved will be optimal. Contracting costs may be reduced, but not eliminated. Agency costs or intertemporal externalities may cause local officials concerned with short-term costs to eschew efficient contracts or to accept contract terms contrary to the long-term interests of their constituents. Informational asymmetries may preclude even the most well-meaning official from reaching an ideal agreement.

Second, the background rules against which localities bargain may affect outcomes. Much interlocal bargaining occurs within legal frameworks that grant an entitlement to one party or the other, thereby affecting the threats that each party credibly can make. The fixed geographical position of the parties may minimize the costs of bargaining around those rules, but not to the Coasean zero. A city, for instance, that can annex territory without the consent of the annexe¹⁵ is in a better bargaining position to obtain concessions from adjacent unincorporated areas than it would be if the legal rule required consensual annexations. Conversely, a legal rule that allows adjacent areas to incorporate, and thus avoid annexation,¹⁶ provides them with a credible threat against the central city. Thus, if contracting costs are high, the assignment of initial entitlements may be crucial to burden-sharing arrangements.

Third, I do not deny that invidious forms of discrimination based on race and class can frustrate efforts to solve regional problems and reduce the use of interlocal bargains.¹⁷ Yet to focus on discrimination

¹⁵ See, e.g., *Murphy v. Kansas City*, 347 F. Supp. 837, 843-45 (W.D. Mo. 1972) (upholding annexation procedure that denies annexe^{es} right to vote on proposed annexation).

¹⁶ Typical annexation statutes allow annexation only of unincorporated land. See Laurie Reynolds, *Rethinking Municipal Annexation Powers*, 24 *Urb. Law.* 247, 293-99 (1992) (suggesting types of state statutes that may prevent defensive incorporation by metropolitan margins).

¹⁷ For instance, John Powell has contended that local autonomy has become a mechanism by which white suburbanites have isolated racial minorities economically. Bob Wing, *What We Need to Do About the 'Burbs: An Interview with John Powell*, *ColorLines* (Applied Research Ctr., Oakland, Cal.), Fall 1999, http://www.arc.org/C_Lines/CLArchive/story2_3_01.html. For an example of localities that resist burden sharing based on ostensi-

alone both understates and overstates the problem of regional development and misses an important opportunity to redress the issue. It understates the problem in that critics of interlocal segregation do not claim that more burden sharing exists in areas that are racially homogeneous than in areas that are racially diverse. It overstates the problem by ignoring the extent to which the same issues exist if local boundaries are replaced by regional ones. As I suggest below, it is by no means clear that transforming multiple jurisdictions into a single regional one would reduce racial or class tensions. Indeed, the displacement of multiple jurisdictions with a single regional one would allow a regional minority, whether defined in terms of ethnic, philosophical, or socio-economic interests, more readily to be outvoted in the selection of particular local public goods and services.¹⁸ But where invidious discrimination exists, reliance on bargains need not displace other regionalizing strategies, and certainly does not negate constitutional protections that might require centralized intervention. Thus, I am suggesting only that, in some situations, interlocal bargains are likely to lead to a better allocation of local resources than we would expect from centralization. My claim is that intraregional inequalities are best addressed by a mix of strategies of which bargains are an essential part.

The argument proceeds as follows. In Part I, I summarize arguments in favor of decentralized governments rather than regional ones. In Part II, I explore the circumstances in which interlocal contracts are most common. These are situations in which bargains would facilitate economies of scale and scope that benefit all participants. Nevertheless, these bargains are likely to be underutilized, in large part due to contracting costs and legal doctrine. In Part III, I explore why burden-sharing contracts might be underutilized. Based on the characteristics of contracts that achieve scale economies, there is reason to believe that the relative infrequency of explicit interlocal contracting is attributable to contracting costs and institutional design rather than to invidious interlocal exploitation. Finally, in Part IV, I explore whether informal cooperation through implicit bargains may avoid both legal and strategic problems associated with contract and better accommodate interlocal interests than do formal contracts. If that is correct, then the fact that formal contracts "as compensation

ble class differences, see Kenneth T. Jackson, *Gentleman's Agreement: Discrimination in Metropolitan America*, in *Reflections on Regionalism* 185, 194-97 (Bruce Katz ed., 2000) (describing discriminatory practices in Darien and New Canaan, Connecticut).

¹⁸ See John A. Powell, *Addressing Regional Dilemmas for Minority Communities*, in *Reflections on Regionalism*, *supra* note 17, at 218, 228-32 (discussing minority resistance to regionalizing strategies).

for spillovers or to ameliorate wealth differences [between communities] are virtually unknown,"¹⁹ may be attributable less to nefarious exploitation than to the availability of alternative and superior mechanisms for resolving interlocal conflicts. I conclude with some remarks about the possibility of reducing the costs of interlocal bargains.

I

REGIONALISM AND ITS LIMITS

Before addressing the possibility of bargains, it is worthwhile to consider the alternatives that commentators have recommended to remedy regional disparities. These alternatives focus on shifting the decisionmaking process about local activities to a more centralized forum. No consensus exists on the appropriate form of centralization.

One set of proposals, premised on the assumption that borders matter, simply would alter boundaries to internalize the external effects of local action. This could be accomplished by relaxing annexation rules, which would permit central cities to consolidate with outlying areas.²⁰ The resulting, more centralized governing body presumably would weigh the costs and benefits of any proposed action from a regional perspective. Alternatively, existing localities could combine in a metropolitan government to the same effect: Legislatures with regional jurisdiction presumably would address regional problems better than parochial local legislatures,²¹ would avoid underproduction by decentralized governments of goods with spillover ben-

¹⁹ Briffault, *supra* note 6, at 432-33.

²⁰ David Rusk, for instance, has advocated liberalization of annexation procedures as a primary mechanism for achieving the elasticity that he deems necessary for the revitalization of central cities. Rusk, *supra* note 1, at 20-22, 101-03; see also Reynolds, *supra* note 16, at 258-302 (advocating more expansive use of involuntary annexation). For a rigorous critique of Rusk's analysis of the effects of elasticity, see Edward A. Zelinsky, *Metropolitanism, Progressivism, and Race*, 98 *Colum. L. Rev.* 665, 665-78 (1998) (book review) (challenging Rusk's statistical methodology, core assumptions, and predictions of more effective racial integration). For an additional endorsement of annexation as a solution to regional disparities, see Jackson, *supra* note 17, at 212.

²¹ For a particularly robust version of such a regional legislature, see, for example, Frug, *supra* note 1, at 85-89 (proposing regional legislature as means of decentralizing planning, democratizing decisionmaking, and coordinating inter-state metropolitan legal entitlements). An example of a regional legislature can be found in Unigov, which is the result of the consolidation of the city of Indianapolis and Marion County. Under the consolidation, many units of the two governments were consolidated into one civil government, and the City Council and the County Council were joined to become the City-County Council. See League of Women Voters of Indianapolis, *Unigov Handbook* (1994), <http://www.indygov.org/unigov/>; see also Advisory Comm'n on Intergovernmental Relations, *Metropolitan Organization: The Allegheny County Case 1* (1992) (reporting on case study of dynamics of Pittsburgh area communities); Advisory Comm'n on Intergovernmental Relations, *Metropolitan Organization: The St. Louis Case*, at iii (1988) (reporting on case study of dynamics of St. Louis area communities).

efits,²² and would ensure more equitable distribution of regional resources.

A second suggestion would retain decentralized localities but would remove from their control discrete governmental functions that have significant multi-jurisdictional effects. This view recognizes that jurisdictional boundaries only fortuitously will coincide with the optimal allocation of some local public goods and certainly will not coincide with the optimal delivery of all services. Creating a service provider with a jurisdiction that transcends municipal boundaries to create an optimal service area allegedly permits greater specialization and expertise than is available for general-purpose governments. At the same time, exempting service providers from administrative and legal restrictions that apply to general-purpose governments increases financial and geographical flexibility.²³ Public authorities and special districts that operate interjurisdictional transit systems, sewage and water systems, or electrical energy generation systems are typically justified in terms of these economies.²⁴ Apart from allowing cost savings or gauging demand better, regional bodies can coordinate (in theory at least) the activities of disparate general-purpose jurisdictions. Planning districts, for instance, may permit regional development consistent with an overall objective that would minimize sprawl and its attendant regional costs.²⁵

A third palliative recommends that decentralized localities be retained and allowed to make decisions, but that a more "neutral" entity be entitled to review those decisions to inhibit opportunistic or paro-

²² See Wallace E. Oates, *Fiscal Federalism* 4-10 (1972) (arguing that centralized governments are more successful at providing efficient outputs for public goods and services). In a federal system, it may not be necessary to restructure governmental boundaries to reduce the effects of spillover benefits. Incentives to underproduce can be eliminated if the central government collects taxes in excess of its spending and confers grants on decentralized entities to induce them to invest in the socially optimal amount of the good. See *id.* at 11-20.

²³ Foster, *supra* note 6, at 96-100 (describing six distinctions between general and special-purpose governments: functional specialization, geographic flexibility, political visibility, financial flexibility, administrative flexibility, and planning and land use control).

²⁴ See Nancy Burns, *The Formation of American Local Governments* 25-30 (1994) (describing economic and development interests behind formation of Southern California water district and tristate steel authority); Annmarie Hauck Walsh, *The Public's Business* 40-41 (1978) (discussing purported advantages of public authorities with respect to legal, administrative, and financial autonomy); James McAndrews & Richard Voith, *Can Regionalization of Local Public Services Increase a Region's Wealth?*, 33 *J. Regional Sci.* 279, 298 (1993) (concluding that, under assumptions about strategic position and absence of skewed political influence, tax-supported regional authority may be able to improve geographic distribution of firms and create regional wealth).

²⁵ See, e.g., Buzbee, *supra* note 4, at 96-98 (criticizing such regional entities as antidemocratic while admitting their potential for addressing problems such as sprawl).

chial decisions. This entity might be a state environmental protection agency that examines land use decisions or that approves road-building projects.²⁶ Equally common, however, are proposals for judicial intervention to consider the extraterritorial consequences of local decisions. Examples include judicial review of annexation decisions to determine whether the annexed area is sufficiently "contiguous" to the annexing jurisdiction,²⁷ review of incorporation decisions by administrative bodies charged with considering the interests of those within and without the proposed municipality,²⁸ and decisions that measure the "reasonableness" of local land use decisions in light of their extraterritorial impact.²⁹ Some courts have gone so far as to require that municipal officials consider the interests of neighbors when enacting zoning ordinances and to invalidate ordinances that impose costs on neighboring localities.³⁰

Each of these reforms responds to the premise that local action fails to internalize the costs imposed on neighbors and may seek to exploit the interests of neighbors. Each of the suggested reforms, however, also imposes costs that reduce its efficacy.

²⁶ See, e.g., *Town of Mt. Pleasant v. City of Racine*, 127 N.W.2d 757, 759 (Wis. 1964) (citing Wisconsin Department of Resource Development finding that proposed annexation is not contrary to public interest) (annexation voided on alternate grounds); Downs, *supra* note 1, at 171-72 (discussing advantages and disadvantages of state government departments as alternatives to local government).

²⁷ See *In re Annexation of Certain Territory*, 614 N.E.2d 1278, 1284 (Ill. App. Ct. 1993).

²⁸ See, e.g., *In re Incorporation of Borough of Glen Mills*, 558 A.2d 592, 593-94 (Pa. Commw. Ct. 1989) (describing advisory committee that makes recommendations regarding incorporation of new borough).

²⁹ See, e.g., *In re Enlargement and Extension of Mun. Boundaries of Jackson*, 691 So. 2d 978, 980-83 (Miss. 1997) (applying "reasonableness" requirement of proposed annexation by examining extraterritorial effects); *Town of Mt. Pleasant*, 127 N.W.2d at 760 (using "test of reason" to invalidate annexation); Clayton P. Gillette, *Expropriation and Institutional Design in State and Local Government Law*, 80 Va. L. Rev. 625, 670-86 (1994) (discussing costs of judicial review of contiguity requirement); Laurie Reynolds, *The Judicial Role in Intergovernmental Land Use Disputes: The Case Against Balancing*, 71 Minn. L. Rev. 611, 624-36 (1987) (discussing adoption by state courts of balancing of interests tests to resolve intergovernmental land use disputes).

³⁰ See, e.g., *Britton v. Town of Chester*, 595 A.2d 492, 495 (N.H. 1991) (holding that zoning regulations must consider low-income nonresidents); *Quinton v. Edison Park Dev. Corp.*, 285 A.2d 5, 8 (N.J. 1971) (holding that building permit conditions for shopping mall must consider interests of residents in adjoining township); Saxer, *supra* note 9, at 661-71 (describing legal challenges against neighboring municipality zoning ordinances). In his current work involving the extent to which the capitalization of local public goods into housing prices affects the investments of localities, William Fischel contends that he has been unable to locate cases in New Hampshire involving efforts by one locality to create land uses that exploit neighboring localities. William A. Fischel, *The Homevoter Hypothesis* 22 (Nov. 5, 1999) (unpublished manuscript on file with the *New York University Law Review*).

A. *Boundary Changes*

The expansion of jurisdictional boundaries through annexation or regionalization threatens the benefits of decentralization. Small jurisdictions promote political participation,³¹ as recognized even by those who advocate more local attention to metropolitan perspectives.³² Expansion of boundaries necessarily reduces the competition among localities that is credited with controlling bureaucratic budgets and facilitating monitoring of local officials.³³ Finally, larger boundaries may integrate residents who likely have competing preferences about the provision of local public goods, so that some preferences, even those that do not cause spillovers, get frustrated.³⁴ Indeed, it is on this

³¹ See Robert A. Dahl & Edward R. Tufte, *Size and Democracy* 61-65 (1973) (arguing that "local governments nurture participation and heighten the citizen's sense of effectiveness" and finding that, in Sweden, values of participation and effectiveness are best achieved in small, densely populated communities).

³² See Briffault, *supra* note 7, at 1123-24.

³³ See, e.g., Robert P. Inman & Daniel L. Rubinfeld, *The Political Economy of Federalism*, in *Perspectives on Public Choice* 73, 83-85 (Dennis C. Mueller ed., 1997) (stating that competition between small governments at least suggests increased efficiency in production of public goods); Vincent Ostrom et al., *The Organization of Government in Metropolitan Areas: A Theoretical Inquiry*, 55 *Am. Pol. Sci. Rev.* 831, 837 (1961) (describing potential problems associated with metropolitan governments); Mark Schneider, *Intermunicipal Competition, Budget-Maximizing Bureaucrats, and the Level of Suburban Competition*, 33 *Am. J. Pol. Sci.* 612, 625 (1989) (finding that municipal bureaucrats facing competition are less able to expand budgets). For a discussion of the literature, see Advisory Comm'n on Intergovernmental Relations, *Interjurisdictional Tax and Policy Competition: Good or Bad for the Federal System?* 60-63 (1991). This is not to say that competition is costless. Interjurisdictional competition, for instance, decreases reliance on ability-to-pay taxes, since those with the greatest ability to pay may exit more easily to other jurisdictions if they are paying taxes in excess of benefits received. See Wallace E. Oates & Robert M. Schwab, *The Allocative and Distributive Implications of Local Fiscal Competition*, in *Competition Among States and Local Governments: Efficiency and Equity in American Federalism* 127, 137-38 (Daphne A. Kenyon & John Kincaid eds., 1991); Wallace E. Oates & Robert M. Schwab, *Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?*, 35 *J. Pub. Econ.* 333, 342-43 (1988) (noting that increasing tax rates drive taxpayers to other communities). Thus, to the extent that one believes that localities, rather than states or the federal government, should be involved in redistribution, competition may be more problematic than beneficial.

³⁴ John D. Donahue, *Tiebout? Or Not Tiebout? The Market Metaphor and America's Devolution Debate*, 11 *J. Econ. Persp.* 73, 74 (1997) ("Diverse policy regimes can cater to heterogeneous preferences and accommodate varying conditions."); Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 *U. Chi. L. Rev.* 1484, 1493-94 (1987) (noting that decentralized jurisdictions enable more preference satisfaction); see also Zelinsky, *supra* note 20, at 667 (arguing that metropolitan governments "would be less responsive than the smaller localities they would replace"). For support for the proposition that individuals consider a locality's service and tax package in deciding where to reside, see Vicki Been, "Exit" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine, 91 *Colum. L. Rev.* 473, 520-28 (1991). This is not to say that individuals who live in areas with relatively poor local public goods "prefer" their condition. But it is by no means clear that the appropriate remedy for inadequate services

basis that some commentators believe that the best mechanism for revitalizing central cities is to provide more authority to sublocal entities that can match services with the desires of neighborhood residents or businesses.³⁵

One plausible response is that preference satisfaction is an arbitrary objective that, of itself, does not warrant decentralization. To the extent that preferences are formed by social and political surroundings, the rearrangement of boundaries can reshape preferences or permit compromise among competing preferences, as groups within a single jurisdiction come to understand each other's perspectives, even if they do not come to share them.³⁶ This vision of amicable collaboration among disparate strangers who respect their separate communities and reach viable accommodations provides an appealing alternative to the image of atomized individuals attempting to achieve uniform preferences. Joining together disparate groups, however, does not inevitably produce happy compromise or reflective reconsideration of preexisting preferences. There must exist some incentive to change initial preferences, born either of an inability to achieve them or of a sympathy for those who feel otherwise. If those who share a

is the expansion of municipal boundaries rather than, for instance, more centralized funding of those services to an adequate level.

³⁵ See, e.g., Robert C. Ellickson, *New Institutions for Old Neighborhoods*, 48 *Duke L.J.* 75, 77 (1998) (advocating Block Improvement Districts); George W. Liebmann, *Devolution of Power to Community and Block Associations*, 25 *Urb. Law.* 335, 337 (1993) (citing one authority as saying: "[E]xisting officials find themselves in a competitive local government environment. Their constituents can bargain and negotiate for the types and levels of service they desire."); Robert H. Nelson, *Privatizing the Neighborhood: A Proposal to Replace Zoning with Private Collective Property Rights to Existing Neighborhoods*, 7 *Geo. Mason L. Rev.* 827, 835-36 (1999) (discussing benefits of treating exclusion of use as ordinary exercise of private property right held by given neighborhood); Richard Voith, *Central City Decline: Regional or Neighborhood Solutions?*, *Bus. Rev. (Federal Res. Bank of Phila.)*, Mar.-Apr. 1996 (discussing advantages and disadvantages to "neighborhood solutions" of cities' decline), <http://www.phil.frb.org/files/br/brma96dv.html>. For a cautious endorsement of business improvement districts, which augment municipally provided services to a commercial area within a city, see Richard Briffault, *A Government for Our Time? Business Improvement Districts and Urban Governance*, 99 *Colum. L. Rev.* 365, 476-77 (1999) (noting that current benefits of business improvement districts outweigh costs, but that calculus is susceptible to change).

³⁶ See, e.g., Frug, *supra* note 1, at 22. Frug's concept of "community building" entails the possibility that heterogeneous residents of a community would come both to modify their view of self-interest and to accept views inconsistent with their own. He concludes that contact with members of different groups

would enable disparate strangers to work together to solve common problems, a process that can change not only their relationship with each other but their understanding of their own self-interest. . . . Only in the places where daily life is centered—in the cities in which they live, work, shop and go out—can people learn to be comfortable with those different from themselves.

Id.

particular preference constitute a sufficient majority, they have no need to attract a minority into a winning coalition through compromise.³⁷ They have less need to consider the interests of dissenters, since expansion of jurisdictional boundaries increases the costs of exit, leaving the minority with a less credible threat of migration. Those who would have preferences consistently frustrated in a heterogeneous jurisdiction might find small, homogeneous localities more satisfying.³⁸ Additionally, some issues simply are not susceptible to compromise. The decision whether to preserve or develop rural land, for instance, has a zero-sum quality. While there is certainly a difference between developing an area for single-family residences as opposed to a toxic waste dump, once its primeval condition has been disturbed, those who prefer preservation may not consider low-density uses to be a significantly lesser encumbrance.

Boundary changes also possess a permanence that risks creating inefficient long-term changes to address short-term difficulties. The relationship among neighboring localities is likely to be a dynamic one that shifts with economic and political cycles. Central cities may enjoy financial success and popularity in one era, only to decline in another. The current revitalization of cities suggests that local investments concerning crime, transportation, and social amenities (arguably induced by competition from suburbs for residents and tax base) significantly will influence the desire of individuals to work or reside in central cities rather than outlying suburbs. Subsequent budget surpluses or shortfalls due to economic events beyond the control of city officials will affect the capacity of cities to continue these investments. New technologies for the provision of local public goods may alter the size of the optimal service area. Political motivations for interlocal cooperation may shift as metropolitan issues become more or less salient.³⁹ Boundary changes that respond to immediate but temporary crises are

³⁷ *Id.*; see Briffault, *supra* note 7, at 1158-59 (noting that suburban majority would out-vote central city minority if cross-border voting were permitted); Zelinsky, *supra* note 20, at 678 (arguing that different constituencies would gain power in metropolitan context). Annexation of suburban areas in the name of promoting racial integration, for instance, may dilute the power of the central city's racial minority group as its members become less necessary to form a majority in the city's political processes. See Powell, *supra* note 18, at 228-32.

³⁸ See Downs, *supra* note 1, at 170 (noting that both city and suburban residents oppose metropolitan government and believe that transferring local government powers to metropolitan government would make officials "more remote from any influence individual citizens might hope to exert").

³⁹ See, e.g., Bruce J. Katz, *Reviving Cities: Think Metropolitan* (Brookings Inst., Policy Brief No. 33, 1998) (arguing that notion of sustained urban revival is premature in light of decentralization of people and jobs), at <http://www.brook.edu/COMM/policybriefs/pb033/pb33.htm>.

likely to lock in institutional structures that are inappropriate (or less appropriate) once the temporary problem dissipates. Annexations, for instance, are rarely followed by disannexation.⁴⁰ It is unclear whether this phenomenon illustrates the success of most annexations, or (especially given the dramatic disparity between numbers of annexations and disannexations)⁴¹ the tendency of entrenched interest groups to expand boundaries but not contract them.⁴²

Regionalization, then, does not necessarily provide an effective antidote to the desire of some "to insulate themselves from the fiscal needs of the rest of the region."⁴³ If we simply reassemble self-interested residents within common boundaries, we risk displacing interlocal conflicts with conflicts among residents of equally artificial neighborhood boundaries within a larger metropolis. One need only consider the rivalries that exist among schools within the same municipality, disputes about intralocal inequality of services⁴⁴ (especially those that have nothing to do with race or other invidious discriminants), or disputes about which part of town will suffer a school,⁴⁵ fire station,⁴⁶ or police station closing to realize that harmony does not reign simply because residents share a municipal boundary. Expanding local boundaries does not necessarily "make localities the focus of their residents' loyalties, concerns, and identities."⁴⁷ Rather, those loyalties may be transferred to the neighborhood within the larger locality. Inhabitants of large cities may identify themselves as

⁴⁰ But see *In re Exclusion of Certain Territory from City of Jackson*, 698 So. 2d 490, 495 (Miss. 1997) (disannexing most of 4.92 square miles previously annexed by Jackson).

⁴¹ See Dennis Epple & Thomas Romer, *On the Flexibility of Municipal Boundaries*, 26 *J. Urb. Econ.* 307, 310-11 (1989) (noting that annexations occur with much greater frequency than detachments). Between 1970 and 1979, there were 1026 disannexations in the United States and more than 61,000 annexations. Steven Garasky & Donald R. Haurin, *Tiebout Revisited: Redrawing Jurisdictional Boundaries*, 42 *J. Urb. Econ.* 366, 367 (1997).

⁴² See Saul Levmore, *Irreversibility and the Law: The Size of Firms and Other Organizations*, 18 *J. Corp. L.* 333, 336-39 (1993) (describing incentives of managers to expand organizational size). Resistance to contraction of organizations may be a function of the desire that bureaucrats within the current regime have to maximize budgets. See William A. Niskanen, Jr., *Bureaucracy and Representative Government* 36-42 (1971) (discussing budget maximization by bureaucrats).

⁴³ Briffault, *supra* note 7, at 1141.

⁴⁴ See, e.g., *Veach v. City of Phoenix*, 427 P.2d 335, 336-37 (Ariz. 1967) (involving lawsuit against city for negligently failing to provide water that could have prevented destruction of plaintiff's market by fire). See generally Carl S. Shoup, *Rules for Distributing a Free Government Service Among Areas of a City*, 42 *Nat'l Tax J.* 103 (1989) (analyzing how urban governments do and should allocate services).

⁴⁵ See, e.g., *Moore v. Sch. Comm.*, 378 N.E.2d 47, 48 (Mass. 1978) (regarding dispute over closing of neighborhood school).

⁴⁶ See, e.g., *Chandler v. District of Columbia*, 404 A.2d 964, 965 (D.C. 1979) (considering lawsuit alleging that District was negligent for temporarily closing local fire station).

⁴⁷ Briffault, *supra* note 7, at 1143.

residents of “the Upper West Side” or “the Castro”⁴⁸ or “Southie,”⁴⁹ identifying only secondarily with the city of which those neighborhoods are a part. Intracity neighborhoods may be as racially segregated (and certainly as economically segregated) as the metropolitan areas of which those cities are a part.⁵⁰ Nor are sublocal loyalties merely aesthetic. Relatively affluent residents who wish to insulate themselves from urban fiscal demands, for instance, may react to regionalization by privatizing services they desire and voting to underfund services that are sought by others.⁵¹ Without more, then, regionalization simply may generate a different form of strategic behavior, but one that has no less serious consequences for those disfavored by the existence of multiple jurisdictions.

B. Public Authorities

Regionalization of discrete tasks through public authorities or special districts similarly reduces the benefits of interlocal competition by reducing the number of providers of local public goods and potentially frustrating political accountability. One might think that accountability for the provision of local public goods is enhanced when service recipients can identify with greater precision the party responsible for defective performance (the “parks authority” rather than

⁴⁸ See Frances FitzGerald, *Cities on a Hill* 25-119 (1981) (describing social and political life in Castro area of San Francisco).

⁴⁹ See J. Anthony Lukas, *Common Ground* 206 (1985) (describing racial and ethnic cleavages in Boston).

⁵⁰ See Paul A. Jargowsky, *Poverty and Place: Ghettos, Barrios, and the American City* 59-88 (1997) (analyzing size and scope of neighborhood poverty and racial composition of poor neighborhoods); Scott J. South & Kyle D. Crowder, *Residential Mobility Between Cities and Suburbs: Race, Suburbanization, and Back-to-the-City Moves*, 34 *Demography* 525, 527 (1997) (commenting on high levels of racial residential segregation in American cities); Elvin K. Wyly et al., *A Top 10 List of Things to Know About American Cities, Cityscape* (U.S. Dep’t of Housing & Urb. Dev.), Vol. 3, No. 3, 1998, at 7, 23-24 (noting substantial income inequality and continued racial segregation in central cities), <http://www.huduser.org/periodicals/cityscape/vol3num3/article2.pdf>. Nevertheless, Douglas Massey and Nancy Denton report that black suburbanization rates lag behind those of whites, concluding that suburbanization has contributed to segregation in metropolitan areas. See Douglas S. Massey & Nancy A. Denton, *American Apartheid* 67-74 (1993).

⁵¹ Clayton P. Gillette, *Opting Out of Public Provision*, 73 *Denv. U. L. Rev.* 1185, 1207-10 (1996) (discussing when those who can privatize public services will or will not do so). There are, of course, both legal and economic constraints on the capacity of individuals to underfund public services. Residents, for instance, frequently have a great deal of their wealth capitalized into house prices and will not want to see local services so underfunded as to threaten property values. Those same incentives, however, may affect regional property values as well as intracity ones. Of course, political boundaries may matter. The need for intralocal coalition building within a heterogeneous political entity may induce relationships that shape preferences, rather than just reflect the existing preferences of residents. The issue that remains is whether these benefits of regionalization can be replicated through alternative devices, or are otherwise worth their costs.

“the city” readily can be blamed for dilapidated playgrounds). But accountability may be impeded by the multiplicity of governmental actors, as constituents must invest more in determining precisely who is responsible for which service. As Roderick Hills has argued in a different context, constituents may have little information about which governmental entity provides which service.⁵² Constituents, who already confront collective action problems in monitoring public officials, will have less incentive to monitor multiple service providers, and are likely to incur the related costs only with respect to issues in which they have an idiosyncratically high interest.⁵³ Moreover, constituents may feel less of a capacity to influence the policy choices of public authorities than those of general-purpose municipalities. Interjurisdictional authorities and special districts that lack taxing authority tend to be appointed rather than elected.⁵⁴ When elected, they are often exempt from constraints that improve accountability, such as one-person-one-vote limitations.⁵⁵ They also tend to enjoy revenue-raising capacity with fewer restrictions than general-purpose municipalities have,⁵⁶ to employ user fees and service charges that are not subject to the same constraints as taxes,⁵⁷ and to fund capital projects through revenue bonds that induce officials to be attentive to the demands of creditors or developers, perhaps at the expense of residen-

⁵² See Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and “Dual Sovereignty” Doesn’t*, 96 Mich. L. Rev. 813, 828 (1998) (observing that when Congress delegates regulatory responsibility to state and local officials, voters may be confused about which level of government is source of regulation).

⁵³ Robert Inman and Daniel Rubinfeld claim that government spending per capita rises with the number of governmental units (i.e., special districts) per square mile. Inman & Rubinfeld, *supra* note 33, at 84. They conclude that this results from an inability of small units to take advantage of economies of scale. *Id.* But it is equally plausible that small governments, especially special districts that are susceptible to the entreaties of a few constituents, are particularly vulnerable to public choice problems that increase costs, as the majority of constituents have an insufficient interest in the limited service to monitor officials.

⁵⁴ Foster, *supra* note 6, at 7.

⁵⁵ See Clayton P. Gillette & Lynn A. Baker, *Local Government Law 178-86* (2d ed. 1999) (discussing voting rights in special-purpose governmental elections).

⁵⁶ See, e.g., Jameson W. Doig, “If I See a Murderous Fellow Sharpening a Knife Cleverly . . .”: The Wilsonian Dichotomy and the Public Authority Tradition, 43 Pub. Admin. Rev. 292, 294 (1983); Comment, *An Analysis of Authorities: Traditional and Multicounty*, 71 Mich. L. Rev. 1376, 1382 (1973).

⁵⁷ See, e.g., Foster, *supra* note 6, at 111 (discussing differences between tax-funded and user-fee-funded services in eyes of taxpayers). There have been some efforts to apply to user fees and assessments many of the same restrictions that apply to taxes. See, e.g., Cal. Const. arts. XIII C, XIII D. These both were added to the California Constitution by initiative movements after localities attempted to raise, through fees and assessments, revenues lost by prior restrictions on taxes.

tial constituents.⁵⁸ Typically, authorities are permitted to enter into bond covenants that require that they charge rates or fees sufficient to pay debt service.⁵⁹ The result is that officials of regional authorities have less incentive to economize on costs than do local or municipal officials, since the former have a monopoly on the service they provide and can pass their costs on to users. While officials of general-purpose municipalities similarly must be concerned with access to capital markets, they face competing, if imperfect, incentives to serve the interests of the electorate.

Even regional authorities that are involved in planning, rather than revenue raising, and that thus may be less attentive to the entreaties of creditors and underwriters, may be more susceptible to capture than officials of smaller jurisdictions. Developers who must obtain numerous approvals of a single centralized authority are repeat players before that authority. Opponents of projects, however, are likely to appear before the authority only with respect to projects that directly affect them. The result is familiar to students of administrative agencies—those charged with regulating become “captured” by the regulated as a relatively small, but intensely interested, group dominates the deliberative processes of the agency.

I do not want to overstate the critique of authorities. It is not clear how much we can make of these theoretical tendencies towards inefficiency and unaccountability. A recent, relatively rigorous attempt to compare costs for the same service provided by special districts and general-purpose governments reveals that costs are higher for certain types of the former.⁶⁰ It is not clear, however, whether these costs reflect less efficient provision of service or satisfaction of demand for a higher quality of service by district constituents.⁶¹ At the very least, it is plausible to conclude that authorities do not provide an unambiguous solution to the problem of interlocal conflict even in areas, such as service provision, where they might be able to compensate for the fortuities of historical local boundaries.⁶²

⁵⁸ See Clayton P. Gillette, *Fiscal Federalism and the Use of Municipal Bond Proceeds*, 58 N.Y.U. L. Rev. 1030, 1062-66 (1983) (discussing how interests of other parties to bond transactions may diverge from interests of issuer's constituents).

⁵⁹ See, e.g., N.Y. Pub. Auth. Law § 1010(7) (McKinney 1994).

⁶⁰ See Foster, *supra* note 6, at 148-88.

⁶¹ *Id.* at 183-84.

⁶² See Buzbee, *supra* note 4, at 97 (noting that regional authorities are “largely insulated from democratic accountability”).

C. Judicial Review of Externalities

Judicial review of decisions with external effects creates a different set of concerns. Courts only can address issues brought before them and, thus, only can determine the "reasonableness" of a subset of actions that impose external effects. In addition, courts likely will be unable to reverse engineer the nuances of political deals in a manner that distinguishes inappropriate municipal opportunism from appropriate political tradeoffs in interlocal relationships. Judicial responses tend to focus on balancing tests or inquiries into legislative intent; these tests, in turn, promote uncertainty, increasing litigation and discouraging negotiated compromise.⁶³

Consider, in this context, judicial efforts to referee disputes when one locality seeks to construct a public facility in another jurisdiction in contravention of the host locality's zoning ordinances. For instance, in *Township of Washington v. Village of Ridgewood*,⁶⁴ a locality sited an elevated water tank partially within its own territory and partially within the boundaries of its neighbor, the Borough of Ho-Ho-Kus. The New Jersey Supreme Court determined that location of an elevated water tank at this site would provide a better quality of water and a less expensive construction cost than would an alternative ground water system. However, Ho-Ho-Kus residents were not to receive any benefit from the water tower, and the tower violated that borough's zoning ordinances. The court concluded that the legislation authorizing extraterritorial siting of water facilities permitted the invading locality to disregard the zoning ordinances of the host locality.⁶⁵ But the court augmented the statute with a requirement that the invading locality exercise its authority "reasonably."⁶⁶ While, in the court's view, Ridgewood failed that test, the source of this failure was entirely unclear. For instance, would Ridgewood have been acting unreasonably if the savings it enjoyed from constructing the elevated tank (\$66,000) exceeded the resulting total diminution of property value in Ho-Ho-Kus? The court neither undertook nor ordered any analysis of the comparative costs that would permit one to conclude whether the "reasonableness" of Ridgewood's conduct was related to net social value. Perhaps the court intended to preclude any imposition of costs on a locality that was not to enjoy the project's benefits. After all, the court concluded that since cost was the only basis for Ridgewood's decision, it "should have assumed that cost rather than

⁶³ See Reynolds, *supra* note 29, at 637-41.

⁶⁴ 141 A.2d 308 (N.J. 1958).

⁶⁵ *Id.* at 314.

⁶⁶ *Id.* at 311.

visit the burden of an elevated structure of 160 feet upon the other municipalities."⁶⁷

Wholly apart from the ambiguity of the court's language, neither interpretation is very satisfying if the objective is for courts to make decisions that reflect regional concerns. A requirement to compare the costs and benefits of alternative sitings would involve costly analysis that could discourage construction of efficient municipal improvements.⁶⁸ A flat prohibition against imposing costs on nonbeneficiaries of the project would preclude Ridgewood from undertaking a project even though its savings significantly exceeded the burden to its neighbors. In short, judicial intervention based on "reasonableness" seems to provide little assurance that resolution of interlocal disputes will reflect the conclusions of a centralized decisionmaker rather than the favoritism of one locality over another.⁶⁹

D. *Does Regionalization Improve Decisionmaking?*

These costs might be worth incurring if regionalization systematically neutralized the self-interested behavior of localities. Those who endorse regionalization imply that it will generate this result. The assumed capacity of regions to reconcile conflicting interests reflects the Madisonian assumption that relatively centralized governments are less susceptible to capture by dominant groups.⁷⁰ But, at least where the choice is between local and regional decisionmaking, it is by no means clear that centralization translates into a greater likelihood that those affected will receive representation. As I suggested might be the case with regional authorities, different groups have organizational advantages at different levels of government. Some are better able to organize at the local level, while others enjoy greater organiza-

⁶⁷ *Id.* at 312.

⁶⁸ Assume, for instance, that the elevated tank obstructed the views of twelve homes in Ho-Ho-Kus, diminishing the value of each by \$5000. In that event, construction of the tower still would save social costs of at least \$6000. If the value of each home was diminished by \$6000, however, construction of the tower likely would be inefficient, depending on the value placed on having water of better quality. But even in the first case, making the necessary calculations and proving them in court easily could eliminate any savings for Ridgewood and thus induce it to forego what would be a socially beneficial project.

⁶⁹ There is some hint in *Ridgewood* that the court believed that village officials had misled Ho-Ho-Kus officials about the nature of the structure they were building. Hence, the court may have been compensating for the perceived deception. But to the extent that borough officials were mistaken, the facts of the case leave it unclear whether the mistake was due to deception or lack of care in discovering the nature of the project.

For an additional case in which a court employed a reasonableness standard to resolve interlocal zoning disputes, see *City of Crown Point v. Lake County*, 510 N.E.2d 684, 689 (Ind. 1987) (applying "balancing of interests" test to intergovernmental zoning dispute and discussing cases).

⁷⁰ See *The Federalist* No. 10 (James Madison).

tional capacity at the metropolitan or state level. Thus, centralization merely may shift the identity of the winners of political battles from those who are best able to capture a highly decentralized decisionmaker to those who are best able to capture a more centralized decisionmaker.⁷¹ If regionalization simply replaces one set of strategic actors with another, the identity of the winners and losers might change, but no social gains necessarily will result.⁷²

Nevertheless, there remains a legitimate fear that without some mechanism for internalizing the externalities of local decisionmaking, intraregional inequities will remain unaddressed and opportunities for more productive regional service provision will be unrealized. Few can doubt that localities compete over commercial development in order to increase the local tax base regardless of the effects on regional welfare,⁷³ that poor regional planning permits one group to impose the adverse effects of its preferences on surrounding localities,⁷⁴ that judicial intervention has reduced intraregional disparities in affordable housing and educational funding,⁷⁵ or that there is a general perversity in heralding the capacity of some to realize their preferences through decentralized government, if that requires reducing the ca-

⁷¹ See Clayton P. Gillette, *The Exercise of Trumps by Decentralized Governments*, 83 Va. L. Rev. 1347, 1397-1406 (1997) (analyzing locally powerful and centrally powerful interest groups in context of gay rights legislation).

⁷² Interest group concerns also affect a more recent proposed variant of regionalization in which voting rights are disaggregated from residence. Some have suggested, for instance, that citizens in metropolitan regions be permitted to vote in elections of localities where they do not reside. See, e.g., Frug, *supra* note 1, at 106-07 (proposing system in which people could allocate votes to whichever local elections mattered most to them); Richard Thompson Ford, *The Boundaries of Race: Political Geography in Legal Analysis*, 107 Harv. L. Rev. 1841, 1909 (1994) (same). As Professor Briffault has pointed out, one plausible result would be a one-way ratchet in which suburbanites would participate in central city affairs, perhaps in a manner that would reflect narrow self-interests, while central city residents would be less involved in suburban affairs. See Briffault, *supra* note 7, at 1156-62.

⁷³ See Jonathan Schwartz, Note, *Prisoners of Proposition 13: Sales Taxes, Property Taxes, and the Fiscalization of Municipal Land Use Decisions*, 71 S. Cal. L. Rev. 183, 201-04 (1997) (noting effects of "fiscalization of land use," including devaluation of existing businesses, failure to favor beneficial housing and manufacturing developments, and diminishment of property values of nearby residents).

⁷⁴ See *id.*

⁷⁵ See William N. Evans et al., *Schoolhouses, Courthouses, and Statehouses After Serrano*, 16 J. Pol'y Analysis & Mgmt. 10, 12-28 (analyzing court-mandated school finance reform) (1997). But see G. Alan Hickrod et al., *The Effect of Constitutional Litigation on Education Analysis: A Preliminary Analysis*, 18 J. Educ. Fin. 180, 208 (1992) (acknowledging evidence that reduction in disparities between school districts may be result of litigation efforts, but concluding that there is not enough data to render final judgment on question).

capacity of neighboring residents to realize theirs.⁷⁶ The very presence of externalities, in short, suggests an institutional decisionmaking apparatus that is geographically coextensive with the effects of local action.

Are there, then, alternatives to regionalization that would induce localities to internalize the effects they impose? Under some circumstances, residents of one locality should be concerned with the interests of neighboring localities. Where nonresidents who would suffer the costs of local action have specific surrogates within the acting locality, we would expect the latter to represent the interests of the former. For instance, a city's decision to impose a parking tax or a commuter tax might be thought likely to overtax nonresidents, since they are not represented by decisionmakers. But shopowners who fear that nonresident customers will gravitate to suburban shopping malls, or employers of nonresidents who fear that they will have to increase wages or lose nonresident employees to suburban employers, should serve as pretty good proxies for those who initially would bear the incidence of the tax. Thus, there may be less reason to believe that a locality adopted a policy for exploitative purposes if the decisionmaking process involved resident groups that could serve effectively as surrogates for affected nonresidents. What remains to be seen is whether interlocal bargains similarly reflect the interests of all localities within a region.

II

CONTRACTS FOR COORDINATION

It is useful at the outset to distinguish among three different motivations for regionalization. In the first case, regionalists simply attempt to reduce allocative inefficiencies that arise from the fortuitous boundaries that demarcate local governments.⁷⁷ The fact that a municipality has a size or configuration that permits efficient delivery of police services says nothing about its capacity to allocate water or garbage collection services efficiently as well. Thus, regionalists may simply seek a better match between optimal service areas and the provider of the service. Where this occurs, one would imagine that the relevant localities could coordinate with relative ease. Each of the

⁷⁶ See Gary J. Miller, *Cities by Contract: The Politics of Municipal Incorporation* 167-72 (1981).

⁷⁷ This is typically the motivation for regional service authorities. See Comment, *An Analysis of Authorities: Traditional and Multicounty*, 71 *Mich. L. Rev.* 1376, 1418-28 (1973).

participating municipalities presumably would gain from the efficiencies realized by joint provision.⁷⁸

In the second case, regionalization might cure inefficiencies that arise where one locality opportunistically imposes on another costs that are not worth incurring from a regional perspective even though the acting locality enjoys net gains from the activity. Where each of several localities can gain at the expense of neighbors, the possible result is a traditional Prisoners' Dilemma in which each locality has an incentive to act noncooperatively out of fear that others will do likewise. This is the rationale behind regulations that prevent siting undesirable activities "in my backyard."⁷⁹ The related effort to capture benefits that might otherwise be seized by others within the region allegedly explains races to attract taxable developments⁸⁰ and to employ tax subsidies that entice industry to one locality at the expense of others.⁸¹ In each case, regional action presumably would negate the efforts of individual localities to maximize local wealth at the expense of others.

The third motivation for regionalization involves a desire to cure distributional disparities. One locality may have a monopoly over a natural resource that allows it to extract supracompetitive prices from neighboring localities that also wish to take advantage of that resource. Indeed, a municipality may seek to incorporate for the very purpose of expropriating for itself the tax benefits of a particular resource within its boundaries.⁸² Or, one locality may have adopted

⁷⁸ See Jennifer Preston, *Whitman Budget Speech Focuses on Property Taxes*, N.Y. Times, Jan. 26, 1999, at B1 (reporting Governor Whitman's call upon taxpayers to demand that local officials "share more municipal and school services with neighboring cities and towns").

⁷⁹ See *Envirosafe Servs., Inc. v. County of Owyhee*, 735 P.2d 998 (Idaho 1987) (holding that county ordinance regulating hazardous waste disposal was preempted by state regulation). There is a significant literature that contests claims that centralized decisionmaking is necessary to avoid this "race to the bottom." See, e.g., Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. Rev. 1210, 1233-47 (1992) (arguing that interstate competition is potentially consistent with maximization of social welfare).

⁸⁰ See Schwartz, *supra* note 73, at 204-09 (discussing competition for taxable development in terms of Prisoners' Dilemma and Winner's Curse).

⁸¹ See, e.g., Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 Harv. L. Rev. 377, 389-97 (1996) (arguing that, in spite of enormous effort expended by states in competition to provide tax incentives to businesses, state taxes are too small to have significant impact on business decisions). But see Clayton P. Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 Minn. L. Rev. 447, 485-88 (1997) (arguing that business incentives can constitute signal that creates better matching of firms and localities).

⁸² See, e.g., Burns, *supra* note 24, at 37-40 (discussing as examples several California cities incorporated solely to shield and benefit businesses contained within their boundaries); Miller, *supra* note 76, at 37-40 (describing incorporation of Downey, California,

housing or zoning policies that restrict the influx of individuals who do not contribute to the tax base or who require redistributive services. The locality, in short, would like to isolate itself from burdens that affect its neighbors. My discussion of burden sharing in Part III of this Article includes efforts both to avoid Prisoners' Dilemmas and to redistribute regional resources.

How easily would we expect interlocal contract to respond to each of these motivations? Take the first set of cases, those involving localities that seek regional economies of scale and scope. Initially, we might anticipate that agreements could be reached with relative ease in these cases, as contracting benefits all participants. These situations roughly correspond to games of pure coordination, in which each party gains from cooperation. The parties only need be assured of the action that others will take, so that they can take similar action. While coordination games may founder where the players do not all share the information necessary to induce coordinated activity,⁸³ the possibility of explicit contract overcomes that defect. Since general-purpose localities simultaneously perform multiple functions, not all of which can have an optimal service area coextensive with municipal boundaries, one would expect coordination agreements among localities for the joint supply of individual goods and services to be fairly common.

Nevertheless, I suggest that contracting costs and legal doctrine are likely to frustrate that expectation. Localities suffer from many of the same contracting costs and threats of strategic behavior as private firms seeking to coordinate their activities. However, localities have less flexibility in avoiding those costs than do firms. Their inflexibility is largely the result of (1) the geographical fixity of localities, which limits the ability to use organizational structures available to firms for reducing contracting costs, and (2) legal doctrines, such as the nondelegation doctrine, which limit the capacity of localities to overcome contracting costs and the threat of strategic behavior. One might conclude that the costs that these doctrines generate justify their elimination. I conclude, however, that residual benefits justify current doctrine, notwithstanding its costs. The force of the argument

around unique resource base). The incorporation statutes of some jurisdictions allow courts to limit incorporations motivated solely by tax incentives. See, e.g., *In re Incorporation of Borough of Pocono Raceway*, 646 A.2d 6 (Pa. Commw. Ct. 1994) (invalidating incorporation of borough comprising eleven residents, most of whom were members of same family that owned raceway to be located within proposed borough's boundaries).

⁸³ See, e.g., Shaun P. Hargreaves Heap & Yanis Varoufakis, *Game Theory: A Critical Introduction* 242 (1995) (indicating need for "consistent alignment of beliefs," as well as high degree of common knowledge, among players concerning coordinated activity).

is that interlocal contract may be underutilized even where all parties would benefit. I will expand on that argument in Part III to suggest that interlocal contract also will be underutilized in burden-sharing contracts for reasons that have nothing to do with suburban exploitation of central cities or of each other.

A. *The Costs of Interlocal Contract*

Some of the reasons why localities forgo the benefits of coordination simply result from application to the public sector of general problems in contracting. Robert Inman and Daniel Rubinfeld, for instance, suggest that governments have difficulty agreeing because they cannot readily verify each other's expressed preferences over bargaining outcomes, they may be served by imperfect agents, they may face significant enforcement costs, and they may have difficulty agreeing on a division of the bargaining surplus.⁸⁴

These obstacles to ideal contracts, however, should not lead us to ignore the possibilities of interlocal agreements if they simply replicate in the intergovernmental context problems that also arise in contracting among private parties. After all, firms somehow circumvent the problems of contracting costs to achieve joint gains. Consider, for instance, the obstacle that Inman and Rubinfeld identify as the most serious impediment to intergovernmental agreement: division of the bargaining surplus.⁸⁵ Private parties who anticipate gains as a result of their agreement nevertheless may disagree on who is to receive what share of those jointly generated gains. Each party to the contract has incentives to select a distribution of the surplus that will maximize its gains from the joint venture. Although a rational firm might be willing to take any part of the surplus, as long as doing so makes it better off than it would be without the agreement, there is much evidence for the proposition that relative position matters and that one party to a beneficial agreement enviously may reject it if the other party is made better off still.⁸⁶ Merely splitting differences may not be acceptable, because one party may stand to obtain more from coordination than the other, even if both parties prefer coordination to

⁸⁴ Robert P. Inman & Daniel L. Rubinfeld, *Making Sense of the Antitrust State-Action Doctrine: Balancing Political Participation and Economic Efficiency in Regulatory Federalism*, 75 *Tex. L. Rev.* 1203, 1222-25 (1997); Robert P. Inman & Daniel L. Rubinfeld, *Rethinking Federalism*, 11 *J. Econ. Persp.* 43, 48-49 (1997) [hereinafter Inman & Rubinfeld, *Rethinking Federalism*].

⁸⁵ See Inman & Rubinfeld, *Rethinking Federalism*, *supra* note 84, at 49.

⁸⁶ See Robert H. Frank, *Luxury Fever* 107-21 (1999) (presenting evidence that sense of well-being depends on relative, not absolute, income).

noncoordination.⁸⁷ Given that coordination games are characterized by multiple stable and efficient equilibria, each of which would make both of the parties better off than the status quo, it is not at all clear that all parties would prefer to settle on the same point. Thus, they must agree either on a particular point or, where the surplus will arise in the future and be of indeterminate size, on a process for subsequent division of the surplus. Each of these procedures is likely to require sufficient bargaining costs that could consume a nontrivial amount of the surplus itself and impede what otherwise would be a successful negotiation.

1. Constraints on Organizational Form

Inducements for joint action obviously affect localities as much as private firms. To take just one source, projects that return economies of scale and scope often involve significant capital expenditures that cannot be justified by a single municipality but that are worth incurring by several localities acting jointly. These projects typically involve transportation systems, hospitals, power plants, waste disposal facilities, or airports.⁸⁸ Localities that agree to construct jointly a solid waste disposal facility or regional hospital, however, still must agree on such matters as how much debt to issue to obtain capital, whom to hire to construct the facility, when to issue debt, and whether the project should be terminated at a particular point. These decisions will affect the distribution (and perhaps the existence) of any bargaining surplus to be realized from the interlocal agreement, just as private firms would have to allocate gains among themselves.

Firms that face these difficulties continue to reach mutually agreeable contracts. Thus, one might conclude that these obstacles are easily cleared. Compared to firms, however, localities face greater obstacles to dividing the bargaining surplus. As noted above, problems of division arise from strategic behavior, as each party attempts to capture the greatest share of the surplus. Specifically, each party is likely to use private information about its cost structure and the benefits it will gain from any joint project to indicate why it re-

⁸⁷ Assume, for instance, that A and B receive benefits only if they drive on the same side of the road, but that A receives a benefit of 1 whether she drives on the right or left while B receives a benefit of 2 if he drives on the right and 1 if he drives on the left. Bargaining over the additional 1 that B receives if he coordinates on the right is likely to be costly if B believes that A is simply seeking to exploit B's benefit rather than bargaining for something of independent value to A. Walter Mattli similarly concludes that concerns over distribution of gains may interfere with coordination games among potential parties to regional agreements among countries. Walter Mattli, *The Logic of Regional Integration* 55-56 (1999).

⁸⁸ See Cashin, *supra* note 7, at 2029-30.

quires certain concessions to make participation in the joint project worthwhile.

Firms have an organizational flexibility that allows them to minimize these contracting costs. Firms, for instance, can adjust their organizational forms to assign residual rights to parties who otherwise would suffer the greatest impediments to contracting and thus would forgo the contract but for the assignment of ownership to them.⁸⁹ Alternatively, firms can adopt forms that reduce the risk of strategic behavior by bonding the interests of the parties. Indeed, a great deal of the literature concerning organizational behavior suggests that firms select from among the menu of possible organizational forms for the very purpose of surmounting the difficulties otherwise imposed by contracting costs.⁹⁰ For instance, firms can avoid the risks involved in dividing the contract surplus (and ex post holdup efforts that constitute efforts to renegotiate initial allocations of that surplus) through vertical integration. Thus, any allocation decision is made by parties who internalize all the interests of the activities that generated that surplus.⁹¹ Or, firms that seek to cooperate but fear strategic behavior by a trading partner may select an organizational form that reflects the comparative advantage of each party in monitoring centralized inputs and outputs in order to maximize the surplus generated from joint action. Franchising, for instance, allows a franchisor with a comparative advantage for monitoring inputs to undertake that task, while delegating to the franchisee the responsibility for monitoring outputs and labor, which might deviate profitably among markets and which, therefore, can be monitored profitably on a more localized basis.⁹² Alternatively, firms in long-term relationships may agree on mechanisms that allow measurement of the bargaining surplus and reallocation should the gains to one party become too great. For instance, buyers and sellers who enter into long-term arrangements may agree to quantity or price terms that allow some flexibility should initial expectations about future performance go awry. Parties may select price

⁸⁹ See Henry Hansmann, *The Ownership of Enterprise* 21 (1996) (citing as example of such firms rural electric utilities organized as consumer cooperatives).

⁹⁰ See *id.* at 21-22. See generally Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 *J. Fin. Econ.* 305 (1976) (analyzing corporate organization).

⁹¹ See Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 *J.L. & Econ.* 297, 302 (1978) (analyzing vertical integration and long-term contract as solutions to problem of opportunistic behavior).

⁹² See, e.g., Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 *J.L. & Econ.* 223, 228 (1978) (noting that franchisees can best run day-to-day operations, but that it is inexpensive for franchisor to monitor quality of goods). See generally James A. Brickley & Frederick H. Dark, *The Choice of Organizational Form: The Case of Franchising*, 18 *J. Fin. Econ.* 401 (1987).

indices to which contract prices are linked, insert renegotiation clauses, or permit customary variations from stated quantities to reflect spot market prices.

Municipal corporations have less flexibility to adjust organizational arrangements in order to reduce the costs of allocating contractual benefits. While boundaries may expand to match an ideal service area, legal constraints on the abandonment of sovereignty and practical restrictions obligate each party to retain an organizational structure that only can be adjusted in highly regulated ways. Consider first the possibility of boundary changes, which are the functional equivalent of corporate mergers. Although voluntary annexation and consolidation agreements remain possible, they are subject to more significant statutory and constitutional constraints than are corporate mergers.

This difficulty may be exacerbated further simply because the geographical fixity of localities limits the parties that can join in the coordinating project and potentially increases strategic behavior that impedes contractual solutions. Firms that cannot reach a satisfactory bargain with one potential trading partner may be able to find a reasonable substitute. The threat of competitive bargains may prevent each party from acting too strategically, as the other party may seek a more favorable division of the surplus with someone else. Localities, however, face fewer competitive constraints on opportunistic conduct. If Locality A and Locality B together constitute an optimal service area for the delivery of waste collection services, A cannot avoid B's strategic claims by threatening to contract with Locality C that offers few of the same economies. Of course, the same bilateral monopoly suggests that B will be unable to displace A, and thus might be less willing to jeopardize a bargain by acting strategically. Thus, if A and B have the same preference for achieving a bargain, the bilateral monopoly will not necessarily affect completion of the deal. The existence of the bilateral monopoly, however, strengthens the hand of the player who is less desirous of the deal (or who, at least, can portray itself as less desirous).

Firms also have an easier time than localities do in overcoming bargaining obstacles, because the relevant parties tend to have similar or complementary objectives. If both parties are attempting to maximize profits, as is typically the case with firms, prospective monetizable gains from joint action can be compared to determine whether each side is receiving its "fair share" of the surplus. This same result, however, cannot be expected where the parties do not have complementary objectives or objectives that cannot be reduced to a single metric. Assume, for instance, that two parties, A and B, bargain to

divide a package that contains a fishing rod and an opera ticket. If the two assets are of relatively equal monetary value, division should not be difficult, as either party could transform what he or she received into the other asset through market transactions. Alternatively, even if the assets diverge in market value, division still may be easy if A likes to fish but dislikes opera, and B likes opera but dislikes fishing. In this situation, subjective values may compensate for transaction costs that each party would have to incur to transform the asset he or she could not use personally into something more desirable. As a result, we would expect A to take the fishing rod and B to take the opera ticket. A more significant problem arises if both A and B have some desire both to fish and to attend the opera and the goods have dissimilar market values. Now each may be reluctant to surrender his or her ability to undertake one of the activities in order to have a greater ability to undertake the other.

In a sense, this is the position in which bargaining localities are likely to find themselves. Localities typically have multiple objectives, rather than simply the efficient delivery of services, and local officials often have conflicting, not complementary, objectives. Even when localities involved in the provision of public goods compensate for market failures, they may have legitimate objectives that deviate from efficiency. They may wish to ensure that services are provided equally to all citizens, that pricing permits universal access to the good being provided, or that some intralocal redistribution occurs.⁹³ These deviations from efficiency norms are sometimes proposed as reasons to believe that privatization of governmental activities would generate more efficient performance.⁹⁴ In the current context, however, they play a different role. The various objectives of localities may make fair division of the bargaining surplus more opaque, as parties cannot readily determine what contractual arrangement would advance its own nonmonetizable interests or those of other parties. The result, again, is a greater tendency for strategic behavior with the concomitant disincentive to enter any contractual arrangement. Thus, it should not be surprising to discover that interlocal service agreements tend to occur among localities that are already relatively homogeneous.⁹⁵ But that fact simply may reflect that localities with similar

⁹³ See generally Robert L. Lineberry, *Equality and Urban Policy* (1977) (discussing distribution of public services); Shoup, *supra* note 44 (same).

⁹⁴ See, e.g., Ronald A. Cass, *Privatization: Politics, Law and Theory*, 71 *Marq. L. Rev.* 449, 451, 483 (1988) (presenting view that privatization is cure for government inefficiency).

⁹⁵ Thomas R. Dye et al., *Differentiation and Cooperation in a Metropolitan Area*, 7 *Midwest J. Pol. Sci.* 145, 154-55 (1963) (finding more cooperative arrangements in undiffer-

objectives have an easier time achieving bargains, rather than invidious discrimination towards the residents of less similar localities. Indeed, interlocal service agreements among dissimilar localities appear most frequently where the project is relatively minor, such as joint use of police monitors, so that different approaches to the project are unlikely to affect any of the contracting localities adversely.⁹⁶

2. *Informational Asymmetries in Interlocal Contract*

Even if issues of organizational form could be resolved, municipalities additionally face unique contracting costs related to information asymmetries. Obstacles to fair division typically involve the possibility that parties with private information will misrepresent their valuation of the contract in order to obtain a larger share of the bargaining surplus.⁹⁷ Thus, one who receives a proposal for a purported fair division is likely to assume that the proposer has private information that will allow it to obtain excessive gains from the proposed distribution. Therefore, the recipient of the proposal is likely to invest in creating and justifying its own proposal and in determining the true benefits that the contract will confer on the proposer. These costs increase, perhaps exponentially, with the number of bargainers. Firms can minimize these costs by selecting two-party ventures. Thus, it is common for buyers and sellers who seek economies of scale to enter a series of bilateral agreements rather than a global arrangement affecting multiple parties. There may be a variety of reasons, including concerns about antitrust violations and a desire to diversify a portfolio of contracts, that explain why firms would enter a series of two-party agreements, rather than a multiparty arrangement. But one effect (and perhaps a cause) is that pairwise bargaining is likely to involve lower contracting costs in the form of informational disparities and monitoring than a multiparty arrangement. It may be for this reason that even when multilateral agreements might be useful (because, for instance, the conduct of one party may affect other parties), the ten-

entiated semirural sectors of metropolitan areas than in highly differentiated urban sectors, and more cooperation among economically and socially similar urban communities than among dissimilar urban communities).

⁹⁶ See *id.* at 154. For a more nefarious interpretation of these results, see Cashin, *supra* note 7, at 2019-20 (characterizing effect of fragmented local control as “a highly parochial perspective among citizens”).

⁹⁷ Louis Kaplow & Steven Shavell, *Do Liability Rules Facilitate Bargaining? A Reply to Ayres and Talley*, 105 *Yale L.J.* 221, 223 (1995). For a discussion of how information asymmetries cause bargaining failures generally, see Lucian Arye Bebchuk, *Litigation and Settlement Under Imperfect Information*, 15 *Rand J. Econ.* 404 (1984) (using economic modeling to demonstrate effects of size of amount at stake, magnitude of parties’ litigation costs, and nature of parties’ information on likelihood of settlement).

gency of firms is to appoint a single decisionmaker to negotiate multiple bilateral contracts. Thus, construction projects are likely to involve a general contractor who contracts serially with numerous subcontractors rather than a global contract among all contractors. Moreover, firms that seek to achieve economies of scale can often increase their size internally until they reach a point that, when matched with one other firm, achieves the optimal size to realize economies of scale. The recent spate of law firm mergers, for instance, suggests that firms may believe that efficiencies are realized when there are in excess of 500 lawyers in a firm.⁹⁸ These mergers, however, tend to take place between two firms rather than three or more firms with lawyers totaling the desired number.

The nature of many governmentally supplied goods that are susceptible to economies of scale, on the other hand, makes pairwise arrangements less useful. Joint action among localities makes sense because the service at issue can be provided optimally within a certain geographical range that may contain numerous localities. It makes sense for affected localities to contract only if the entire geographical range is included. For instance, it would not be fruitful to create a multijurisdictional waste disposal facility to curtail regional pollution but omit one of the polluting jurisdictions. Similarly, the efficiency of a rapid transit system constructed to serve regional transportation needs would be dramatically reduced if it failed to serve one of the region's commuter localities. The fortuity of local boundaries, however, means that ideal service boundaries are unlikely to correspond to only two localities. Thus, productive joint action can occur only if it involves multiple parties. Paradoxically, the increase in transaction costs that flows from the need to conclude a multilateral agreement can frustrate the likelihood of the venture's success.

B. Legal Doctrine: Nondelegation in Local Government Law

Consider next how legal doctrines that apply uniquely to local governments may further frustrate efforts to divide the contract surplus and thus limit the capacity to enter into interlocal agreements. Many commentators who critique local government law doctrine for being overly restrictive concentrate on the issue of municipal authority. Gerald Frug attributes "city powerlessness" to allegedly nefarious legal doctrines that place the exercise of municipal authority at the

⁹⁸ See, e.g., Wendy Davis, *Whitman Breed, Winston Strawn Agree to Merge*, N.Y. L.J., Aug. 1, 2000, at 1 (quoting attorney at merging firm as saying that his former firm "did not have the critical mass" to meet clients' needs); Brenda Sandburg, *Pillsbury, N.Y. Firm to Merge*, *The Recorder*, July 18, 2000, at 1 (describing mergers).

mercy of state legislatures.⁹⁹ For Frug, the doctrine that imposes the greatest legal constraint on interlocal agreements is Dillon's Rule,¹⁰⁰ which precludes local governments from engaging in activities for which they have not received explicit authority from the state legislature.¹⁰¹ Thus, the doctrine is thought to keep local governments from entering bargains without first attaining the explicit permission of state legislatures.

At least with respect to interlocal agreements, this critique of existing doctrine is simply misplaced. One reason is that Dillon's Rule has been supplanted by home rule grants in most states.¹⁰² Frug correctly notes that the scope of home rule is typically limited to matters of municipal concern or those that are "purely local," so that state courts must decide the scope of the grant. He is also correct that, in theory, courts might not use the home rule grant to carve out an area of local autonomy.¹⁰³ After all, any agreement that involves more than one locality is unlikely to concern only parochial municipal matters. But the case law suggests that courts have upheld systematically those interlocal agreements that have been challenged as violations of home rule provisions.¹⁰⁴

⁹⁹ Frug, *supra* note 1, at 24; see also Rusk, *supra* note 1, at 20-22 (discussing varying extents to which state laws grant municipalities power to expand).

¹⁰⁰ Frug, *supra* note 1, at 45-48.

¹⁰¹ Dillon's Rule provides that a municipal corporation possesses only those powers that have been granted to it by the legislature in express words, those powers necessarily or fairly implied in or incident to the powers expressly granted, and those powers essential to the accomplishment of the purposes of the corporation. 1 John F. Dillon, *Commentaries on the Law of Municipal Corporations* 448-50 (5th ed. 1911). Further, the powers that municipalities receive are subject to a rule of narrow construction, with any doubt being resolved against exercise of the power. This is in contrast to the rule of construction for private corporations, which are also creations of the legislature. See Gillette & Baker, *supra* note 55, at 283 (comparing rules of construction for private and municipal corporations).

¹⁰² For example, Indiana's home rule statute explicitly abrogates the limitations on the powers of municipal corporations defined in Dillon's Rule. See Ind. Code Ann. § 36-1-3-4 (West 1997).

¹⁰³ See Frug, *supra* note 1, at 51.

¹⁰⁴ See, e.g., *DeFazio v. Wash. Pub. Power Supply Sys.*, 679 P.2d 1316, 1319-21 (Or. 1984) (upholding validity of interlocal agreements to construct and operate power plants). It is also necessary to distinguish two kinds of cases in which localities are denied home rule authority. In one type of case, a court finds that a locality is not authorized to exercise a particular power. In another type of case, a court finds that a locality is authorized to exercise a power, but that exercise has been negated by a conflicting state or federal law. The latter does not demonstrate a failure to recognize an area in which cities can act independently, but only that, even in such areas, localities may act in a manner that adversely affects others to such a degree that a more centralized decisionmaker should be able to intervene. If a home rule locality, for instance, were to enact an ordinance prohibiting Jews from running for office, one would not say that the ordinance was invalid because the locality did not have the home rule authority to enact it; nothing could be clearer than that home rule jurisdictions may set standards for elective office. The ordinance instead would

More to the point, even where Dillon's Rule is applied, its practical effect on interlocal agreements has been eviscerated by the enactment of explicit grants for interlocal cooperation. Forty-two states have adopted broad legislative authorization for municipal corporations to enter interlocal contracts.¹⁰⁵ Authorization frequently takes the form of an expansive "joint powers act" that permits any locality within the state to cooperate with any other locality in the state to perform jointly any act that each could have performed separately.¹⁰⁶ Hence, a locality that could construct a power plant to generate electrical energy for its residents may agree with other localities to construct a jointly owned and operated plant that may be more economically feasible than multiple stand-alone structures. Liberal interpretation of these acts has permitted broad use of interlocal agreements, at least where their effect is to realize efficiencies from joint production.¹⁰⁷ Joint powers acts have been the basis for interlocal waste disposal plants, electrical energy generation plants, libraries, and designations of purchasing agents.¹⁰⁸ Some services that do not require significant capital investment are also provided through joint service agreements. These include police and fire communication systems, ambulance services, libraries, sewage disposal, and jails.¹⁰⁹

Consider in this context *Goreham v. Des Moines Metropolitan Area Solid Waste Agency*.¹¹⁰ This case involved an arrangement

be invalid because it would be inconsistent with protections afforded by a more central level of government. This distinction is discussed at much greater length in Terrance Sandalow, *The Limits of Municipal Power Under Home Rule: A Role for the Courts*, 48 *Minn. L. Rev.* 643, 661-68 (1964).

¹⁰⁵ Advisory Comm'n on Intergovernmental Relations, *State Laws Governing Local Government Structure and Administration* 26-27 (1993).

¹⁰⁶ See, e.g., Ark. Code Ann. §§ 25-20-101 to -104 (Michie 1996) (providing that any powers exercised by public agency of state may be exercised jointly with another public agency of state or of another state with same powers); Ind. Code § 36-1-7-2 (1981) (providing specifically that "[a] power that may be exercised by an Indiana political subdivision and by one . . . or more other governmental entities may be exercised: (1) by one . . . or more entities on behalf of others; or (2) jointly by the entities"); Kan. Stat. Ann. §§ 12-2901 to -2904 (1991) (providing that any powers exercised by public agency of state may be exercised jointly with another public agency of state or of another state with same powers); Ky. Rev. Stat. Ann. § 8.050 (Michie 1996) (providing that Interstate Cooperation Commission shall facilitate enactment of statutes and agreements giving departments and agencies authority to enter into intergovernmental agreements, contracts, and compacts).

¹⁰⁷ See Advisory Comm'n on Intergovernmental Relations, *Intergovernmental Service Arrangements for Delivering Local Public Services* 48 (1985) (citing economies of scale as main reason that cities engage in intergovernmental service agreements). For an example of a broad construction of a joint powers act, see *Rider v. City of San Diego*, 59 Cal. Rptr. 2d 659, 664 (Ct. App. 1996), *aff'd*, 959 P.2d 347 (Cal. 1998).

¹⁰⁸ See David W. Tees et al., *The Interlocal Contract in Texas* 11 (1990) (describing how Houston-Galveston Area Council serves as purchasing agent for cities and counties).

¹⁰⁹ See Advisory Comm'n on Intergovernmental Relations, *supra* note 107, at 30, 32.

¹¹⁰ 179 N.W.2d 449 (Iowa 1970).

among the fourteen governmental units in the Des Moines metropolitan area to form a joint agency for the collection and disposition of solid waste.¹¹¹ The issue addressed by the court involved whether the legislature could delegate to municipalities the authority to form the Agency, a "quasi municipality" of the state.¹¹² The court followed legal principles familiar from administrative law to conclude that the legislature could permit political subdivisions to perform legislative tasks as long as the scope of the delegation was constrained by sufficiently specific guidelines.¹¹³ Since the localities could perform jointly only those tasks that each one had previously been statutorily authorized to perform independently, the court concluded that those authorizing statutes constituted reasonable guidelines that restricted the Agency's activities. Hence, the legislature had not delegated any illegitimate authority to the Agency.¹¹⁴

Such reasoning may be sufficient to authorize localities to do jointly what they could do individually. But the court's discussion eluded a more difficult issue concerning the relationship among the municipalities that composed the Agency. The Agency was to be governed by a board "composed of one representative from the governing body of each member of the Agency, each having one vote for every 50,000 residents or fraction thereof population in his area of representation."¹¹⁵ Presumably, decisions were to be made on the basis of majority rule. Initially, the allocation of decisionmaking authority based on proportion of population may be thought appropriate under the same principles that inform "one-person-one-vote" requirements in elections for officials. This voting arrangement is subject to at least two imperfections, however, one of which is generic to any voting scheme, the other of which evolves specifically and uniquely from local government law doctrine. The first imperfection involves the likelihood of strategic voting. Any interlocal enterprise—a transportation system, an electrical generating plant, a waste disposal plant, or the like—must assign decisionmaking authority for the diverse participants in the project. The design of any decisionmaking institution, however, is affected by the incentives each participating voter has to pursue strategies that create personal benefits, the costs of which can be imposed on or shared with other participants.¹¹⁶ Those incentives

¹¹¹ *Id.* at 452-53.

¹¹² *Id.* at 453.

¹¹³ *Id.* at 454-55.

¹¹⁴ *Id.* at 456.

¹¹⁵ *Id.* at 453.

¹¹⁶ See *City of South El Monte v. S. Cal. Joint Powers Ins. Auth.*, 45 Cal. Rptr. 2d 729, 735 (Ct. App. 1995) (holding that adoption and enforcement of municipal ordinance was

lead to the need for interlocal agreement in the first instance. A population-based voting scheme of the type adopted in *Goreham* inherently privileges a particular form of strategic behavior. Imagine, for instance, that a central city involved in a joint enterprise, such as the one in *Goreham*, has a population exceeding the total population of the other municipal participants. Assigning votes on a per capita basis and making decisions by simple majority rule essentially allows the central city to veto the preferences of the other localities. What initially appears to be a system of representative decisionmaking turns out to permit one large locality to dominate all others and thus dilutes the confidence of potential participants that the bargaining surplus from any agreement will be divided fairly.

Of course, alternatives are possible to prevent such dominance. Each alternative, however, invites a different form of strategic behavior. For instance, moving from a majority to a supermajority system might dilute the power of an otherwise dominant locality. But it also increases the incentives of minority participants to hold out for greater shares of the surplus, frustrating the possibility of agreement. While strategic voting is hardly unique to interlocal arrangements,¹¹⁷ the fact that localities, unlike private parties, cannot easily avoid these difficulties by merging or using alternative forms of organization means that socially useful formal interlocal relationships are less likely to be implemented.

The problem becomes more significant once we relax the assumption that municipal officials are attempting solely to satisfy the preferences of their constituents and assume instead that officials pursue some personal objectives, such as maximizing their budgets or the scope of their authority. From their perspective, the joint exercise of power is likely to reduce personal authority, even if it allows them to deliver services to constituents more efficiently. Decisions that local officials previously made autonomously are now subject to the decisionmaking structure created by the interlocal agreement and over which individual officials have less control.¹¹⁸ Local officials may be concerned that individual decisions in which the interests of constituents are subordinated to the region as a whole will be more salient

not within scope of insurance coverage determined by joint powers agreement and pooled funds of member cities).

¹¹⁷ See William H. Riker, *Liberalism Against Populism* 140-43 (1982) (describing universality of strategic voting).

¹¹⁸ See Mattli, *supra* note 87, at 13 (“[E]conomically successful leaders may not see the need to pursue deeper integration because their expected marginal benefit from further integration in terms of retaining political power is minimal and thus not worth the cost of integration.”).

than small per capita reductions in constituents' costs of services that can be realized through coordination, notwithstanding that aggregate savings make coordination worthwhile.

Strategic voting is endemic in governance structures; there is nothing about it that is unique to local government law. Legal doctrine becomes relevant, however, in limiting how localities can address the ubiquitous problem. Strategic behavior would dissipate if local participants in a joint action agency simply could designate one of their number or an outside party to make decisions or to negotiate with regional interest in mind. Think, for instance, of negotiations by unions with a firm, or by the NCAA or professional sports leagues with broadcasters or sponsors of sports events. This procedure would provide an equivalent to mergers in the private sector, while retaining the independence of individual localities.

Herein lies the second imperfection in the voting scheme described in *Goreham*. It omits the possibility of delegation to a single decisionmaker that could internalize the interests of all parties. That delegation, however, likely would run afoul of local government law doctrine. To make this point, I will digress into a discussion of the doctrine and suggest why it should be retained, notwithstanding the obstacles it creates for interlocal contract. A reader willing to accept these propositions without further demonstration may fruitfully skip this digression and proceed directly to Part III.

Assume that the other participants in *Goreham* believed that Des Moines, as the largest producer of waste, served as an adequate surrogate for their interests, and thus entrusted Des Moines' representatives to make all decisions.¹¹⁹ Of course, the appointment of any agent entails the likelihood of some divergence from the principal's interests. For instance, Des Moines occasionally might make decisions contrary to the interests of smaller members. But that risk might be worth taking if it were less than the risk of strategic behavior in a multimember decisionmaking institution.

The appointment of agents, however, runs head on into local government doctrine. Local government law retains a significant nondelegation doctrine that limits decisionmaking authority to locally elected officials. The doctrine is sometimes bound up in the general proposition that a locality cannot bargain away its police powers.¹²⁰

¹¹⁹ Indeed, one of the themes of Mattli's work on integration among nations is that a strong regional leader can solve coordination problems and thus is necessary to successful integration. See Mattli, *supra* note 87, at 56.

¹²⁰ See *County Mobilehome Positive Action Comm. v. County of San Diego*, 73 Cal. Rptr. 2d 409, 410 (Ct. App. 1998) (holding that county ordinance invalidly abnegated right of culture county boards to regulate rents); *Landau v. City of Leawood*, 519 P.2d 676, 680

Perhaps the most expansive applications of the nondelegation doctrine have occurred in recent efforts to achieve economies through interlocal agreements. Consider, for instance, the arrangements in *Vermont Department of Public Service v. Massachusetts Municipal Wholesale Electric Co.* (MMWEC).¹²¹ In that case, the court invalidated contracts between a joint action agency composed of municipalities and a group of "participants" consisting of four Vermont municipalities and two electric cooperatives.¹²² The contracts constituted agreements for the sale of "electric capacity and energy, if any," that was to be generated by a nuclear power plant in which MMWEC (but not the participants) had an ownership interest.¹²³ Payments by the participants were linked to expenses incurred by MMWEC in construction and operation of the plant.¹²⁴ The participants, however, played no role in MMWEC's decisions that affected those costs.¹²⁵ The court concluded that the arrangement violated the nondelegation doctrine by committing to MMWEC the participants' authority over their spending power.¹²⁶ The court noted that the participants retained neither any "vestige of control" over decisions to incur debt nor any "voice whatsoever in the management of the project."¹²⁷ In addition, the court found that, by agreeing to restrict its ability to issue debt secured by the same revenues that secured obligations to MMWEC, the participants had "fettered the future exercise" of borrowing powers legislatively granted to them alone.¹²⁸

The *MMWEC* decision is representative of failed efforts by municipalities to delegate control over decisionmaking processes. The default of the Washington Public Power Supply System (at the time, the largest ever default on a municipal debt) was precipitated by a Washington Supreme Court decision that concluded that participants in an arrangement similar to that in *MMWEC* had delegated too

(Kan. 1974) ("A city cannot contract away its statutory duties and responsibilities, particularly where they touch upon the police power."); Griffith, *supra* note 9, at 294-99 (tracing Supreme Court's expansion of inalienable power doctrines to encompass state's police power).

¹²¹ 558 A.2d 215 (Vt. 1988).

¹²² *Id.* at 216.

¹²³ *Id.* at 217. The "if any" phrase, while grammatically awkward, is key to understanding the case. The effect of the phrase was to impose on the participants an obligation to make payments even if the power plant proved incapable of producing electricity. Thus, the participants claimed that they did not have the authority to enter into a contract that gave them a chance of receiving electricity, even if they had the authority to enter into a contract to buy electricity.

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.* at 219-20.

¹²⁷ *Id.* at 221.

¹²⁸ *Id.* at 222.

much control to a joint power agency over decisions affecting the financial welfare of Washington municipalities.¹²⁹ Nor is delegation prohibited only when the delegate is in a different state and thus might be thought to have interests that overlap only minimally with those of the delegator.¹³⁰ To the contrary, the doctrine has been used to invalidate delegations of municipal authority to a state official,¹³¹ to the federal government,¹³² and to local efforts at privatization of services ranging from the operation of municipal hospitals¹³³ to the installation of sidewalks.¹³⁴

Not all courts have found the creation of joint action agencies, with the inevitable element of delegation, to be invalid. Some courts have approved arrangements in which all participants are represented or have ownership interests, as in *Goreham*, even if they do not (and cannot) each have the level of "control" that the Vermont court appeared to require.¹³⁵ Nevertheless, the nondelegation decisions re-

¹²⁹ *Chem. Bank v. Wash. Pub. Power Supply Sys.*, 666 P.2d 329, 343 (Wash. 1983); cf. *Roehl v. Pub. Util. Dist. No. 1*, 261 P.2d 92, 105 (Wash. 1953) (recognizing unlawfulness of delegation of legislative or discretionary functions by municipal corporations to others).

¹³⁰ See *Chem. Bank*, 666 P.2d at 343 (invalidating delegation by Washington municipalities to Washington public authorities); see also *Landau v. City of Leawood*, 519 P.2d 676 (Kan. 1974) (holding that city cannot contract away statutory duties, especially when those duties are related to police power); *State ex rel. Hawks v. City of Topeka*, 270 P.2d 270, 279-80 (Kan. 1954) (holding that Topeka overstepped delegation of authority by implying power not expressly granted by Kansas law). But see *Kansas City v. City of Raytown*, 421 S.W.2d 504, 513 (Mo. 1967) (upholding delegations between parties of same state); *Vill. of Dennison v. Martin*, 210 N.E.2d 912, 920 (Ohio 1964) (same).

¹³¹ See, e.g., *Thompson v. Smith*, 129 A.2d 638, 646-47 (Vt. 1957) (invalidating provision of zoning ordinance conditioning said ordinance upon attorney general's approval).

¹³² See, e.g., *Ark.-Mo. Power Co. v. City of Kennett*, 78 F.2d 911, 922-23 (8th Cir. 1935) (invalidating contract entered into by city with federal Public Works Administration).

¹³³ See, e.g., *Council of N.Y. v. Giuliani*, 710 N.E.2d 255, 260-61 (N.Y. 1999) (holding that proposed privatization of hospitals was not authorized by statute).

¹³⁴ See, e.g., *Syrtel Bldg., Inc. v. City of Syracuse*, 358 N.Y.S.2d 627, 630 (Sup. Ct. 1974) (holding that mayor lacked power to contract with regard to sidewalks absent more specific authorization by common council).

¹³⁵ See, e.g., *Municipality of Metro. Seattle v. City of Seattle*, 357 P.2d 863, 868-69 (Wash. 1960) (holding that representative form of metropolitan municipal corporation in which all fifteen appointed board members are directly responsible to their constituents is constitutional); *Frank v. City of Cody*, 572 P.2d 1106, 1110-11 (Wyo. 1977) (upholding validity of joint agency in which all members have equal voice regardless of size of represented interests). Many of the decisions that uphold these arrangements were brought as collusive actions to obtain a decision by the highest court of the state authorizing the arrangements prior to the issuance of bonds, proceeds of which were to finance the facility to be owned and operated by the joint owners. See, e.g., *Bd. of Comm'rs v. All Taxpayers, Prop. Owners & Citizens*, 360 So. 2d 863 (La. 1978); *State ex rel. Mitchell v. City of Sikeston*, 555 S.W.2d 281 (Mo. 1977); *Johnson v. Piedmont Mun. Power Agency*, 287 S.E.2d 476 (S.C. 1982). The nonadversarial nature of the resulting case might be thought to limit the precedential effect of the opinions.

On the other hand, some might complain that those actions in which the nondelegation doctrine has been employed to invalidate interlocal arrangements tend to involve

strict the ability of localities to place decisionmaking authority in the hands of a discrete group that can reduce contracting costs—the very mechanism that permits firms to overcome obstacles that otherwise would frustrate contracts for mutually beneficial projects.

This effect, however, does not necessarily justify elimination of the nondelegation doctrine. The intuition that underlies the doctrine, that is, that the delegate will ignore the interests of the delegator's constituents, does require some redress. A flat prohibition on delegation may be unnecessary where the delegator retains some control over the delegate. Where, for instance, delegation agreements are renewable or subject to termination, the delegate might be expected to consider the delegator's interests in order to ensure continuation of the contract. MMWEC, for instance, arguably would not want to make decisions that would raise the costs to nonvoting participants to a point where they would be better off obtaining electricity elsewhere.¹³⁶

The claim that potential competition will make delegates accountable, however, may prove less convincing in the case of the very interlocal contracts where the nondelegation doctrine is most frequently invoked. As in *MMWEC*, interlocal agreements typically return economies to participants because the service that is jointly provided requires significant capital outlays, such as in the case of an electrical generation plant.¹³⁷ Capital for these projects is generally obtained through the sale of debt securities that have maturities in excess of twenty years. In order to make the bonds saleable, the interlocal agreements that support these transactions bind participants to obtain the service from the interlocal entity for the period that the

projects that generate unexpected costs, so that courts were really trying to shift losses from residents who would have to pay the costs of projects from which they would receive no benefits to bondholders who would bear the loss if the underlying contracts, from which they expected repayment, were void. Both *Chemical Bank* and *MMWEC* did involve nuclear power plants of questionable efficiency. *Vt. Dep't of Pub. Serv. v. Mass. Mun. Wholesale Elec. Co. (MMWEC)*, 558 A.2d 215, 216-17 (Vt. 1988); *Chem. Bank v. Wash. Pub. Power Supply Sys.*, 666 P.2d 329, 331 (Wash. 1983). On the other hand, the nondelegation doctrine has been used also to invalidate other projects. See *Smith v. Spring Garden Township*, 34 Pa. D. & C.2d 54 (1964).

¹³⁶ Similarly, when localities privatize services that previously have been provided by government employees, we do not necessarily conclude that an unlawful delegation has occurred, since the private provider has significant market incentives to act in a manner consistent with the interest of the delegator. See *Richardson v. McKnight*, 521 U.S. 399, 409 (1997) (noting that private prison operators face competitive market pressures to keep costs down and do their job safely and effectively).

¹³⁷ See *MMWEC*, 558 A.2d at 220 (finding that contract reduced need for participants to make capital investment); see also, e.g., *Thurston v. S. Cal. Pub. Power Auth.*, 204 Cal. Rptr. 546, 548 (Ct. App. 1984) (noting that joint powers agency issued bonds and notes for acquisition of agency's interest in plant and accompanying capital costs).

bonds are outstanding. As a result, the threat that strategic behavior by the delegate would cause the delegator to exit the relationship is less significant than it would be if the participants did not have long-term obligations. To the extent that the exit option is eliminated, the threat of supplier opportunism increases and control over the delegate is reduced.

Even if exit is not an option, one might believe that local officials (subject to electoral redress) would not contract away control if the risk of delegate opportunism were greater than the expected savings from joint action. Again, agency costs, and monitoring costs in particular, provide a potential response. Local officials might desire to obtain the immediate benefits of joint action, discounting the potential costs of delegation by the probability that they (the officials) no longer will occupy municipal office when those costs materialize or that those costs will be sufficiently opaque that they cannot readily be attributed to delegation. If, for instance, a delegate who makes decisions for all participants in an electrical generating project imposes an increase in utility rates on all consumers who reside in participating localities, delegating officials might be confident that (1) the increase is too trivial for most consumers to notice, (2) consumers who do notice will not be able to determine the reasons for the increase, or (3) consumers who do attribute the increase to a decision by the delegate will not be able to demonstrate that the same increase would not have been required had the locality been acting on its own. In any event, local officials will not fear electoral redress for their failure to monitor delegates. Thus, in the absence of a nondelegation doctrine, local officials might overdelegate.

But that argument seems counterintuitive. As I have suggested above, officials whose interests deviate from those of their constituents are likely to favor too little delegation, not too much.¹³⁸ Those officials are typically thought to be maximizing budgets or personal power.¹³⁹ Each of these requires the officials to control a significant bureaucratic structure, regardless of the consequences for constituents. Thus, rent-seeking officials should underinvest in joint efforts to provide services efficiently. Officials and bureaucrats who seek higher office should want to demonstrate competence as the head of an organization, not as an equal partner. And officials who seek to maximize budgets should look askance at projects that provide scale

¹³⁸ See *supra* text accompanying notes 117-20.

¹³⁹ See Niskanen, *supra* note 42, at 36-42 (describing budget maximization by bureaucrats); Ronald A. Cass & Clayton P. Gillette, *The Government Contractor Defense: Contractual Allocation of Public Risk*, 77 *Va. L. Rev.* 257, 321-27 (1991) (describing budget maximization and program advancement objectives of public officials).

economies, especially if those economies can only be realized by granting authority over budgets to a separate entity. Of course, some objectives cut the other way. Officials who want to maximize leisure might prefer to delegate responsibility to others. But, at most, that suggests that officials' motivations concerning delegation are too mixed to rely on them to support a general principle against delegation.

A potential anomaly in the *MMWEC* decision provides a more compelling justification for the nondelegation doctrine. The Vermont court implied that, notwithstanding the doctrine's apparent constitutional origins, the state legislature could explicitly enable Vermont localities to delegate decisionmaking authority to *MMWEC*.¹⁴⁰ Notwithstanding the curious suggestion that the legislature could cure a constitutional defect,¹⁴¹ legislative approval of delegation may be a proper curative if nondelegation is intended to impede intensely interested groups from receiving authority to perform local functions. The possibility that one locality or group of localities (the delegates) would attempt to extract decisionmaking authority from other localities (the delegators) and use that control to the detriment of the latter is precisely the risk that arises in the case of interlocal contracts. There may be times, however, when delegation is entirely appropriate and would facilitate desirable interlocal contracts that might not otherwise be implemented. The issue is whether there is a relatively easy way to separate "good" delegations from "bad" ones.

A nondelegation doctrine that can be waived only at the state legislature level might perform that function by placing a check on local officials who otherwise would overdelegate. The costs of capturing two legislatures might deter interest groups from undertaking the task at all. Moreover, capturing the state legislature may increase costs more than arithmetically. That body is likely to represent more diverse interests simply as a consequence of its size and the more heterogeneous population it represents. As a consequence, more interest groups are likely to be represented within the state legislature, frustrating efforts by any particular group to achieve its agenda.

The costs of capture also increase with the number of representatives within the state legislature and with the procedural hurdles that must be overcome. These include not only the existence of bicameral legislatures at the state level, but also more robust committee systems that can demand additional rents to forward proposed legislation to

¹⁴⁰ *MMWEC*, 558 A.2d at 218.

¹⁴¹ Of course, one might read the constitutional doctrine as only prohibiting delegation without legislative approval.

the entire body. To the extent that legislative grants of authority to delegate apply to specific localities, they might be seen as prime opportunities for legislative rent seeking.

The greater costs of capturing centralized legislatures, however, do not necessarily mean that the state is less likely to authorize "bad" delegations. While fewer interest groups may survive the state legislative process, the costs involved in that process predict that survivors are less likely to face opposition from a countervailing group. For instance, while both landlords and tenants may be able to organize at the local level, landlords alone may have the financial stake and wherewithal to incur organizational costs at a more centralized level. Thus, it may be that the decision made at the central level favors a different interest group than the one that would be favored at the local level. This shift does not translate into decisions that are more likely to reflect "good" results.

The nondelegation doctrine as applied in *MMWEC*, however, seems to reduce the risk of interest group capture. Under the court's rationale, delegates must obtain permission from both the local legislature (which must agree to delegate a function) and the state legislature (which must approve the delegation).¹⁴² Thus, the allocation of decisionmaking authority does not favor merely the interest group that is better able to coalesce at a particular governmental level. Rather, it permits delegation only where the delegate is able to convince legislatures at two levels of the benefits it can confer by serving as the delegator's agent. Since these legislatures will represent different constituencies and be vulnerable to different and perhaps competing interests, it is plausible that the necessary joint approval is a fairly good indicator that delegation is not simply a result of interest group politics.

The problem is that the increased costs of obtaining legislative grants of delegating authority can deter socially desirable, as well as undesirable, delegation. And the ability of an antidelegation interest group to frustrate a desirable delegation is enhanced, since that group need convince only one of the two legislatures not to approve the delegation. Obviously desirable delegation may be less costly to obtain, simply because more legislators may be willing to sponsor it, so that lower rents should be charged for support. Nevertheless, a dual-approval rule necessarily increases costs to some degree. Thus, we might believe that there is an empirical issue to be resolved about whether most proposed delegation is benign or malign. If most proposed delegation is benign, then it might be thought wasteful to require approval

¹⁴² *MMWEC*, 558 A.2d at 220-22.

by two legislative bodies (one of which is itself bicameral). But the very requirement of dual approval may affect the mix of benign and malign proposals. Proposals for delegation typically involve services for which separate fees can be charged to constituents. That is the nature of financing for such services as waste disposal, electrical energy generation, and water service. Thus, it is conceivable that proponents of activities that are approved will have an opportunity to recover the costs related to obtaining those approvals. On the other hand, proposals that are not approved will not be implemented, so there will be no opportunity to recover related costs. As a result, there should be a presumption that proposals subject to a dual approval requirement will be socially beneficial, as it is less likely that proponents of proposals that will not survive scrutiny will be willing to incur the costs of pursuing enactment.¹⁴³

The nondelegation doctrine, then, is not necessarily a wasteful anomaly of local government law. But even if it provides net benefits, it continues to generate costs that frustrate some desirable interlocal contracts. Along with structural impediments to interlocal arrangements, nondelegation is likely to inhibit contracting, even when, contracting costs aside, all parties would benefit from agreement. The issue that remains is whether this difficulty becomes even more severe when the potential agreement is not simply allocational, but redistributive.

III

BURDEN-SHARING CONTRACTS

I have suggested that even contracts that require cooperation for regional allocation functions are likely to be underutilized due to con-

¹⁴³ One might imagine an additional, paternalistic argument against delegation. Initially, one might imagine that services could be provided regionally if different localities provided fewer services, each of which could be shared by each locality within the region. One library may be sufficient to service a region, especially if the providing locality could divert to the library savings it enjoyed because it shared other services with other localities in the same region. In theory, this possibility might engender greater interlocal agreement. But to the extent that this arrangement also constitutes a delegation of local functions to another municipality, the monopolistic nature of these goods means that they are highly vulnerable to "holdup" problems, in which one party can extract supracompetitive prices from others in order to contribute to a joint enterprise that cannot otherwise succeed. The locality that houses the library enjoys an advantage in securing additional funding from others, since the cost of paying more than one's pro rata share of library support is less than the cost of starting one's own library. The holdup threat becomes more trivial, however, as each locality within the region serves as the situs for some fair share of regional public goods. For instance, the locality that houses the library might not house the regional government center or courthouse. Localities strategically may disperse activities if they thereby can exchange "hostages" that reduce the incentive for any of their members to chisel on the interlocal relationship.

tracting costs and legal doctrine. But if agreements for coordination are difficult to conclude, matters become worse when we turn to contracts to resolve regional problems that call for redistributive or burden-sharing solutions. If problems of strategic behavior or legal doctrine can disrupt mutually wealth-enhancing coordination, they should have even greater effect where at least one party must sacrifice for the larger regional welfare and each party has incentives to minimize its share of the sacrifice. Pollution control poses this difficulty, as do zoning regulations that force high-density uses into neighboring areas and subsidies that attract businesses to one locality rather than another.¹⁴⁴

In this Part, I examine whether, notwithstanding incentives against sharing, burden-sharing contracts can be expected where their use would enhance regional welfare. This examination leads to two more tentative discussions. First, if burden-sharing contracts are theoretically plausible, but constrained by contracting costs similar to those that impede contracts for coordination, is it possible to reduce those costs and generate more interlocal contracting? Second, if explicit contracts are theoretically possible, is it appropriate to infer anything about the desirability of interlocal cooperation where parties fail to contract for it? In short, should the absence of cooperation serve as a signal that no gains would be available from cooperative behavior?

A. *Suburban Subsidies of Central Cities*

In recent years, legal discussion about burden sharing among localities has focused on two major areas: exclusionary zoning¹⁴⁵ and school finance.¹⁴⁶ In each of these areas, judicial intervention has pre-

¹⁴⁴ Contractual solutions are less likely where the localities that benefit from their activity impose costs on others that are less than those benefits. In that situation, the losers will be unable to compensate the gainers. Involuntary arrangements under these circumstances would be inefficient. See Alex Anas, *The Costs and Benefits of Fragmented Metropolitan Governance and the New Regionalist Policies*, 2 *Planning & Markets* (1999), <http://www-pam.usc.edu/volume2/v2i1a2print.html>. There may be an independent case for involuntary centralization based on redistributive grounds. But there is a significant argument that redistribution at the local or regional level is likely to be unproductive given the relative ease with which firms and individuals who would bear the burden can exit to less redistributive jurisdictions. See Robert C. Ellickson, *Cities and Homeowners Associations*, 130 *U. Pa. L. Rev.* 1519, 1555-56 (1982) (noting that both rich and poor may move to exploit locational differences in benefits and burdens); Helen F. Ladd & Fred C. Doolittle, *Which Level of Government Should Assist the Poor?*, 35 *Nat'l Tax J.* 323, 329 (1982) (explaining how taxpayer mobility exacerbates disparity of fiscal burdens between states).

¹⁴⁵ See, e.g., J. Peter Byrne, *Are Suburbs Unconstitutional?*, 85 *Geo. L.J.* 2265 (1997) (book review) (discussing exclusionary zoning, race, and burden sharing).

¹⁴⁶ See, e.g., Peter Enrich, *Leaving Equality Behind: New Directions in School Finance Reform*, 48 *Vand. L. Rev.* 101 (1995); Michael Heise, *Schoolhouses, Courthouses, and Statehouses: Educational Finance, Constitutional Structure, and the Separation of Powers*

ceded regional responses. For instance, local “willingness” to contract for a certain amount of affordable housing,¹⁴⁷ or interlocal contract to “buy out” a limitation on expenditures for local schools,¹⁴⁸ has been preceded by judicial invalidation of prior exclusionary practices.¹⁴⁹

More recently, a third area—sprawl—has captured the interest of regionalists.¹⁵⁰ Although the term defies precise definition, sprawl is related to low-density residential and commercial land uses in areas that are increasingly distant from the central city. A review of the sprawl literature suggests that it is concerned not only with density, but also with specific land uses. Activists who proceed under the banner of antisprawl campaigns frequently target “megastores” or national chains that threaten to displace locally owned providers of similar goods and services.¹⁵¹ Whether viewed quantitatively or qualitatively, sprawl is attributed, at least in part, to efforts by individual localities to capture economic benefits of growth while imposing costs on others in the same region.¹⁵²

Doctrine, 33 *Land & Water L. Rev.* 281 (1998); Michael Heise, *State Constitutions, School Finance Litigation, and the “Third Wave”: From Equity to Adequacy*, 68 *Temp. L. Rev.* 1151 (1995); James E. Ryan, *Race, Schools, and Money*, 109 *Yale L.J.* 249 (1999).

¹⁴⁷ See, e.g., Patrick Field et al., *Trading the Poor: Intermunicipal Housing Negotiation in New Jersey*, 2 *Harv. Negot. L. Rev.* 1, 6-10 (1997) (discussing passage of New Jersey legislation creating interlocal market in housing obligations in response to judicial invalidation of previous practices); Mark Alan Hughes & Therese J. McGuire, *A Market for Exclusion: Trading Low-Income Housing Obligations Under Mount Laurel III*, 29 *J. Urb. Econ.* 207, 207-11 (1991) (same).

¹⁴⁸ See *Edgewood Indep. Sch. Dist. v. Meno*, 917 S.W.2d 717, 725-29 (Tex. 1995) (discussing Texas legislation that provides for trading educational obligations interlocally, passed in response to previous judicial invalidations of educational finance statutes).

¹⁴⁹ See *S. Burlington County NAACP v. Township of Mt. Laurel*, 336 A.2d 713, 725-27 (N.J. 1975).

¹⁵⁰ See, e.g., Robert W. Burchell & Naveed A. Shad, *The Evolution of the Sprawl Debate in the United States*, 5 *Hastings W.-Nw. J. Envtl. L. & Pol'y* 137 (1999) (providing overview of alternatives to current forms of metropolitan development that lead to sprawl); Buzbee, *supra* note 4 (examining urban sprawl in light of federalism and institutional analysis framework); Timothy J. Dowling, *Reflections on Urban Sprawl, Smart Growth, and the Fifth Amendment*, 148 *U. Pa. L. Rev.* 873 (2000) (arguing that sprawl is undeniable problem and that efforts to combat it comport with traditional regulation of land use and takings clause).

¹⁵¹ See, e.g., *Sprawl-Busters*, at <http://www.sprawl-busters.com> (last visited Feb. 1, 2001) (containing information on resistance to proposed locations for Wal-Mart, Home Depot, and other national chains); *Sprawl Watch Clearinghouse*, at <http://www.sprawlwatch.org> (last visited Feb. 1, 2001) (providing list of resources aimed at prevention of superstore sprawl); see also Buzbee, *supra* note 4, at 67 (noting that increasing prevalence of malls and superstores has contributed to sprawl); Cashin, *supra* note 7, at 2012-14 (discussing debate over impacts and costs of sprawl).

¹⁵² See, e.g., Anas, *supra* note 144 (discussing reasons for sprawl and addressing role of spillover effects); Buzbee, *supra* note 4, at 94-96 (noting how mismatch between regional development and numerous independent local governments creates lack of incentives for addressing sprawl).

Each of these debates about burden sharing focuses on the relationship between cities and suburbs. Central cities are typically viewed as older, poorer, and more crowded than the suburbs that surround them. As a result, burden-sharing agreements evoke claims that suburbs must subsidize central cities, a condition that commentators view as unlikely to materialize in the presence of parochialism.¹⁵³ These commentators proffer regionalism as a panacea to this combination of local selfishness and intraregional disparity.

Our ability to point to the infrequency with which localities enter burden-sharing arrangements of their own volition, however, simply may demonstrate that we have greater recall of controversy than of more mundane, and hence less salient, cooperation. What is surprising about burden-sharing agreements is the extent to which they have evolved apart from explicit judicial mandate. Here are a few examples:¹⁵⁴

- Virginia permits localities to enter into a “revenue, tax base or economic growth-sharing agreement” that obligates one locality to pay another designated taxes or other revenues received by the first locality.¹⁵⁵ The relevant laws had their origins in amendments to the state’s annexation law and were intended to provide an alternative to annexation battles.¹⁵⁶ Under the law and its predecessors, for instance, the City of Charlottesville and Albemarle County, which surrounds but does not include the City,¹⁵⁷ contribute portions of their respective real property tax revenues to a common revenue

¹⁵³ See, e.g., Cashin, *supra* note 7, at 2015 (arguing that fragmented local political units “entrench a narrow, ill-conceived conception of self-interest that blinds citizens to the real potential benefits of collective alliances across borders”); Ford, *supra* note 72, at 1863 (stating that home rule and municipal secession laws “allow parochial enclaves to define themselves in ways that are, potentially, politically and economically opportunistic”).

¹⁵⁴ I include only voluntary agreements that are legislatively authorized (as they must be), but not legislatively mandated. One of the oldest tax-sharing agreements, the Charles R. Weaver Metropolitan Revenue Distribution Act (also known in the literature as Minnesota’s Fiscal Disparities Act, see Kirk J. Stark, *Rethinking Statewide Taxation of Nonresidential Property for Public Schools*, 102 *Yale L.J.* 805, 816 (1992) (referring to statute as “Minnesota’s Fiscal Disparities Act” and “Metropolitan Fiscal Disparities Act”)), provides for the sharing among 300 taxing jurisdictions in the Minneapolis/St. Paul area of tax revenues generated by economic growth. *Minn. Stat. Ann.* § 473F (West 1994); see also Roger S. Richman & M.H. Wilkinson, *Interlocal Revenue Sharing: Practice and Potential* 7 (n.d.). The plan was implemented, rather than simply authorized, by the state legislature, and was adopted over the opposition of some of the participating communities. John L. Knapp & Philip J. Grossman, *Virginia Issues: Tax Sharing Among Localities* 2 (1980). Thus, it does not represent the type of volitional bargain with which I am concerned.

¹⁵⁵ *Va. Code Ann.* § 15.2-1301, -3300 to -3400 (Michie 1997).

¹⁵⁶ See, e.g., *County of Rockingham v. City of Harrisonburg*, 294 S.E.2d 825 (Va. 1982).

¹⁵⁷ Cities in Virginia are contiguous with counties, rather than included within them, a point that may facilitate interlocal bargains for reasons that I discuss below.

and economic growth sharing fund that is distributed between them on the basis of population and local tax rates.¹⁵⁸

- Municipalities in New Jersey that have a portion of their property in the Hackensack Meadowlands District participate in a revenue-sharing program to compensate them for the fiscal impact of land use decisions made by the Hackensack Meadowlands Development Commission, which oversees development in the District.¹⁵⁹ The Commission coordinates economic development activities within the area. Since these activities may have a disproportionately positive or negative effect on localities within the District, compensation from beneficiaries to those adversely affected can be accomplished through sharing of the economic gains obtained by the former. The impetus for the plan came from the localities themselves rather than from the state.¹⁶⁰
- The City of Louisville and Jefferson County, Kentucky, entered into an interlocal compact in 1986 that required sharing of revenues from an occupational license fee, which is based on the income of businesses in the jurisdictions.¹⁶¹ As in Virginia, the goal of the Compact was to forestall efforts by the city to annex unincorporated land in the county by providing the city with some of the benefits of county economic development while still maintaining independent jurisdictions.¹⁶² Additionally, the Compact was intended to increase the efficiency of governmental services by allowing the jurisdictions to collaborate in the provision of services.¹⁶³
- Studies by Roger Parks and Ronald Oakerson indicate that localities in the Pittsburgh and St. Louis areas have entered into numerous contracts to produce local public goods ranging from street maintenance to education to police and fire services in a pattern that the authors describe as "a routine process that occurs within the context of industry-like structures."¹⁶⁴ At least in some cases,

¹⁵⁸ Annexation and Revenue Sharing Agreement, Feb. 17, 1982 (on file with the *New York University Law Review*).

¹⁵⁹ See N.J. Stat. Ann. § 13:17-60 (West 1991) (creating intermunicipal account to compensate municipalities for lost tax revenue resulting from public land use).

¹⁶⁰ See Richman & Wilkinson, *supra* note 154, at 9-11 (describing Hackensack Meadowlands District revenue sharing program).

¹⁶¹ See Louisville, Ky., Code of Ordinances ch. 40 (1999), <http://www.louky.org/code/ch040.htm>; see also Annalee Duganier, *Interlocal Tax Revenue Sharing Strategy for Kenton County, Kentucky 34-46* (1997) (unpublished M.C.P. thesis, University of Cincinnati) (on file with the University of Cincinnati Library).

¹⁶² See Louisville, Ky., Code of Ordinances, *supra* note 161, § 40.02, <http://www.louky.org/code/ch040-02.htm>.

¹⁶³ See *id.* §§ 40.10-17.

¹⁶⁴ Roger B. Parks & Ronald J. Oakerson, *Comparative Metropolitan Organization: Service Production and Governance Structures in St. Louis (MO) and Allegheny County*

interlocal negotiations have led to suburban commitments to protect the central city's earnings tax base.¹⁶⁵

Interlocal burden-sharing contracts, therefore, may not be as rare as is commonly supposed. In a recent paper, Anita Summers studied twenty-seven large urban areas and determined that each achieved some level of regional cooperation between the central city and its suburbs.¹⁶⁶ Not only did each of these areas (with the exception of Houston) coordinate to share some services, but each area participated in some form of regional tax sharing.¹⁶⁷

Not surprisingly, these examples largely address relationships between central cities and their suburbs. For reasons I explore in greater depth below, one would anticipate a greater level of cooperation among localities that are geographically proximate than among localities that are simply found within the same state. Nevertheless, such arrangements are counterintuitive if one accepts the assumption, implicit in much of the local government law literature, that localities act in an isolated, parametric manner. This literature tells a variety of stories about interlocal relationships, each of which purports to explain why interlocal contracts do not exist in greater numbers.

The first story is the most malign one. It suggests that localities self-interestedly attempt to exploit each other in ways that foreclose volitional burden sharing.¹⁶⁸ The argument of this literature is that suburbanites utilize the police services, fire protection services, and street maintenance services of the central city without making compensatory direct payments. Given that commuting suburbanites also generate benefits for the central city, it is not clear whether this literature necessarily assumes that suburban opportunism reduces social wealth.¹⁶⁹ Some of the literature appears either to ignore the question of net costs or to assume that, even if the social consequences of suburban opportunism are positive, there exist countervailing distributional concerns. In either event, this literature suggests that the sole remedy lies in a reversal of local government doctrine that elevates the independence of localities.

(PA), 23 *Publius* 19, 27 (1993) [hereinafter Parks & Oakerson, *Comparative Metropolitan Organization*]; Roger B. Parks & Ronald J. Oakerson, *Metropolitan Organization and Governance: A Local Public Economy Approach*, 25 *Urb. Aff. Q.* 18, 24 (1989).

¹⁶⁵ Parks & Oakerson, *Comparative Metropolitan Organization*, *supra* note 164, at 36.

¹⁶⁶ Anita A. Summers, *Regionalization Efforts Between Big Cities and Their Suburbs*, in *Urban-Suburban Interdependencies*, *supra* note 2, at 181, 181.

¹⁶⁷ *Id.* at 188-90.

¹⁶⁸ See Cashin, *supra* note 7, at 2015; Roderick M. Hills, Jr., *Dissecting the State: The Use of Federal Law to Free State and Local Officials from State Legislatures' Control*, 97 *Mich. L. Rev.* 1201, 1275-76 (1999).

¹⁶⁹ See Kathryn A. Foster, *Regional Impulses*, 19 *J. Urb. Aff.* 375, 390 (1997).

Much of this story takes its cue from the deliberate efforts of some suburbs to isolate urban problems.¹⁷⁰ Once entrenched, suburbanites used a variety of means to protect their enclaves from invasion. Public transportation stopped at city boundaries. Large-lot zoning imposed restrictions on the mobility of the relatively poor. Annexation of incorporated territory was prohibited, precluding central cities from reattaching suburbs. The self-interest underlying these developments discouraged suburbs from contributing to the welfare of the relatively poor and exacerbated the decline of central cities by removing both residents and employers. Hence, failure to assist the central city contractually is simply an extension of the selfish motivations that generated flight to the suburbs in the first instance.

An alternative story about local isolation involves assumptions of different preferences among potential residents of cities and suburbs. As some have noted, people may migrate to the suburbs for reasons that have less to do with racism or invidious discrimination against the poor than with a desire to pursue visions of the good life that cannot easily be realized within the central city.¹⁷¹ Once established, however, those suburbanites allegedly have no greater link, and hence feel no greater obligation, to the central city than do residents of more distant jurisdictions. Indeed, once entrenched, suburbs may wish to compete with central cities for residents, labor, and tax base.¹⁷² Com-

¹⁷⁰ See Kenneth T. Jackson, *Crabgrass Frontier: The Suburbanization of the United States* 87-102 (1985) (arguing that privileged urbanites in late nineteenth century preferred to relocate on edges of cities rather than remain within cities); Evan McKenzie, *Privatopia: Homeowner Associations and the Rise of Residential Private Government* 56-74 (1994) (describing use of homeowner associations as means to exclude racial and ethnic minorities from suburbs).

¹⁷¹ See *City of Jackson v. City of Ridgeland*, 551 So. 2d 861, 869 (Miss. 1989) (Blass, J., dissenting) (stating:

Many good citizens move to get out of the city. Many have lived outside all of their lives and have no desire to come into a city. They are governed by a county government. They may be satisfied with it or, perhaps, feel that one local government is bad enough, without having to put up with two. Some are ordinary folk, living on fixed incomes, who are unable to pay the additional taxes. They are not selfish persons who have moved just far enough to escape taxes, while remaining close enough to enjoy the cultural benefits afforded by the city. Many probably prefer the murmur of the pines, the hum of insects, the early evening call of the whippoorwills, to the sounds of the symphony or the opera, and choose the light of the moon, the beauty of the stars and the flight of the fireflies to theater and ballet. They prefer, perhaps, rabbits to switch blades, petunias to "pot," and mocking birds to sirens.);

Vicki Been, Comment on Professor Jerry Frug's *The Geography of Community*, 48 *Stan. L. Rev.* 1109, 1110 (1996) (emphasizing aspects of moving to suburbs that do not relate to fear of others, including economic factors); Buzbee, *supra* note 4, at 67 (describing shift in workplace locations).

¹⁷² See Richard Briffault, *Localism and Regionalism*, 48 *Buff. L. Rev.* 1, 27 (2000) (arguing that localities may be less concerned with "efficiency, democracy, or community" than

petitive jurisdictions might eschew subsidies that distort decisions made by potential residents, labor, and firms that each locality is trying to attract.¹⁷³ Hence, it might be rational to avoid interlocal subsidies, even if the subsidizing group would obtain some benefit from the agreement.

Both of these explanations deny the existence of interlocal complementarities that could be realized by contract and the capacity of localities to recognize those synergies. If cities and suburbs could maximize their joint welfare through mutual support, then one would expect cities and suburbs to enter into agreements that capture these gains, just as firms rely on contracts to increase joint profits. At the very least, some explanation for the failure to realize these gains should be forthcoming. These stories perform that task poorly.

Begin with the story that localities compete for residents and tax base, and thus cannot coordinate. Some recent literature does support this hypothesis.¹⁷⁴ Suburbs increasingly have become “full-service” localities in which individuals can work and shop as well as live.¹⁷⁵ Some of this shift is due to transitions in the national economic base from manufacturing (which tended to be concentrated in central cities and which contributed to pollution and undesirable land uses that suburbanites presumably have sought to escape) to service employment, such as wholesaling, retailing, and construction (which is more amenable to suburban settings).¹⁷⁶ One recent study suggests, for instance, that jobs in retail banking and insurance have become more suburban.¹⁷⁷ The reasons for the shift include accessibility to

with interlocal competition for tax base and attracting business opportunities); Edward W. Hill et al., *Can Suburbs Survive Without Their Central Cities? Examining the Suburban Dependence Hypothesis*, 31 *Urb. Aff. Rev.* 147, 153 (1995) (arguing that comparative health of cities and suburbs depends on each jurisdiction’s ability to attract residents); Schneider, *supra* note 33, at 615-21 (examining phenomenon of competition between municipalities as it constrains growth in size of government); Schwartz, *supra* note 73, at 204-06 (discussing inefficiencies created by competition between cities).

¹⁷³ Alan L. Saltzstein, *Los Angeles: Politics Without Governance*, in *Regional Politics* 51, 61 (H.V. Savitch & Ronald K. Vogel eds., 1996).

¹⁷⁴ See Thomas M. Stanback, Jr., *The New Suburbanization* 1-16 (1991) (describing symbiotic and competitive relationship between cities and their suburbs).

¹⁷⁵ See John Brennan & Edward W. Hill, *Where Are the Jobs? Cities, Suburbs, and Competition for Employment* 7 (Brookings Inst., Survey Series No. 2-6, 1999) (finding that central cities are losing private sector employment market share to suburbs), <http://www.brookings.edu/es/urban/hillfa.pdf>; Downs, *supra* note 1, at 46-47 (describing increasing trend of people living and working outside cities); Edwin S. Mills & Luan Sendé Lubuele, *Inner Cities*, 35 *J. Econ. Literature* 727, 732 (1997) (describing growth of business districts in suburban areas).

¹⁷⁶ Stanback, *supra* note 174, at 24-25, 34 (finding national shift in employment from manufacturing to service employment).

¹⁷⁷ Daniel Immergluck, *Cities and Finance Jobs: The Effects of Financial Services Restructuring on the Location of Employment* 22-23 (Brookings Inst., Discussion Paper No.

low-cost employees who wish to remain close to home, the limited capacity of central cities to increase transportation systems, and technological developments that have reduced the need for face-to-face communication among businesses.¹⁷⁸ As this transition occurred during the 1970s and 1980s, increases in rates of employment in suburbs have tended to exceed increases in rates of employment in central cities.¹⁷⁹ While this shift might be attributable in part to the need in new suburbs to accommodate the basic necessities of residents (in local grocery stores, local bank branches, and so on), there also does appear to have been significant displacement of city employment by suburban employment. Technological advances that permit telecommuting further may close the gap between cities and suburbs as economic centers.¹⁸⁰ As a result, those who reside in the suburbs have less need to enter the city for work-related reasons.

Even competitors, however, have incentives to coordinate if they can realize joint gains by doing so.¹⁸¹ Intraregional competition may exist along some lines, while the same parties simultaneously cooperate where doing so will redound to their mutual benefit. Again, analogy to the behavior of private firms is illustrative. Think, for instance,

99:11, 1999), <http://www.brookings.edu/es/urban/immergluck.pdf>. The study, however, concludes that there is less evidence that other sectors of financial services, such as nonretail banking, are suburbanizing. See *id.* at 25-27.

¹⁷⁸ *Id.* at 26; Mills & Lubuele, *supra* note 175, at 732 (emphasizing factors including congestion in central locations and modern communication methods that reduce need for face-to-face communication).

¹⁷⁹ Brennan & Hill, *supra* note 175, at 1; Stanback, *supra* note 174, at 26 tbl.2.4. This is by no means a universal phenomenon, however. Brennan and Hill report that nearly twenty percent of the ninety-two largest central cities had positive employment growth rates that exceeded the growth rates in their suburbs between 1993 and 1996. Brennan & Hill, *supra* note 175, at 6. It is conceivable that this percentage has increased as the revival of cities appears to have increased subsequent to 1996. Moreover, one would anticipate employment rates to be high in new suburbs, as their very "newness" indicates that few jobs existed in the area previously, so that any increase over a low base will appear significant. The increase should be especially notable if the new suburb must develop the basic amenities of suburban life, such as new commercial enterprises and service providers, for instance grocery stores and banks, that require additional staffing. Brennan and Hill do not indicate the extent to which the new suburban jobs reflected displacement of jobs previously located in the central city.

¹⁸⁰ There are reports, however, that the willingness of employers to allow employees to conduct business through telecommuting is greatly exaggerated. See Kemba J. Dunham, *Telecommuters' Lament: Once Touted as the Future, Work-at-Home Situations Lose Favor with Employers*, *Wall St. J.*, Oct. 31, 2000, at B1.

¹⁸¹ Cooperation among competitors is often seen as inconsistent with public welfare, as evidenced by the existence of antitrust laws. But there are situations in which competitors would reduce transaction costs or capital costs through cooperation in a manner that redounded to the benefit of the public at large. See Saul Levmore, *Competition and Cooperation*, 97 *Mich. L. Rev.* 216 (1998) (exploring reasons for cooperation and noncooperation among competitors).

of the recent efforts by competitors to form industry-wide consortia for the purchase of products through online exchanges.¹⁸² Realizing scale economies through cooperation does not reduce competitiveness among these participants. Alternatively, consider the existence of separate divisions within General Motors. This organizational form generates competition to develop new products and cost-cutting procedures that generate spillover effects for other divisions within the corporation.¹⁸³ At the same time, coordination among members in the same "organization" minimizes "inter-divisional" costs and generates efficient sharing of information and capital.¹⁸⁴ The fact that officials of Oldsmobile may want to outperform Chevrolet, for instance, does not mean that they are indifferent to General Motors's competitive position with respect to Ford. Similarly, intraregional competition for residents and jobs can reduce inefficient expenditures and provide the electorate with an easier mechanism for monitoring the performance of officials.¹⁸⁵ The recent "revival" of cities is attributed by some to competitive pressures from suburbs that force cities to provide services both fairly and efficiently in order to retain a viable tax base.¹⁸⁶ If at the same time, however, localities within the region are interdependent with respect to their economic condition, then we would expect competition to give way to coordination in those areas in which doing so would increase wealth to all members of the region. This argument does not deny the existence of intraregional competition. It suggests only that such effects do not detract necessarily from intrare-

¹⁸² See, e.g., Claudia H. Deutsch, *Online Exchange for Health Care Companies Could Cut Costs*, N.Y. Times, Mar. 30, 2000, at C6 (describing plan by health care companies to form online exchange to provide information about products and enable customers to place orders); Neil Irwin, *Tapping into Savings: Big Firms Buying Fuel Through New Online Exchange*, Wash. Post, Oct. 5, 2000, at E1 (describing American Petroleum Exchange, online marketplace for gasoline and diesel fuels).

¹⁸³ See Paul Milgrom & John Roberts, *Economics, Organization, and Management* 544-50 (1992) (describing advantages of multidivisional form for firms, including improved information and incentives, enhanced coordination and control, and increased ability to manage diverse businesses).

¹⁸⁴ *Id.* at 544-45.

¹⁸⁵ On the extent to which interjurisdictional competition affects the level of governmental spending, see Advisory Comm'n on Intergovernmental Relations, *supra* note 33, at 57-66.

¹⁸⁶ See, e.g., Jim Boren, *Seattle's Investment in Downtown Is Ongoing Commitment*, Fresno Bee (Cal.), Sept. 17, 2000, at G3; Carey Goldberg, *Boston Leading a Renewal of Old Northern Cities*, N.Y. Times, Nov. 3, 1998, at A1; John Handley, *'Tech' Park Is City's Latest Shot in Jobs Tussle with Suburbs*, Chi. Trib., June 11, 1995, at 1C; Sam Staley, *Solutions for Mid-size Cities May Come in Small Packages*, Rich. Times Dispatch, Feb. 25, 1999, at A15; Brookings Inst., *The Central City Initiative: Building Competitive and Livable Central Cities*, <http://www.brookings.edu/es/urban/centralcity.htm> (last visited Jan. 29, 2001).

gional cooperation or generate a downward spiraling "race to the bottom" in the provision of local services.

The same result obtains if we consider the malign story about the city-suburb relationship. Recall that this story suggests that suburbanites exploit the central city by taking advantage of the cultural and commercial benefits of central cities, but then retreat without contributing to the services necessary to provide those benefits and without redressing the social problems endemic to cities. But if there exists a complementary relationship between cities and suburbs, claims of exploitation offer limited explanations for the paucity of interlocal contracts. The very "bedroom community" character of suburbs that has subjected them to ridicule as economically and culturally empty also ensures that residents would remain dependent on the central city.¹⁸⁷ It is difficult to reconcile the view that suburbanites wish to take advantage of what central cities offer with the view that suburbanites have no concern for the viability of the central city to which they are attracted.

Whether these explanations are plausible, therefore, depends in large part on the extent to which cities and their suburbs are interdependent. The more interdependence exists, the more difficult it is to credit claims that suburban exploitation of or indifference to central cities renders interlocal contract impractical. There exists significant evidence that suburbs that serve as a residential base for commuters, and even suburbs with a robust commercial base, remain in strongly interdependent relationships with central cities. First, city employment offers advantages that cannot readily be displaced by suburban employment. As a result, suburban residents' dependence on the city economy can be expected to continue. Thomas Stanback, for instance, demonstrates that city employees tend to have higher earnings than suburban employees, and that these higher rates are attributable to factors other than differences in cost of living.¹⁸⁸ City economies may be more specialized in a manner that requires more workers from higher-paid occupational ranks.¹⁸⁹ As a consequence, the earnings of commuters to the city tend substantially to exceed the earnings of city residents.¹⁹⁰ Suburban employment, on the other hand, often consists

¹⁸⁷ See Downs, *supra* note 1, at 52-57 (describing social and economic functions that only can be provided by city and arguing that welfare of suburbs depends on health of central cities).

¹⁸⁸ Stanback, *supra* note 174, at 41.

¹⁸⁹ *Id.*

¹⁹⁰ *Id.* at 49 (reporting study of fourteen cities and finding that in only two were commuter wages less than twenty percent higher than average of residents who worked in city); see also H.V. Savitch & Ronald K. Vogel, Introduction: Regional Patterns in a Post-City Age, in *Regional Politics*, *supra* note 173, at 1, 6 ("The higher the pay derived within a

of relatively low-paying employment or self-employment.¹⁹¹ Some evidence of this can be inferred from the relative effect of urban and suburban employment growth on suburban house prices. A study of the Philadelphia metropolitan region suggested that an increase in city job growth of one percent translates into an increase of suburban house values of slightly more than \$1000.¹⁹² Increases were greater for suburbs that had commuter rail services to the central city.¹⁹³ Suburban employment growth, however, had “virtually no effect” on house prices.¹⁹⁴ City growth in income, population, and housing values tends to correlate with suburban growth of the same variables.¹⁹⁵

I do not want to make too much of these findings. Correlation is not causation.¹⁹⁶ And these phenomena do provide evidence of a wealthy/poor divide between suburbs and cities that renders the current distribution of residents less than ideal, since the poor likely do not “prefer” the lower levels of services in the city. But the data do suggest (if, as seems likely, commuters make possible the higher average earnings in the city) that financially healthy cities continue to provide substantial employment opportunities to nonresidents, thus creating incentives for those nonresidents to support the city econ-

central city, the more likely its beneficiary is a suburban commuter.”). Savitch and Vogel indicate that in most major counties they studied, there was an increase from 1969 to 1989 in the percentage of central city earnings that were earned by suburbanites. *Id.*

¹⁹¹ Stanback, *supra* note 174, at 56. Immergluck’s explanation for the location of insurance firms in the suburbs is that clerical workers “constitute so much of insurers’ workforces. Firms view suburban locations as good sources of relatively skilled, low-cost and especially female workers, many of whom seek employment relatively close to home.” Immergluck, *supra* note 177, at 26.

¹⁹² Richard Voith, *The Suburban Housing Market: The Effects of City and Suburban Job Growth*, *Bus. Rev. (Federal Res. Bank of Phila.)*, Nov.-Dec. 1996, at 13, 19.

¹⁹³ *Id.* Similarly, Andrew Haughwout concludes that central city infrastructure enhancements significantly increase suburban property values. Andrew F. Haughwout, *Regional Fiscal Cooperation in Metropolitan Areas: An Exploration*, 18 *J. Pol’y Analysis & Mgmt.* 579, 590-93 (1999).

¹⁹⁴ Voith, *supra* note 192, at 20. Voith did conclude that there were wide deviations from these average figures. A one percent increase in city employment growth increased housing values in communities within a twenty-minute driving commute of the central business district by \$5900. *Id.*

¹⁹⁵ See Richard Voith, *Do Suburbs Need Cities?*, 38 *J. Reg. Sci.* 445, 462 (1998) (finding positive correlation between city growth rates and suburban growth rates). One study found that changes in housing prices between cities and their suburbs are generally, though not universally, strong, and stronger than suburb-suburb or city-city associations. William N. Goetzmann et al., *Do Cities and Suburbs Cluster?*, *Cityscape* (U.S. Dep’t of Housing & Urb. Dev.), Vol. 3, No. 3, 1998, at 193, 201, <http://www.huduser.org/periodicals/cityscape/vol3num3/article8.pdf>. Clustering of this type indicates that consumers consider housing in the suburbs and their core city to be substitutes, implying interdependence. *Id.* at 194.

¹⁹⁶ See Hill et al., *supra* note 172, at 150-51 (questioning interdependence thesis).

omy.¹⁹⁷ Conversely, some studies suggest that the presence of a large poor, unskilled population will impose drag either on the region's economy directly or on social interactions that necessarily implicate economic growth.¹⁹⁸

There is some evidence that cities have natural advantages over suburbs in economic productivity simply by virtue of the heterogeneity and density that distinguish them socio-economically from suburbs.¹⁹⁹ This phenomenon is related to the concept of agglomeration economies: Firms that locate close to other firms in the same industry reduce the costs of interfirm communication²⁰⁰ and readily can share inputs in production and consumption.²⁰¹ Some of these benefits may be diluted by technological developments that allow interfirm (and intrafirm) communication from distant locations.²⁰² Recent scholarship indicates, however, that agglomeration economies can be realized even by firms within industries that are unrelated to other firms in the

¹⁹⁷ See William R. Barnes & Larry C. Ledebur, *The New Regional Economies* 42 (1993) (finding that suburban economies do not experience significant income growth without corresponding growth in their central cities); H.V. Savitch & Ronald K. Vogel, *Introduction to Regional Politics*, supra note 173, at 1, 5-7 (describing cycle in which higher pay in central cities benefits suburban commuters, fueling economic growth in suburban communities that then stimulates central city business districts).

¹⁹⁸ See, e.g., Paul D. Gottlieb, *The Effects of Poverty on Metropolitan Area Economic Performance: A Policy-Oriented Research Review*, in *Urban-Suburban Interdependencies*, supra note 2, at 21, 26-27 (summarizing empirical studies on economic links between cities and suburbs and effect of poverty).

¹⁹⁹ The happiest story about the capacity of cities to generate regional wealth by allowing the congregation and development of small, initially unrelated firms is found in Jane Jacobs, *Cities and the Wealth of Nations* 224-32 (1984) (arguing that nation's wealth depends on health of cities and that intermunicipal exchanges are necessary for development).

²⁰⁰ These economies play a large role in recent stories about the development of high technology clusters. See, e.g., AnnaLee Saxenian, *Regional Advantage: Culture and Competition in Silicon Valley and Route 128* (1994).

²⁰¹ See W. Brian Arthur, *Increasing Returns and Path Dependence in the Economy* 103-04 (1994) (providing models to show that agglomeration benefits increase as firms are added to region).

²⁰² See Robert D. Atkinson, *Technological Change and Cities*, *Cityscape* (U.S. Dep't of Housing & Urb. Dev.), Vol. 3, No. 3, 1998, at 129, 137-38, 142-43 (discussing way in which localization is not as important to information industry since it involves processing rather than generating of information and describing rise of "global cities"), <http://www.huduser.org/periodicals/cityscape/vol3num3/article6.pdf>. There are some reasons to believe that central cities are more amenable to technological advances than suburbs. See Mitchell L. Moss, *Technology and Cities*, *Cityscape* (U.S. Dep't of Housing & Urb. Dev.), Vol. 3, No. 3, 1998, at 107, 112-14 (discussing comparative advantages of dense urban areas in deployment of new information technologies since most cities that have high concentration of information industries are also high-use telecommunications customers), <http://www.huduser.org/periodicals/cityscape/vol3num3/article5.pdf>. There are, however, limits to the capacity of technology to compensate for geographical proximity. Atkinson, supra, at 146-48.

same geographic area.²⁰³ Transportation systems, infrastructure, labor markets, and legal and financial services originally developed to support one industry simultaneously will be able to support new industries, thus reducing costs to new firms in the same geographic vicinity. Leaders within each of these industries will have greater access to each other and will be better able to interact within a centralized community.²⁰⁴ Additionally, population density (likely to be greater in cities) may accelerate the rate of human capital accumulation, simply because individuals have more interactions with each other.²⁰⁵ Hence, profit-maximizing firms should continue to see advantages to locating within cities, notwithstanding that many of the employees of those firms reside elsewhere.

A final reason to assume interdependence relates back to the development of regional economies. Notwithstanding the growth of suburban economies, suburban reliance on central cities for economic welfare appears to be increasing. One study revealed that “[o]ver half the income earned within New York, Washington, D.C., and St. Louis [went] to suburbs” as of 1989, and the percentage of suburbanite income generated by the central city increased from 1969 to 1989 in nine out of ten metropolitan areas.²⁰⁶ Workers who live in metropolitan areas appear to fare better than their counterparts outside of metropolitan areas. One researcher reports that workers living in a metropolitan area surrounding a city with a population in excess of 500,000 earn thirty percent more than nonmetropolitan workers of equal education and work experience.²⁰⁷ While differences in costs of living may mean that real wage differentials are not that high, the fact that firms are willing to pay higher wages suggests that they are obtaining a higher marginal product from their workers, and it is plausible that they are sharing the benefits of that productivity with workers in order to dissuade productive workers from exiting to other jurisdictions. This evidence is consistent with other findings that “the prosperity of metropolitan regions is influenced by the health of their core cities,”²⁰⁸ and that “[w]here there [are] wide disparities between the eco-

²⁰³ See, e.g., John M. Quigley, *Urban Diversity and Economic Growth*, 12 *J. Econ. Persp.* 127, 132 (1998) (arguing that economies from shared inputs and reduced transaction costs increase with diversity of economic activities).

²⁰⁴ Downs, *supra* note 1, at 52-53 (describing benefits of “face-to-face contacts of community leaders in a central city’s downtown”).

²⁰⁵ See Edward L. Glaeser, *Are Cities Dying?*, 12 *J. Econ. Persp.* 139, 140, 147-49 (1998) (discussing impact of urban density on learning and on human capital accumulation).

²⁰⁶ Savitch & Vogel, *supra* note 173, at 6-7.

²⁰⁷ Glaeser, *supra* note 205, at 142.

²⁰⁸ Elizabeth B. Waters, *Tackling Urban Problems in Virginia: Cities Can’t Do It Alone*, *Va. Rev.*, Nov.-Dec. 1994, at 33, 33.

conomic health of a city and its suburbs, the entire region suffer[s].”²⁰⁹ Studies of interlocal financial relationships support the proposition that economic health is regional. Central city deterioration adversely affects suburban housing prices.²¹⁰ Low levels of education in the central city affect regional labor markets, the capacity to attract commercial and industrial enterprises,²¹¹ and the capacity to increase municipal revenues to support the local public goods that are desired in suburban neighborhoods without increasing dreaded taxes.

In the face of these effects, increased suburbanization of both residents and employers does not necessarily imply antipathy towards the central city. Even agglomeration effects, which suggest suburban solicitude for city economies, have optimal stopping points. At some point, the economies offered by central cities diminish. For instance, traffic congestion reduces the benefits that can be realized by shared transportation networks.²¹² Once an optimal point is reached, firms may form clusters that generate industry benefits in suburbs. But this suburbanization reflects economic decisions that are likely to enhance regional advantage rather than antiurban bias.

Finally, the malign story fails to explain why revenue-sharing agreements are infrequent even where the divergence between wealthy and poor jurisdictions is not so great. Initially, this seems like an unlikely environment for wealth transfers. We typically associate subsidies with the need to equalize resources among jurisdictions or persons with widely disparate wealth. But given the existence of interregional competition, we should expect to see at least some regions that compete intraregionally on grounds other than taxes. Revenue sharing among homogenous localities would allow regions to attract residents and firms on the basis of services while still living within a relatively homogeneous socio-economic environment. In short, revenue sharing among these localities would be tantamount to price-fixing arrangements among firms, allowing customers to make selections on the basis of services rather than price. The absence of such agreements suggests something other than antipathy for redistribution as an explanation for the paucity of interlocal contract.

²⁰⁹ *Id.* at 34.

²¹⁰ See Richard Voith, *City and Suburban Growth: Substitutes or Complements?*, *Bus. Rev. (Federal Res. Bank of Phila.)*, Sept.-Oct. 1992, at 21 (discussing debate over nature of relationship between city and suburban economies).

²¹¹ See, e.g., Natalie Cohen, *Business Location Decision-Making and the Cities: Bringing Companies Back 15* (Brookings Inst., Working Paper No. 00:3, 2000), at <http://www.brookings.org/ES/URBAN/cohen.pdf>.

²¹² See Mills & Lubuele, *supra* note 175, at 732 (discussing use of cars to permit inexpensive commuting between origins and destinations, “making cars cheaper than public transit” for those who live and work in suburbs).

In summary, the importance of regional financial health has two implications for the exploitation and independence theses. First, it suggests that suburbs should be willing to assist the central city to a significant extent, if not out of altruism, then out of a desire to protect their own financial well-being.²¹³ Second, it suggests that the malign motives of exclusion have limited effects, because suburbanites continue to associate with central city residents through workplace and social contacts, even if they separate for purposes of residence.

Even if we grant interdependence, however, there exists a third story that purports to explain the absence of interlocal contract in terms of suburban self-interest. This story suggests that suburbs abandon central cities out of an inability to overcome collective action problems rather than out of any malice or indifference. I think that something akin to this inference is implicit, for instance, in Richard Briffault's critique of what he labels the "public choice approach" to interlocal relationships. Briffault suggests the following:

The central flaw in the public choice approach, however, is not the loss of local control, but rather, the inability of metropolitan area localities to come to grips with the regional prisoners' dilemma caused by local land use decision making, local fiscal autonomy, and local responsibility for the costs of local public services. Localities acting in their own self-interest will fail to make optimal decisions because, in failing to take account of how their decisions affect the welfare of the region as a whole, they may ultimately damage their own well-being.²¹⁴

The "limited rationality" explanation poses a more complicated, and initially more plausible, explanation for the paucity of interlocal contracts. This explanation assumes that suburbs can receive increased regional and personal welfare benefits, even if they contribute nothing, as long as other localities in the region make sufficient contributions to the central city. Hence, each suburb has a self-interested incentive to withhold contributions and free ride on those of others, with the result that no one engages in the conduct from which all would benefit.²¹⁵ As in Prisoners' Dilemma situations generally, the

²¹³ See Downs, *supra* note 1, at 51-59 (arguing that welfare of suburban residents is closely linked to central cities' ability to provide social and economic services).

²¹⁴ Briffault, *supra* note 7, at 1147; see also Summers, *supra* note 166, at 183 ("Essentially, it is rational for residents of any one suburb to vote against tax sharing on redistributive grounds: it will be trivial in its effects, and is likely to be costly.").

²¹⁵ A similar point is quantified in Haughwout, *supra* note 193, at 592-93. He calculates that a \$1 billion investment in central city infrastructure would be a losing proposition if made either by the city alone or by suburbanites alone, but that the same investment would generate \$1.11 billion in total new property value in the region as a whole, and thus would be worth making. He concludes: "This is a classic coordination problem: neither city nor

proffered solution is centralization to force all parties into the position they could agree to if only they could bind each other.

There are times when Briffault's rationale seems telling. Imagine, for instance, two adjoining localities, each of which fears that the other will develop a shopping mall at the fringe of their common boundary and that the new mall will displace existing local stores. Each locality has an incentive to construct the mall within its own jurisdiction, even if it wishes that the mall not be built at all. If one locality fails to develop the mall but the other one does develop it, local stores in both jurisdictions will be affected. Thus, it would be better to be the locality that gets the revenues from the new mall, as those revenues will offset the loss generated by any demise of existing stores. The result is the Prisoners' Dilemma that Briffault invokes to criticize localism.

This is a highly stylized example, however. There are two objections to extrapolating from it to explain interlocal relations generally. First, the interaction of localities may not correspond to the nefarious Prisoner's Dilemma. Regional benefits will not be distributed evenly. Thus, for some jurisdictions, expected costs of contributions, in fact, may exceed expected benefits. Of course, one would predict that there will be no burden-sharing contract in these situations, but not because of free riding.²¹⁶ Alternatively, if regional benefits from interlocal agreements are sufficiently great, then the game that potential subsidizers face is not the Prisoners' Dilemma, but the more indeterminate Chicken Game, in which one party may cooperate, because the personal benefits of cooperation exceed the gains from defection, even though those benefits would be greater still if others also cooperated.

Second, and more importantly, the "limited rationality" explanation relies on an incomplete description of the Prisoners' Dilemma dynamic and thus ignores the fact that interlocal relations represent the very situation that generated decentralized, contractual solutions to threats of free riding. Suburbs, fixed in their geographical position, must deal with their neighbors into the infinite future. Once we accept (as the "limited rationality" explanation does) the premise that suburbs and cities are interdependent, it follows that they are not stuck in the traditional one-shot Prisoners' Dilemma that gives rise to suboptimal defection. Instead, the inability of each locality to exit

suburbs have an incentive to fund the investment alone, but both would benefit if the investment were made." *Id.* at 593.

²¹⁶ See Anas, *supra* note 144 (discussing desirability and problems associated with implementing compacts among municipalities, noting that compacts only should be implemented when economic benefits exceed added economic costs of implementation).

from constant interactions with neighbors means that defection from cooperation in any one situation exposes the defector to retaliation in subsequent interactions. The prospect of future play with the same party in such an iterated Prisoners' Dilemma restrains each player's willingness to take advantage of an immediate opportunity to gain at the expense of neighbors.

In this context, the superior strategy for each player is to cooperate with all other prisoners who cooperate.²¹⁷ Repeat play among the parties (and thus the threat of retaliation for defection) can be assured as long as exit costs are sufficiently substantial, a condition that is satisfied where the parties are geographically bound. Exit, for instance, becomes difficult if investments in the existing relationship cannot be transported easily to other transactions. This is not simply a repetition of the "repeat play" condition. Parties theoretically could face repeated iterations because it is in their mutual interest to deal with each other, even though either could walk away costlessly from the transaction at any time.²¹⁸ And one could face high exit costs from a relationship even though contact is infrequent.²¹⁹ As much of the literature on the capacity to generate cooperation in the absence of the state suggests,²²⁰ these circumstances belie the need for a centralized mechanism to force self-interested parties to cooperate. Instead, these conditions present the ideal circumstances for contracts to provide mutual assurances that each participant will contribute to common objectives.

Nevertheless, the presence of multiple actors may interfere with interlocal agreements. Some of the literature concerning Prisoners' Dilemma situations suggests that even an iterated game may not lead to cooperation where more than two players are involved because multiparty agreement requires increased transaction costs and monitoring costs.²²¹ The regional issues to which burden sharing poses a possible solution typically involve multiple local governments, none of

²¹⁷ See Robert Axelrod, *The Evolution of Cooperation* 27-54 (1984) (discussing cooperation in Prisoners' Dilemma); Hargreaves Heap & Varoufakis, *supra* note 83, at 170 (same).

²¹⁸ For instance, think of a purchaser of books who frequents one bookstore, but who could just as easily patronize another bookstore should the first prove unsatisfactory.

²¹⁹ Think of married parties who are estranged from one another but who do not want to incur the costs of divorce.

²²⁰ See, e.g., Hargreaves Heap & Varoufakis, *supra* note 83, at 170, 176-78 (discussing cooperation in Prisoners' Dilemma without intervention of collective agency); Michael Taylor, *Anarchy and Cooperation* 43-53 (1976) (describing evolution of conditional cooperation in iterated, n-person Prisoners' Dilemma).

²²¹ See Per Molander, *The Prevalence of Free Riding*, 36 *J. Conflict Resol.* 756, 768 (1992) (concluding that noncooperative behavior should be expected where group includes more than two members and where monitoring is difficult).

which is imposing a distinct and separate harm on the central city and any of which could independently contribute to the central city's welfare. As Briffault suggests, where any one of multiple localities can contribute to regional welfare, each has an incentive to hold out or free ride on the efforts of others. Since regional welfare will constitute a public good, any locality can benefit from the contributions of others, even if it has withheld contributions. One would imagine, for instance, that bargaining over the placement of salient but undesirable land uses that have external effects, such as waste dumps and water towers, would be more difficult when multiple localities are involved than when there are only two plausible candidates. Similarly, ensuring that each of multiple jurisdictions is contributing its fair share to regional welfare requires significant monitoring of local budgets.

One test of this concern for multiparty cooperation is to see whether there is a greater likelihood of burden sharing where there is a single identifiable party that can relieve the burden on the central city, so that transaction costs and strategic behavior among multiple potential subsidizers are reduced. Virginia presents a nice laboratory for this experiment because it has a unique governmental structure in which counties and cities are mutually exclusive entities.²²² Until recently, interlocal burden sharing in Virginia was handled through the threat of long and acrimonious annexation procedures.²²³ Since 1979, however, there has been a statutory moratorium on nonconsensual annexations in the state and a grant of statutory authority for cities and their surrounding counties to enter into revenue sharing agreements.²²⁴ The result has been that city efforts to extract payments from counties proceed through negotiation against a background that denies annexation rights. Because cities tend to be located within independent counties, however, only one city and one county are involved in the ensuing negotiations. At least four agreements have been reached between cities and counties, which seems to exceed the amount of general revenue sharing among localities in other states.²²⁵ This phenomenon provides at least weak evidence for the proposition that suburban areas are willing to contribute to the success of central cities, but that, as in tort law, strategic behavior that results where there are multiple potential "rescuers" can discourage any qualified

²²² See Va. Const. art. VII, § 1 (defining terms "county" and "city").

²²³ For examples of annexation procedures in Virginia, see, for example, *County of Rockingham v. City of Harrisonburg*, 294 S.E.2d 825 (Va. 1982); *City of Richmond v. County of Chesterfield*, 156 S.E.2d 586 (Va. 1967).

²²⁴ See Va. Code Ann. § 15.2-3300 to -3400 (Michie 1997).

²²⁵ See Richman & Wilkinson, *supra* note 160, at 11-22.

party from initiating the effort of mutual assistance.²²⁶ At the same time, Virginia's experience suggests that solving of that problem could lead to significant use of interlocal agreements. Thus, I return below to the question of whether institutional arrangements among localities can compensate for the monitoring problems that arise in multiparty settings.²²⁷

B. Alternative Explanations for the Infrequency of Agreements

1. Misjudging the Benefits of Cooperation

Of course, the mere existence of conditions that allow interlocal contracts to emerge does not mean that localities actually will agree. If localities do not recognize their interdependence and take advantage of the economies available to them, we would not realize potential regional wealth. Again, it is useful to return to the analogy of firms. The benefits of cooperation largely define the lesson of Annalee Saxenian's study of the simultaneous success of computer-related firms in Silicon Valley and failure of similar businesses in the Boston area.²²⁸ Both areas contained sufficient numbers of firms to permit agglomeration effects,²²⁹ so the mere presence of clustering cannot explain the former's dominance. But Saxenian found more cooperative and fluid social and professional relationships among California firms than among their Boston equivalents, and attributes the different levels of success to those characteristics.²³⁰ As Saxenian concludes, "[i]n Silicon Valley, the region and its networks, rather than individual firms, became the locus of economic activity."²³¹ The Silicon Valley ethos encouraged sharing information among individuals from different firms, while Boston firms were more secretive, professionally isolated, and vertically integrated, notwithstanding geographic proximity.²³² For Saxenian, openness and interfirm networks facilitated collective learning to the mutual benefit of all Silicon Valley firms. While firms may not have been sharing burdens explicitly, they appear to have treated each other as partners within a common network, rather than simply as competitors or adversaries to be repelled at every opportunity. The cooperative relationship between

²²⁶ See William M. Landes & Richard A. Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 *J. Legal Stud.* 83 (1978) (discussing economic model of "rescue" as applied to competitive market).

²²⁷ See *infra* notes 281-90 and accompanying text.

²²⁸ Saxenian, *supra* note 200, at 1-3.

²²⁹ *Id.* at 6.

²³⁰ *Id.* at 161.

²³¹ *Id.* at 37.

²³² *Id.* at 161-62.

suppliers and purchasers in Silicon Valley, for instance, inherently entailed a degree of risk sharing, even if it did not require salvation of a firm in financial difficulty.²³³ The morals of the story are that culture matters and a cooperative culture is more productive than a strictly competitive one. Obviously, the conditions for cooperation and mutual benefit existed in the Boston area as well. The firms in that area simply did not take advantage of the opportunities before them. Similarly, the presence of interdependence among localities in a region does not create regional wealth necessarily.²³⁴

For instance, some localities may choose not to participate in a regional effort for fear that mobile residents and firms that would be net subsidizers will migrate to regions that impose less of a redistributive burden.²³⁵ Fear of redistributive effects, however, cannot explain fully the paucity of burden-sharing agreements. After all, if these agreements genuinely return net benefits to a region, even mobile individuals and firms should be willing to remain, as long as the present value of those benefits is sufficient to offset the subsidy the firms must pay. Moreover, the fear that subsidies will cause receiving

²³³ Saxenian describes the relationships between suppliers and purchasers in Silicon Valley as a "network of long-term partnerships," and indicates that they evolved from the recognition of firms that "their success was tied irretrievably to that of their suppliers." *Id.* at 145-46. She concludes:

These new partnerships marked a decisive break with the adversarial supplier relations of traditional mass-production companies, in which subcontractors manufactured parts according to standard specifications, competed viciously to lower price, and often served as buffers against fluctuations in demand. . . .

The new Silicon Valley systems firms sought to avoid making their suppliers dependent, explicitly rejecting IBM's model for more reciprocal relationships. They came to view their relations with suppliers as long-term partnerships rather than short-term procurement arrangements. They saw collaboration as a way to speed the pace of introduction of new products and to improve product quality and performance.

Id. at 146.

²³⁴ One may object that Saxenian's story does not translate well to the interlocal context. Since even small localities will be significantly larger than most firms (especially startup firms of the type Saxenian concentrates on), it may be difficult to attribute a shared ethos to cities and suburbs. But even if the translation is imperfect, her story suggests some parallels to the local context. The first parallel reinforces the contention that I made above. The existence of multiple entities, whether firms or localities, that are nominally in competition, whether for customers, residents, or employers, does not entail necessarily an inability to cooperate for mutual benefit. The second parallel emerges from Saxenian's observations that vertical integration may cause firms in innovative technologies to produce goods inferior to those of firms that specialize. *Id.* at 125. This admonition is reminiscent of the claims in *supra* Part I concerning the benefits of decentralized government that emerge from increasing preference satisfaction and accountability.

²³⁵ See Been, *supra* note 34, at 511-28 (describing competition by localities for firms and residents); Glaeser, *supra* note 205, at 156 (stating that "redistribution at the local level causes major distortions to locational choices").

jurisdictions to serve as “welfare magnets”²³⁶ does not necessarily apply in the case of interlocal agreements that subsidize firms as well as individuals. Interlocal burden sharing should attract to the central city some firms that expect net benefits from the transfer and retain firms that otherwise might exit to jurisdictions that do not provide a subsidy.

2. *Agency Costs*

An alternative explanation is that agency costs among suburban officials frustrate regionally productive bargains. Local officials in relatively successful suburbs may fear that their constituents will resist the use of locally generated revenues to assist nonresidents.²³⁷ Even local officials who anticipate net long-term benefits from regional cooperation may prefer to cater to constituent perceptions of suburban independence, rather than attempt to change those perceptions, if that strategy maximizes their chances of reelection.²³⁸ This appears to be a common explanation for the unwillingness of local officials and legislators who represent relatively wealthy areas to support the use of local property tax revenues to equalize school expenditures.²³⁹ Alternatively, officials may wish to take credit for avoiding increases in tax rates, and may prefer the certainty of not making transfer payments to the possibility that regional gains will offset the amounts of those payments. Tax increases or service cutbacks that will be necessary to fund transfer payments will be salient, while the marginal revenues received from increased regional health will be difficult for constituents to disaggregate from other revenues. The result is that local officials will receive the blame for the costs of the subsidy but will have difficulty receiving credit for the benefits. These effects are exacerbated by the fact that the potential offsetting benefits will arise, if at all, only in the future—perhaps after current officials have left office and when they no longer can receive political benefits from their decision.

While these arguments are plausible, they do not explain fully the paucity of interlocal contracts. The school finance analogy does not hold, because suburban residents may be able better to identify with

²³⁶ See, e.g., Paul E. Peterson, *The Price of Federalism* 121 (1995) (defining “welfare magnet” as jurisdiction having high welfare benefits, thus attracting poor people).

²³⁷ See Orfield, *supra* note 1, at 108 (recounting suburban officials’ reluctance to form alliance with central city, fearing “political degradation”).

²³⁸ See Downs, *supra* note 1, at 52 (“The belief among suburbanites that they are independent of central cities is a delusion.”).

²³⁹ See Note, *Unfulfilled Promises: School Finance Remedies and State Courts*, 104 *Harv. L. Rev.* 1072, 1078-81 (1991).

the central cities in which they work and which they use for social and cultural purposes than with the central city school system with which they have little contact. Hence (with the caveat that I explore below), they may be more willing to finance expenditures for city services from which they anticipate benefits than specific programs for which they have little affinity. There is, for instance, little reason to believe that residents object to contracts for goods or services that provide an appropriate *quid pro quo*, simply because the recipient of those locally generated revenues is a nonresident.²⁴⁰ Thus, as long as officials can offer an offsetting benefit in the form of regional growth, the dedication of tax revenues to nonresidents may not be a formidable obstacle.

Indeed, there is some reason to believe that agency costs should generate a significant amount of interlocal burden sharing. The effects of an interlocal transfer on any one taxpayer of the subsidizing jurisdiction are likely to be insubstantial.²⁴¹ Thus, even if residents would prefer that locally generated revenues remain within the jurisdiction, they may be unwilling to invest much in lobbying for that result. However, the central city receives the aggregate subsidy embodied in a burden-sharing agreement. Officials of the central city, therefore, have significant incentives to lobby suburban officials for such arrangements. One might respond that these incentives are of little consequence as long as central city officials have no electoral leverage to exercise over their suburban counterparts. But focusing exclusively on electoral accountability understates the possible sources of influence. Local officials within a region are likely to be interested in election or appointment to statewide office. Alterna-

²⁴⁰ Notwithstanding occasional preferences for contracts of employment or services with residents, see, e.g., *City & County of Denver v. State*, 788 P.2d 764, 765 (Colo. 1990) (upholding municipalities' right to adopt residency requirements for municipal employees), contracting with nonresidents seems to be a perfectly acceptable norm, see e.g., *Cuvo v. City of Easton*, 678 A.2d 424 (Pa. Commw. Ct. 1996) (affirming constitutionality of one-year residency requirement for applicants for city firefighter positions).

²⁴¹ The existence of lawsuits challenging the use of local property taxes for other school districts suggests that at least some residents have been able to overcome the collective action problem. School finance, however, may be particularly salient because quality of education is a primary factor in decisions about where to reside among people with significant mobility. See, e.g., William H. Frey, *Central City White Flight: Racial and Nonracial Causes*, 44 *Am. Soc. Rev.* 425, 438-39 (1979) (analyzing causal factors, including school-related factors, and mobility incidence by race and income); W. Norton Grubb, *The Flight to the Suburbs of Population and Employment, 1960-1970*, 11 *J. Urb. Econ.* 348, 358 (1982) (pointing out correlation between high city spending for schools and increased outmigration of low- to middle-income families, consistent with theory that central cities spend more per student but suffer diseconomies of scale); David P. Varady, *Influences on the City-Suburban Choice: A Study of Cincinnati Homebuyers*, A.P.A. J., Winter 1990, at 22, 33 (noting that families concerned about inadequate central city schools were more likely to buy suburban homes).

tively, they may desire advancement within their political party or seek employment within the private sector after their term of office is complete. They can create support for those efforts by demonstrating solicitude for regional welfare and thus might be willing to address interlocal needs even if that is inconsistent with the preferences of constituents.

C. Costs of Contracting as an Impediment to Cooperation

Up to this point, I have suggested that the paucity of burden-sharing agreements cannot be explained fully by exploitation, limited rationality, or agency costs. In this Section, I suggest that, just as in the case of contracts for coordination, the contracting costs associated with burden-sharing agreements provide a far more compelling explanation for their infrequency. As in the case of coordination contracts,²⁴² costs that might be reduced in the interfirm context by changing organizational forms cannot be handled as readily in this context, given the relative inflexibility of municipal governance and legal doctrine.

1. Pervasive Contracting Costs

Some of these costs replicate those that applied in coordination settings. For instance, the nondelegation doctrine and related doctrines that restrict the use of municipal assets to municipal purposes or that prohibit lending of credit to another entity pose as much of an obstacle to burden-sharing subsidies as they do to contracts that seek to achieve economies of scale. As in those cases, the need to divide the bargaining surplus among multiple parties, even where all parties agree that intraregional subsidies would produce net benefits, suggests that negotiation costs would be substantial. Again, strategic behavior in multiparty transactions should increase these costs, as each locality seeks to use private information about its own financial position to minimize its contributions to regional welfare and responds opportunistically to background legal rules.

Contracting costs, however, may increase dramatically in the case of burden sharing. First, participating localities are also likely to realize different degrees of benefit from cooperation (depending on such factors as distance from the central city, dependence on urban employees, etc.), so that it will be difficult to ascertain a formula for burden sharing that acceptably allocates the bargaining surplus. As a result, fair distribution of regional assets at one point in time may not be fair at other points in time. Second, background legal rules may

²⁴² See *supra* Part II.

provoke greater opportunism in the context of burden sharing. In the case of coordination contracts, all parties are likely to have similar status under background rules of law that affect their relationship. For instance, all parties to a jointly owned electrical generation plant will have authority to generate and sell electrical energy. But the background rules may affect parties differently in the case of burden sharing, and those effects are likely to influence the bargaining strategies adopted by the parties. A central city that has a statutory unilateral right of annexation²⁴³ may have a credible threat that could induce cooperative agreements (although that right also might induce strategic annexation threats by central cities and complicate bargaining over the surplus). Note that the Virginia agreements discussed above were preceded by annexation threats by central cities. The more common rule that precludes annexation of incorporated suburbs, however, may frustrate bargains or require the central city to accept a smaller share of the surplus in order to obtain any agreement at all. One might respond that legal rules could be designed to induce cooperation. I suggest below, however, that designing such rules is a more complicated matter than it first appears.²⁴⁴

2. *Relational Contract as a Cost Reduction Mechanism*

Standing alone, however, these costs should not pose substantial obstacles to interlocal contract. Recall that the geographical fixity of localities requires repeat play, reduces transactions costs, ties fortunes together, and allows opportunities for retaliation should one party not cooperate when expected to do so. These same conditions are characteristic of long-term contracts between commercial actors who must enter arrangements against an uncertain future, but whose contractual dependence on each other produces incentives to make mutually beneficial adjustments while the contract is in force.²⁴⁵ The difficulties that commercial actors face in specifying precise obligations in long-term arrangements frequently can be overcome through more incompletely specified relational contracts in which the meaning of relatively vague terms is defined through the development of an interdependent relationship.²⁴⁶ The likelihood of repeat play during the contract term induces each party to resolve unforeseen contingen-

²⁴³ See, e.g., *Weber v. City Council*, 513 P.2d 601 (Cal. 1973).

²⁴⁴ See *infra* notes 267-69 and accompanying text.

²⁴⁵ See Clayton P. Gillette, *Commercial Rationality and the Duty to Adjust Long-Term Contracts*, 69 *Minn. L. Rev.* 521, 554-55 (1985).

²⁴⁶ *Id.* at 555-56.

cies in a manner that maximizes their joint interests.²⁴⁷ At the same time, the relational commitment reduces the costs required to negotiate a complete contingent contract.²⁴⁸

Relational contract generally is considered plausible where parties have made transaction-specific investments that inhibit exit from the relationship.²⁴⁹ These investments tie the parties to each other's fortunes so that they have incentives to share risks rather than to act strategically. At the same time, no party has an incentive to take short-term advantage of the other. As in the Prisoners' Dilemma, parties to a long-term contractual relationship will have subsequent opportunities to retaliate for any opportunistic behavior. In essence, transaction-specific investment creates a bilateral monopoly between the parties that ties their futures together. But it is not the act of making the investment that is important; rather, the work is being done by the subsequent existence of that bilateral monopoly. That same condition is satisfied by the geographical fixity of localities. Thus, we would expect that interlocal agreements could reflect the low costs of relational contracting.

Some support for this proposition can be inferred from those interlocal agreements that do exist. Rather than trying to define long-term obligations in detail, they employ aspirational language and general formulae, perhaps on the assumption that the details of the relationship will be worked out and adjusted as the relationship is implemented. Thus, the Charlottesville-Albemarle County agreement consists of nine single-spaced pages. An agreement among Boulder

²⁴⁷ See Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 Cal. L. Rev. 205, 222-30 (1987) (comparing long-term contractual relationships to revised Prisoners' Dilemma where open lines of communication allow parties to foster cooperation through repeated interactions).

²⁴⁸ Indeed, informal standards of appropriate conduct may induce superior performance, relative to performance to the letter of a contract. If an actor desires to avoid claims of shirking that threaten continuation of the relationship, then an imprecise standard of adequate performance creates incentives for more than minimal performance to ensure that the parties do not disagree about whether "adequacy" has been satisfied. See Russell Hardin, *Collective Action 208-09* (1982) (explaining that flexibility in contracts of convention allows parties to avoid high costs of agreement and minimum performance characteristic of explicit contracts). There is some risk that vagueness will induce an inefficiently high level of performance. But given other inducements to underperform, this may not be a significant difficulty if adequate performance cannot be defined readily.

²⁴⁹ See Paul L. Joskow, *Commercial Impossibility, the Uranium Market and the Westinghouse Case*, 6 J. Legal Stud. 119 (1977) (analyzing economic aspects of declining uranium market in relation to impracticability of supplier performance on long-term contracts); Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 83 Am. Econ. Rev. 519, 519 (1983) (discussing "irreversible, specialized investments" and how they are safeguarded by both cooperative acts and unilateral efforts to preempt advantage).

County, Colorado, and the cities of Erie and Lafayette to reduce annexation wars and preserve undeveloped lands generated a written agreement that occupied fourteen pages.²⁵⁰

3. *Observability and Verifiability*

The infrequency of broad-based burden-sharing contracts (such as contracts to share general revenues), however, indicates that repeat play, high exit costs, and opportunities for retaliation may be necessary but not sufficient conditions for relational contract. Even though relationalism displaces the need for constant monitoring of one's trading partner, explicit contract is useful only if each party is able to (1) observe that the benefits each party receives are consistent with the vague expectations of the relationship, (2) detect instances of defection so that opportunities for retaliation can be seized, and (3) verify to a third-party enforcer that these conditions of breach have been satisfied.²⁵¹ If defection cannot be detected and verified, then courts cannot be relied on to enforce the terms of the bargain and the costs of explicit contract may not be worth incurring.²⁵²

The problem with broad-based burden sharing between central cities and suburbs is that net payers cannot easily satisfy these conditions. In particular, they will have difficulty observing compliance with the bargain (detecting chiseling²⁵³) and verifying compliance to a third party. Take first the problem of observability. Parties to contracts may have difficulty specifying precisely what they want from their contracting partners and the conditions that would constitute compliance with those expectations. Nevertheless, it may be possible for each of the parties to know good or chiseling performance "when he sees it," perhaps by monitoring outputs rather than inputs. Under these circumstances, it may be too costly to draft a contract that specifies expected performance. One may think of the "employment at

²⁵⁰ See Nat'l Ass'n of Counties, County Model Programs: Central East County Intergovernmental Agreement—1995, <http://www.naco.org/counties/models/program.cfm?SEARCHID=1995coun41>.

²⁵¹ On observable versus verifiable events, see Eric A. Posner, The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation, 146 U. Pa. L. Rev. 533, 574 (1998); see also Robert E. Scott, The Truth About Secured Financing, 82 Cornell L. Rev. 1436, 1450-51 (1997).

²⁵² For a discussion of the incapacity of courts to enforce relational contracts, see Alan Schwartz, Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies, 21 J. Legal Stud. 271, 280 (1992).

²⁵³ See Charles J. Goetz & Robert E. Scott, Principles of Relational Contracts, 67 Va. L. Rev. 1089, 1115 (1981) (defining "chiseling" as breach of best efforts requirement to adhere to contract obligations).

will" doctrine in employment law in these terms.²⁵⁴ Employers may have difficulty observing and specifying *ex ante* through contract what would constitute good work practices and therefore may have difficulty explaining to a court what constitutes a "good" or "bad" employee. Nevertheless, an employer may be sufficiently capable of monitoring outputs to know whether an employee is satisfying expectations, even though a nonexpert court would not detect the same qualitative distinctions. In that event, an employment at will doctrine makes sense insofar as it permits employers to avoid both the costs of contractual specification and the costs of judicial intervention, while simultaneously allowing employers to monitor those general conditions that determine whether an employee is successful. At the same time, competitive labor markets constrain employers from acting opportunistically.²⁵⁵

Broad-based burden-sharing obligations among localities fit this paradigm pretty well. The contractual obligations of a paying locality may be relatively precise. The interlocal contract, for instance, may require a suburb to pay a certain percentage of its tax revenues into a common pool.²⁵⁶ However, expenditures from the common pool are necessarily more complicated. Although distribution also may be made pursuant to a precise formula, the subjects of those expenditures may be more controversial. Presumably, expenditures should be made in a manner that increases regional wealth. That is, after all, the objective that induces revenue sharing. In the first instance, delineating uses that increase regional wealth may be difficult. As noted above, localities do not exist simply to provide public goods efficiently. Local governments also justifiably may spend funds in providing "good government," inducing democratic participation or building strong civic communities, notwithstanding that these expenditures are not necessarily cost-effective.²⁵⁷

Given the ambiguous indicia of the output of some locally provided public goods, however, it is difficult to measure the success, fail-

²⁵⁴ See J. Hoult Verkerke, *An Empirical Perspective on Indefinite Term Employment Contracts: Resolving the Just Cause Debate*, 1995 *Wis. L. Rev.* 837, 883 (1995).

²⁵⁵ See *id.* at 843.

²⁵⁶ For instance, the Albemarle County/Charlottesville Annexation and Revenue Sharing Agreement requires each participant to contribute thirty-seven cents for each one hundred dollars of value of locally assessed taxable real property within their respective jurisdictions. *Annexation and Revenue Sharing Agreement*, *supra* note 158, at 2. Distribution is then made based on a formula that considers the population and the "true real property tax rate" of each participant. *Id.* at 2-3.

²⁵⁷ See Briffault, *supra* note 172, at 16-17 (arguing that localism is attractive not just for efficiency reasons, but also for democratic participation opportunities and sense of community it makes possible).

ure, or propriety of some expenditures. What, for instance, should be the proper metric of regionally beneficial expenditures on public education? Class size? Graduation rates? College and job placement? Unlike the case of contracts that provide economies of scale, in which parties can measure performance by reference to market prices for similar goods,²⁵⁸ burden-sharing agreements provide no market check on the productivity of the use of the subsidy. Thus, a potential subsidizer will have difficulty specifying whether the recipient of a burden-sharing subsidy is using contributions for a valid purpose.

Additionally, because dollars are fungible, net payers will have difficulty observing whether their contributions are being used to make productive expenditures that would not otherwise have been made, or instead, are being diverted to less productive programs. For instance, Stephen Moore and Dean Stansel report that the budgets of fiscally distressed cities have increased rather than shrunk, and that, in 1990, cities with the highest growth had an average of 99 city employees per 10,000 residents, while shrinking cities had an average of 235 city employees per 10,000 residents.²⁵⁹ Therefore, potential subsidizers may be concerned that recipient localities will spend additional funds to increase staffing or expand discretionary budgets rather than to meet welfare needs or provide services more efficiently.²⁶⁰

These concerns are familiar from the theory of flypaper effects under federal block grant programs. That theory holds that money will stick where it falls, so that grants made for productive purposes or to reduce local taxes instead will be used to increase expenditures that residents would not fund if their own tax dollars were at stake.²⁶¹ The

²⁵⁸ For instance, localities can compare electric utility rates under joint action agreements with rates charged by investor-owned utilities or rates charged by the municipality prior to entry into the agreement.

²⁵⁹ Stephen Moore & Dean Stansel, *The Myth of America's Underfunded Cities* (Cato Inst., Policy Analysis No. 188, 1993), <http://cato.org/pubs/pa-188.html>.

²⁶⁰ Moore and Stansel recognize that higher urban budgets may be either the cause or consequence of poverty. Their data, however, suggests that high levels of urban spending and taxation preceded high levels of poverty in the same localities, and thus they conclude that the former was not a response to the latter. *Id.*

²⁶¹ See, e.g., Mark Schneider, *The Competitive City 110-20* (1989) (examining allocation of intergovernmental aid and flypaper effect as indicators of bureaucratic power); William A. Fischel, *The Offer/Ask Disparity and Just Compensation for Takings: A Constitutional Choice Perspective*, 15 *Int'l Rev. L. & Econ.* 187, 191 (1995) (explaining that block grants to local governments "can be analyzed as if they were money given, in pro rata share, to the median voter"). For discussions of the flypaper effect, see Ronald C. Fisher, *Income and Grant Effects on Local Expenditure: The Flypaper Effect and Other Difficulties*, 12 *J. Urb. Econ.* 324 (1982) (questioning traditional analyses of flypaper effect when evaluating subnational government expenditure); Wallace E. Oates, *On the Nature and Measurement of Fiscal Illusion: A Survey*, in *Taxation and Fiscal Federalism* 65, 77-78 (Geoffrey Brennan et al. eds., 1988) (evaluating theories explaining flypaper effect as fiscal illusion);

literature suggests that local politicians will not use federal grant money to reduce the tax burden on constituents or to follow the preferences of the median voter, but instead, will spend funds to provide levels of public goods unrelated to the preferences of constituents.²⁶² In the context of interlocal arrangements, the theory predicts that interlocal transfers will not be dedicated fully to the city services that increase regional productivity. Instead, city officials may use the funds to hire additional administrative personnel or construct projects that neither provide direct benefits to suburbanites nor increase the size of the regional budget pie. Alternatively, city officials may use funds that have not been generated by city taxes to serve private interests without triggering the level of scrutiny that residents might otherwise apply. Just as recipients are unable to commit credibly to use funds only for regionally productive functions that would not have been funded otherwise, paying localities will be unable to calculate the external benefits of city expenditures with shared revenue. As a result, localities that might have been willing to assist central cities where doing so could be used observably for projects likely to generate regional benefits are less likely to contribute because they doubt that contributions will be used to alleviate the city's fiscal distress. Far from the malign story of suburban exploitation, this explanation suggests that suburbanites simply eschew forms of assistance that deprive them of control over the use of contributed funds.

For similar reasons, expenditure decisions made by recipients are not readily susceptible to verification. Courts are unlikely to intervene in the expenditure decisions of central cities to determine whether funds have been used in a manner likely to generate regional wealth. Nor is it apparent that we would want courts to make such inquiries, as the expenditure decisions are likely to be the result of complex political bargains that courts have little institutional capacity to evaluate or unwind.²⁶³

D. Default Rules to Reduce Contracting Costs

Nevertheless, one who believes that interlocal agreements are underutilized might advocate using background rules of law to induce

Paul Gary Wyckoff, *The Elusive Flypaper Effect*, 30 *J. Urb. Econ.* 310, 311 (1991) (reviewing and rejecting four best-known explanations of flypaper effect).

²⁶² See, e.g., Wallace E. Oates, *Public Finance with Several Levels of Government: Theories and Reflections* 15 (Univ. of Md. Dep't of Econ., Working Paper No. 90-200, 1990) (suggesting presence of "politicians who seek to expand the public budget for their own purposes beyond levels desired by the citizenry").

²⁶³ Clayton P. Gillette, *Equality and Variety in the Delivery of Municipal Services*, 100 *Harv. L. Rev.* 946, 964-67 (1987) (book review).

suburbs to overcome any aversion to formal agreements. These background rules, for instance, might place suburbs at a distinct disadvantage relative to central cities, but permit suburbs to contract away from the background rule. As indicated above, burden-sharing contracts concerning low-income housing in New Jersey²⁶⁴ and use of local property taxes to finance education in Texas²⁶⁵ were preceded by judicial decisions that provided more draconian measures if such contracts were not concluded.²⁶⁶ Legal rules with this effect may be thought of as the equivalent of a penalty default in contract law, the function of which is to place a risk on a party who *cannot* bear it efficiently in order to induce that party to provide information that will allow a more appropriate allocation of the risk.²⁶⁷ For instance, a default rule that carriers pay no consequential damages for delays in deliveries unless they are aware of special circumstances, will induce shippers of goods, who have superior information about the consequences they will suffer if delivery is not made as promised, to convey that information to carriers. Carriers will be able to adjust their level of care (and their contract prices) accordingly.²⁶⁸

Under a similar rationale, we might support rules that give central cities a unilateral right to annex, on the theory that suburbs would have to contract to purchase the annexation right. Alternatively, a "default" rule of extraterritorial taxation might induce agreements in which suburbs would agree either to annexation or to in-kind payments in order to avoid the threat of more substantial taxation.

The problem with a default rule approach is that it is less clear in the local government context than in the contract context which penalty defaults will generate optimal solutions. In the case of private contracts, we use penalty defaults where we are confident that we have identified both a superior risk bearer and the type of private information that we wish the parties to disclose in order to produce efficient bargains. A party who bears a risk under a default rule, but

²⁶⁴ See Field et al., *supra* note 147, at 4-5; Hughes & McGuire, *supra* note 147, at 207-11.

²⁶⁵ See *Edgewood Indep. Sch. Dist. v. Meno*, 917 S.W.2d 717, 727-29 (Tex. 1995) (describing system of financing for local schools).

²⁶⁶ See *supra* text accompanying notes 147-49.

²⁶⁷ See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *Yale L.J.* 87, 91, 97 (1989) (explaining how "penalty defaults" give one party incentive to contract around default rule, thus encouraging "the production of information"); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 *Cal. L. Rev.* 261, 309-11 (1985) (describing legal rules that "sanction parties who take insufficient precautions against the risk of errors in communication").

²⁶⁸ See Ayres & Gertner, *supra* note 267, at 101-02 (explaining how holding in *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854), operates as penalty default); Goetz & Scott, *supra* note 267, at 309-11 (discussing rules that facilitate communication).

who lacks the relevant information to calculate the expected loss from that risk, may be unable to contract around the rule, both because transaction costs will interfere and because the ignorant party will not be able to determine a fair price for shifting the risk to the informed party.

As the previous discussion of observability and verifiability indicates, in local government law we can be less certain that initial allocation of an entitlement, either to a city or to a suburb, will promote the regional growth that serves as the basis for extracting the payment in the first instance. In addition, the very act of providing subsidies threatens some efficiency losses among localities, as residents of both subsidizing localities and recipient localities have less reason to monitor the use of donated tax dollars. Residents of subsidizers do not receive a direct benefit from the expenditures and likely enjoy few capitalization effects on their own property values from expenditures in other jurisdictions.²⁶⁹ Residents of recipients do not suffer the tax increases or service reductions that result from raising the donated dollars, so they have less incentive to be concerned about its misuse. Tax sharing also dilutes the incentives of suburban communities to accept undesirable land uses that may be productive for the region, but undesirable for the accepting localities, since they will not be able to retain all the tax benefits that the land use generates.²⁷⁰ At the same time, transfer payments are likely to increase the problems associated with centralization generally, that is, lack of accountability, inefficiency, and decreased competition. This is not to say that it is always undesirable to assign an initial entitlement to a central city, so that suburbs would have to purchase the entitlement from the city. As I have suggested, such contracts may maximize regional wealth and help overcome incentives to “free ride” on the efforts of neighboring localities. It is only to say that whether such a default rule solves or aggravates metropolitan problems sufficiently depends on the particular situation that it is difficult to conclude whether granting initial entitlements to cities or suburbs will tend to generate better results. The

²⁶⁹ See William A. Fischel, *School Finance Litigation and Property Tax Revolts: How Undermining Local Control Turns Voters Away from Public Education* 26-34 (Lincoln Inst. of Land Policy, Working Paper, 1998) (on file with the *New York University Law Review*) (arguing that tax revolts have been caused by centralization of school financing).

²⁷⁰ See William A. Fischel, *Metropolitan Sharing of Local Property Tax Bases: Maybe Not Such a Good Idea, After All*, in *The Value of Land: 1998 Annual Review* (arguing that under tax base sharing, larger units of government appropriate increases in value that arise from providing more efficient local services and arguing that tax base sharing encourages communities to zone out locally undesirable land uses), <http://www.lincolninst.edu/LINCOLNINST/workpap/valand1.html>.

consequence is that barriers to interlocal contract cannot readily be overcome by using defaults.

V

ALTERNATIVES TO FORMAL AGREEMENTS

My conclusions to this point suggest that explicit interlocal contracts, especially those that require intraregional redistribution, may fail due to high contracting costs. Inflexibility of organizational form and background legal rules inhibit attempts to circumvent these problems. Nevertheless, there are both theoretical and empirical reasons to believe that localities are willing to engage in interlocal bargains that can be structured in ways that reduce contracting costs. Hence, the infrequency of interlocal agreement does not imply exploitation or limited rationality. If I am correct, then further reduction of contracting costs could enhance interlocal cooperation.

Regionalization may be perceived as a mechanism for achieving such reductions. Presumably, a regional government would bring about the same result as would be reached by independent parties contracting in a world of no transaction costs. But, given the costs of regionalization,²⁷¹ it is not clear whether that strategy returns net benefits, even if it reduces the particular set of problems related to contracting. Thus, before embracing regionalization, one might consider whether regional synergies could be realized without either formal contract or centralization. In this Part, I suggest that informal bargains provide such a solution. Further, these arrangements arguably pervade current interlocal relations, though empirical support of that expectation is lacking.

The argument for informal bargains begins with the same understanding about interlocal relationships that explains why neighboring localities have incentives to cooperate and have the capacity to overcome collective action problems. Repeat play among geographically fixed entities with opportunities to retaliate for noncooperative behavior not only simplifies contracting and reduces threats of strategic behavior,²⁷² but also may render formal contracting superfluous. As the employment at will example suggests,²⁷³ parties that face high costs in specifying performance or verifying noncompliance may employ a relatively vague relational contract. If the costs of even relational contract are high, however, parties will not necessarily eschew transacting. Instead, they may avoid the costs of contract altogether

²⁷¹ See *supra* Part I.

²⁷² See *supra* text accompanying notes 217-20, 245-50.

²⁷³ See *supra* text accompanying note 254.

and rely on an implicit bargain under which each will act to maximize joint interests. The vast literature on the evolution of cooperation indicates that, as long as parties have reasons to believe that their efforts to serve joint welfare will be met with reciprocity, they may be willing to continue cooperating, even though they are under no legal obligation to do so.²⁷⁴

Most importantly for our purposes, the development of cooperation among multiple parties (such as multiple localities within a region) is plausible without formal contracting. As indicated above, cooperative solutions to the Prisoners' Dilemma among multiple parties may be ephemeral, because players have difficulty determining who has defected and who should punish the defector.²⁷⁵ Problems of observability obviously multiply with the number of players. Problems of verifiability similarly increase, as the incentive for any party to demonstrate chiseling by another decreases where multiple parties are involved. Since any potential monitor only will receive a share of the benefit of punishing chiselers, but will bear all the monitoring and enforcement costs, detection will tend to be underutilized.²⁷⁶

The cause is not hopeless, however. That cooperation among multiple parties can be sustained is evident from the vast literature on norms, which, after all, are equivalent to implicit bargains of the type we are investigating. A norm for cooperation, which might arise in the first instance from the opportunity for joint gain, can be enforced if parties to the norm have available a credible threat to punish should their cooperative efforts be met with a noncooperative response. Given incentives against punishment in multiparty situations, credible

²⁷⁴ This substantial literature includes Robert Axelrod, *The Complexity of Cooperation* (1997) (using agent-based modeling to show how social norms of cooperation emerge among many parties and in complex strategic situations); Axelrod, *supra* note 217 (arguing that cooperation without central authority can develop in continuing bilateral relationships through strategies of reciprocity); Jody S. Kraus, *The Limits of Hobbesian Contractarianism* (1993) (analyzing various theories of how cooperation emerged from state of nature); *Paradoxes of Rationality and Cooperation* (Richmond Campbell & Lanning Sowden eds., 1985) (containing articles by various authors on cooperation). For early applications in the legal literature, see, for example, Gillette, *supra* note 245, at 556-58 (arguing that relational interdependence leads to voluntary adjustments of bargains); Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 *J. Legal Stud.* 597, 614-15 (1990) (arguing that "[t]he social forces of reciprocity . . . can bond persons to the desired patterns of cooperation, especially in a world where there are substantial benefits from good business reputation").

²⁷⁵ See Axelrod, *supra* note 274, at 7; Molander, *supra* note 221, at 757, 768.

²⁷⁶ See Axelrod, *supra* note 274, at 50-52; *supra* text accompanying notes 220-21. Axelrod posits that this difficulty can be overcome through the evolution of metanorms that encourage punishment, see Axelrod, *supra* note 274, at 52-54, but I am not relying on such mechanisms to support informal interlocal bargains.

threats require that players be able to decrease the risk of free riding, either by reducing punishment costs for potential punishers or by increasing the personal gain from inflicting punishment. Under these circumstances, norms of cooperation may evolve even among multiple players, sustained by effective threats of sanctions against defectors.

One way to achieve these objectives is to focus on discrete, salient acts of cooperation rather than broad mandates in which compliance is less susceptible to review and redress.²⁷⁷ Limiting the payer's obligation to a relatively specific task reduces the cost of observing whether the obligation has been satisfied and facilitates demonstration of compliance or noncompliance to third parties. Thus, it is noteworthy that localities that employ interlocal contract for burden sharing often employ relatively narrow, specific obligations. Anita Summers has concluded that each metropolitan area she studied participated in some form of regional tax sharing.²⁷⁸ In two-thirds of those cases, however, the regional tax was imposed on specific functions rather than on assets generally, such as a regional property tax.²⁷⁹ The use of these agreements and dedication of revenue to specific activities permits better monitoring of both contributions and expenditures than is possible with broad-based regional taxes. More to the point, their use is consistent with a conclusion that localities are willing to share burdens where regional benefits are apparent, as long as the structure of the arrangement permits payers to overcome costly obstacles to detecting and redressing strategic behavior by other participants.

Informal bargains even more readily satisfy these conditions for sustaining cooperation among multiple parties. Implicit bargains permit localities that face defection to engage in relatively low-cost self-help, which avoids high enforcement costs, including verifying defection to a third-party arbiter.²⁸⁰ Additionally, informal bargains allow localities to retain the benefit of punishing defectors, since they retain for themselves revenues that otherwise would be dedicated to common purposes.

To evaluate the extent to which these mechanisms can facilitate interlocal cooperation, consider again the way in which retaliation is

²⁷⁷ See, e.g., Robert O. Keohane, *Reciprocity in International Relations*, 40 *Int'l Org.* 1, 12 (1986) ("[S]pecific reciprocity may be used to prevent free-riding.").

²⁷⁸ See Summers, *supra* note 166, at 188.

²⁷⁹ *Id.*

²⁸⁰ For instance, Axelrod suggests that norms of promise-keeping can be maintained if individuals refuse to make deals with known promise-breakers. He concludes that the enforcer of such a norm would, "in effect, be vengeful against defectors without having to pay an enforcement cost." Axelrod, *supra* note 274, at 63-64.

available to parties to the bargain. As was the case with relational contracts, the geographic fixity of localities within a region means that exit costs for any locality are high. Repeat play with neighbors is inevitable. Hence, opportunities to engage in retaliatory self-help is assured.

Also, as in the case of contract, the availability of retaliation is only useful if it is possible to distinguish cooperative from non-cooperative behavior by others. As I suggested earlier, observability, or detection of chiseling, requires that the recipient's actions be subject to monitoring. I noted that monitoring formal contractual obligations may be too costly. Thus, one may believe that self-help will be unavailing because victims of chiseling will not know when to use it.

But monitoring becomes less difficult where two conditions coincide. First, if the object being monitored is susceptible to evaluation, noncooperation readily can be detected.²⁸¹ Second, monitoring might matter less if potential subsidizers could terminate contributions at low cost, since they then could minimize losses at any hint of defection. These conditions may not be satisfied easily in the case of formal broad-based burden-sharing agreements. Again, "improper" expenditures by central cities are difficult to detect, and contractual obligations may prevent exit unless breach can be verified to a court. But these conditions may be satisfied more easily in highly tailored, voluntary programs that suburbs view as advancing regional welfare.²⁸² Programs that permit localities to determine contribution levels to specifically targeted projects could allow a locality to monitor the contributions of other suburbs, thus reducing the free riding problem, and to monitor the participation of the central city, thus reducing the risk of flypaper effects. The voluntary nature of the performance allows a subsidizing locality to punish defection through relatively costless self-

²⁸¹ See Molander, *supra* note 221, at 768 (stating that ability to monitor and direct reprisals increases likelihood of stable cooperation of multiple parties without coercion).

²⁸² Once more, firms provide apt analogies. With respect to the first condition, monitoring a performance that readily can be evaluated, financiers of firms may prefer to take security interests in discrete assets of a debtor that are highly susceptible to monitoring, rather than a wraparound security interest in all of the debtor's assets. With respect to the second condition, the possibility of easy termination, frequently financiers are unable to specify *ex ante* all the conditions that might indicate that the debtor is in financial distress or to prove to a court *ex post* that financial distress is imminent. Thus, financiers commonly use clauses that permit unilateral declaration of a default whenever the financier "deems itself insecure." See, e.g., *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1353 (7th Cir. 1990) (noting that loan agreement provided bank with right to terminate financing at any time). Applying the same logic to the municipal context, we would anticipate that potential net subsidizers (suburbs) would be more willing to contribute to central city programs if they (the subsidizers) believed that they could exit the program if the city was not cooperating and if they were not required to incur the costs of first proving breach to third parties.

help. The locality can terminate participation without the need to verify breach or the risk of legal exposure should it determine that its participation is being exploited either by noncooperating suburbs or by the central city.

Of course, there is a risk that localities well positioned to enforce socially desirable norms instead will develop and enforce norms that simply reinforce their dominant position. We can imagine, for instance, that suburbs would use their ability to withdraw support from central cities to extract significant wealth from those cities. But there is reason to expect that suburbs will not significantly misuse their dominant position, if in fact they enjoy one. First, the interdependence thesis suggests that their doing so is contrary to the suburbs' own self-interest. Second, there is a respectable literature in analogous areas that suggests that interjurisdictional cooperation can evolve under the conditions I have outlined. A substantial body of post-Realist theory in international relations contends that a strategy of small reciprocal steps may be particularly effective at controlling the otherwise anarchic structure of international behavior. Early efforts in this direction suggested that incremental, unilaterally initiated action by one nation could induce other nations to reciprocate with similar tension-reducing responses.²⁸³ Subsequent efforts to verify the theory suggest that international cooperation may be driven significantly, though certainly not exclusively, by norms of reciprocity, even in the absence of formal agreement.²⁸⁴ Indeed, norms of reciprocity may be sufficiently strong to induce one jurisdiction to cooperate with another in order to avoid discord with a third jurisdiction.²⁸⁵ If anything, one would imagine that these norms would be all the more compelling in the interlocal arena where differences in culture, preferences, and values that could interfere with defining and implementing cooperative conduct are narrower than in the international arena.²⁸⁶

²⁸³ See Charles E. Osgood, *An Alternative to War or Surrender* 85-89, 98-103 (1962) (explaining how unilateral initiative may halt nuclear arms race by inducing reciprocation).

²⁸⁴ See Joshua S. Goldstein, *Reciprocity in Superpower Relations: An Empirical Analysis*, 35 *Int'l Stud. Q.* 195, 207 (1991) (finding that "the presence of reciprocity . . . ha[s] undoubtedly helped to establish norms and mutual understandings in the superpower relationship"); Keohane, *supra* note 277, at 24-25 (suggesting that international trade has operated on principles of specific or diffuse reciprocity).

²⁸⁵ See, e.g., Joshua S. Goldstein & Jon C. Pevehouse, *Reciprocity, Bullying, and International Cooperation: Time-Series Analysis of the Bosnia Conflict*, 91 *Am. Pol. Sci. Rev.* 515, 525 (1997) (demonstrating how Serbian attacks on or restraint towards Bosnia were followed by reciprocal actions of international community towards Serbia).

²⁸⁶ See, e.g., Robert Jervis, *Realism, Game Theory, and Cooperation*, 40 *World Pol.* 317, 336-44 (1988) (discussing limitations on game theory models of international behavior due to differences in perceptions and values of participants).

One might object that, at most, I have demonstrated that conditions exist for localities within a metropolitan area to cooperate in generating regional wealth. It does not necessarily follow that localities will actually cooperate. Suburban officials may act irrationally, eschew short-term costs even at the expense of long-term gains, or act out of invidious class or ethnic prejudice in failing to assist central city residents. The proof of the theory's validity, in short, lies in an empirical inquiry. If localities avoid burden-sharing agreements because of the related contracting costs, rather than because of animosity towards, or a desire to exploit central cities, then we should see significant numbers of voluntary, informal bargains, in which suburban localities either undertake projects that have potential regional benefits or forbear from conduct that would decrease regional welfare. Contract, in short, should be replaced by the development of cooperative conventions, perhaps begun by relatively minor investments, which are then increased if reciprocal cooperation ensues. The problem is, however, that many of these cooperative strategies entail forbearing from potentially exploitative conduct. In the international context, for instance, cooperation is inferred from restraints on deploying destructive armaments.²⁸⁷ Similarly, localities that seek to achieve intraregional equities or to consider the consequences of local action for neighbors might forbear from certain land uses that impose disproportionate costs on central cities, or from taxes that fall disproportionately on nonresidents, or from development that may induce taxpaying firms in the central city to relocate to suburban areas.

It may be difficult, however, to document these voluntary efforts. Forbearance from exploitation is less salient than affirmative action that appears exploitative. Even if one jurisdiction can observe that neighbors have refrained from potentially exploitative measures, the fact that the activity consists of inaction makes the cooperative ethos less verifiable to others, including researchers. Nevertheless, if my argument about contracting costs is correct, then we would expect to see some highly specific affirmative cooperative efforts that induced other potential cooperators to discern the existence and measure the extent of mutual contributions. In particular, we would expect to see the evolution of voluntary regional programs that have explicit intraregional effects, even though they are costly to the contributing locality.

It may be in these terms that we can explain such phenomena as open enrollment programs that permit central city students to enter

²⁸⁷ See, e.g., George W. Downs et al., *Arms Races and Cooperation*, 38 *World Pol.* 118, 134-37 (1985) (demonstrating difficulty of determining that potential opponent has *not* escalated arms race).

suburban school systems that they deem superior.²⁸⁸ Suburban systems retain some control over the use of funds, since education of central city students occurs in suburbs. In addition, the number of students that each suburb accepts is readily observable, so that each area can measure its relative participation in the program. Similarly, some communities have cooperated to enhance job opportunities for central city residents, either by creating transportation networks that coincide with areas of strong job growth,²⁸⁹ or by engaging in regional job training.²⁹⁰ Alternatively, it may be in these terms that we can explain the counterintuitive willingness of localities to site a greater than expected percentage of locally undesirable land uses in nonpoor neighborhoods.²⁹¹ In each of these instances, the payer locality provides a relatively salient benefit over which it retains significant control so that it simultaneously contributes to regional welfare and reduces the risk of strategic behavior by others.

CONCLUSION

There exists significant theoretical and evidentiary support for the desirability of decentralized governments. There is also significant evidence pointing to the interdependence of such governments within a region. Taken together, these two propositions suggest that metropolitan problems are amenable to cooperative solutions without further governmental centralization. The infrequency of explicit contracts is typically attributed to malign motives of suburban entities. Yet if the two propositions are true, then suburban governments have more to gain through regional cooperation than through selfish isolation. Unless we assume substantial irrationality on the part of suburban residents and officials, therefore, some alternative explanation for

²⁸⁸ See, e.g., *Brewer v. W. Irondequoit Cent. Sch. Dist.*, 32 F. Supp. 2d 619, 620 (W.D.N.Y. 1999) (involving challenge to interdistrict program allowing only minority students to transfer to suburban schools); Angela G. Smith, *Public School Choice and Open Enrollment: Implications for Education, Desegregation, and Equity*, 74 Neb. L. Rev. 255, 274-75 (1995) (describing features of Minnesota's interdistrict enrollment program).

²⁸⁹ See, e.g., Joint Ctr. for Sustainable Cmty., *Connecting People to Jobs Through Transportation* (1997) (reporting on regional plan in St. Louis area to improve transportation services for area job-seekers), at <http://www.usmayors.org/USCM/sustainable/report-1.htm#connecting>.

²⁹⁰ See, e.g., Joint Ctr. for Sustainable Cmty., *Promoting a Competitive Workforce* (1997) (reporting on joint agency in greater Louisville area that provides job training to city and county residents), at <http://www.usmayors.org/USCM/sustainable/report-1.htm#promoting>.

²⁹¹ Vicki Been with Francis Gupta, *Coming to the Nuisance or Going to the Barrios? A Longitudinal Analysis of Environmental Justice Claims*, 24 *Ecology L.Q.* 1, 9 (1997) (presenting study showing negative correlation between initial choice of local undesirable land use sitings and poverty).

the paucity of interlocal contract is necessary. I have suggested that the most plausible explanation lies in the area of contracting costs, rather than exploitation or suburban selfishness. But even if this speculation is correct, interlocal cooperation should not be absent. Instead, cooperation may take noncontractual forms as localities adjust to the difficulty of drafting cost-effective contracts that allocate responsibility both for subsidizing the central city and for monitoring expenditures.

Nothing in this argument suggests that we should rely solely on the willingness of localities to act in a jointly maximizing manner to solve regional issues. Individual localities within metropolitan regions evince significant economic and racial disparities that do not easily fit with a story of benign joint maximization.²⁹² Some localities will forgo the benefits of cooperation out of class or ethnic bias. Other localities, like firms that act suboptimally, simply will fail to recognize that cooperation can generate regional benefits. And, if there is anything to the Tiebout model of local government, some localities, at least with respect to some local public goods, will value certain services at a relatively high level and will resist any lowering of that level in order to share the services with competing localities. For instance, suburbs that spend large sums per capita on education are likely to attract individuals with a greater than average interest in local educational systems. Therefore, they are likely to resist efforts to reallocate part of their education budget to other jurisdictions or to agree voluntarily to cap their spending on education.

Finally, there is some risk that reliance on interlocal bargains, rather than regionalization, to resolve interlocal inequities itself will reduce the number of desirable bargains. The threat of judicially or legislatively imposed regional solutions may induce explicit or implicit bargains. If the absence of a bargain is interpreted to imply that the parties already have achieved an optimal relationship, then courts and legislatures have less motivation to intervene. As a result, localities may refuse to enter burden-sharing agreements because they no longer face more costly alternatives.

But these examples of noncooperation no more condemn the possibility of informal bargains among localities than the occasional opportunism by parties to a long-term sales contract condemns all interfirm relationalism.²⁹³ Thus, my claim is not that local incentives to

²⁹² Savitch & Vogel, *supra* note 173, at 9 (documenting increased concentration of minorities and decreased expenditures in central cities).

²⁹³ See, e.g., *S. Concrete Servs., Inc. v. Mableton Contractors, Inc.*, 407 F. Supp. 581, 583 (N.D. Ga. 1975) (finding that case did not present "a situation in which one party may have been trying to take advantage of a long-standing customer").

cooperate through implicit bargains provide a panacea or displace all legal interventions to correct intraregional disparities. Instead, I conclude that the existing literature, by ignoring contracting costs and ways of reducing them, misses an opportunity to foster more productive interlocal relationships. Recognition of contracting costs and attention to their effects should make us more skeptical of the sources of noncooperation, more appreciative of noncontractual forms of cooperation, and more reluctant to assume that failure to cooperate is evidence of malice or exploitation. After all, none of the alternative mechanisms for achieving intraregional equity is costless. Thus, there is no reason to omit bargains from the mix in determining which strategy to follow in addressing intraregional disparities. In at least some cases, reliance on interlocal bargains better may accommodate competing interests than externally imposed solutions by parties who are likely to be susceptible to the entreaties of particular interest groups, or who are motivated by more salient, but potentially less representative, examples of interlocal opportunism. Without more empirical support, I cannot say that the current level of informal bargains justifies a conclusion that there exists an optimal amount of intraregional cooperation. But to the extent that interlocal agreements fail because of contracting costs, organizational structure, and legal doctrine, we might be served better by removing those barriers than by abandoning decentralized government.